



In detail

Detailed tax information for large businesses.

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Detailed compliance and governance information for large businesses.

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Key information products and resources for large businesses.

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Findings report – Top 1,000 income tax and GST assurance programs



Findings from the Top 1,000 income tax performance, combined assurance review and GST assurance review programs.

Findings report Top 100 income tax and GST program



Findings from the top 100 income tax and GST assurance programs.

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GST streamlined assurance review – what we need from you

If we've contacted you about a GST streamlined assurance review, this is what you need to provide so we can help ensure you're meeting your GST obligations.

5 December 2018

We're committed to making sure large multinational and public companies pay the right amount of goods and services tax (GST).

GST streamlined assurance reviews will give greater certainty about meeting your tax obligations.

What we need from you

If your business is under review, we've sent you a letter outlining the details of our meeting. We'll tailor the review to your unique business profile, and work with you to get the evidence to assess whether you're meeting your GST obligations.

The letter we sent requested that you send information to help with our review. Our focus, at this early stage, is on information and documents that should be readily available. The information we need you to provide is listed below.

We will write to you when we have finished our review to explain the outcome.

Structure and business activities

1. Organisational structure

Provide the latest detailed organisational structure for the Australian business representing the economic group.

2. GST group

- Provide the latest GST reporting structure including GST groups and other GST reporters. If applicable, include any trusts.
- Provide a reconciliation of your consolidated accounting group structure (for financial reporting purposes) to your GST reporting structure.
- Provide the ABN of each entity.

3. Business activities

Provide a brief description of the activities carried out by each of the entities of the GST group, and consolidated accounting group, in the organisational structure.

4. Acquisitions, mergers and disposal of entities

- Provide details of acquisitions, mergers and disposals of any business entities within the indirect tax zone in the review period, including:
 - a brief description of the entities acquired, merged or disposed
 - the gross value of the transactions and the respective GST treatments.
- Provide details of any anticipated or planned restructures of the GST group.

Tax governance and risk management

5. Consideration of our Tax risk management and governance review guide

The Tax risk management and governance review guide sets out principles for board and managerial level controls relating to income tax, excise and indirect taxes, and what we consider best practice for large public groups and multinationals.

- Describe your approach to the guide, including whether you have
 - conducted a gap analysis of current policies and procedures against our guide and identified compensating controls where applicable
 - applied the self-assessment procedures to test and obtain evidence of the controls operating effectively.
- If the self-assessment procedures have been applied, provide the self-assessment report including all the supporting documentation.
- Provide details of any control deficiencies and identified impact on business activity statements, including actions taken to remediate the identified deficiencies.

6. Corporate governance

Provide a copy of your corporate governance framework, identifying the practices driving and supporting good governance.

If you have recently undertaken a self-assessment/gap analysis there is no requirement to provide this information.

7. Tax governance and controls framework

Provide the most recent documentation outlining your tax governance and risk management, including:

- tax governance manuals, guidelines or policy available to staff
- key personnel and decision makers in the tax/finance team including their areas of responsibility/specialisation
- evidence of staff training on tax governance
- tax compliance outsourcing arrangements and third party preparers
- how tax compliance is incorporated into the governance structure
- an overview of how the use of external advisors is incorporated in the tax governance framework and the circumstances when external advice on a GST issue is sought
- how frequently this documentation is reviewed
- copy of any communications (within the last 12 months) to the board and senior management in relation to escalation of GST issues, including, but not limited to, minutes, agenda items and emails
- Confirm whether you have a periodic program to test the operating effectiveness of your control framework by way of internal or external reviews. If yes
 - provide a copy of the program and details of the scope and outcome of the most recent review.
 - was the program and review reports tabled to the board? If yes
 - provide supporting documentation, including but not limited to agenda items, minutes, emails and remedial plans proposed by the board for any tax control failures identified.

If you have recently undertaken a self-assessment/gap analysis there is no requirement to answer this question.

8. Overview of information technology systems

- Provide a business systems architecture diagram outlining how sales and acquisitions flow through the systems.

- Provide flow charts or describe the end-to-end 'order to cash' and 'procure to pay' process with reference to how financial information is captured and stored to account for transactions.
- Provide an overview of the accounting system (or systems) you use to capture transactional data.
- Provide a list of tax codes and respective rates.
- What are the procedures for changing/updating the classifications of supplies/acquisitions and related master files and tax codes?
- Provide a summary of controls in place to ensure the accuracy and integrity of data input and processing.

9. Business Activity Statement (BAS) preparation process

Provide:

- an overview of the BAS preparation process including flowcharts if available
- a copy of the BAS preparation manual or written procedures including who prepares and reviews the BAS prior to lodgment
- details of staff training provided in relation to the BAS preparation and GST technical matters, data input and processing
- review and authorisation process
- skill and qualification of staff preparing and reviewing the BAS
- overview of the accounts payable and accounts receivable process
- an overview of reconciliations of reported GST figures to relevant general ledger accounts and financial statements.

10. Information technology (IT) systems governance

- Provide a copy of the long term and short term IT strategic policy outlining
 - communication process with the board
 - alignment between business and IT strategy
 - staff roles and responsibilities
 - access controls to logical and physical assets

- business continuity plan
 - disaster recovery plan
 - outsourcing practices or guidelines.
- Provide the information systems architecture diagram used in accounts receivable (AR), accounts payable (AP), BAS preparation and delivery processes outlining
 - flow of transactional data (both supplies and acquisitions)
 - a brief functional description of each system.
- What IT control framework do you have in place to support
 - your business objectives
 - monitor and evaluate IT performance
 - monitor and evaluate internal controls
 - ensure compliance with external requirements.
- Provide details of any IT project you have implemented affecting AR, AP, BAS preparation and delivery processes or plan to implement in the next 12 months, including
 - business process changes
 - project management methodology
 - make-up of the project team
 - post-implementation review results.

11. Tax risks flagged to the market

- Describe your processes to identify tax risks flagged by us (or other bodies) to the market.
- Confirm whether you have entered into arrangements the same or similar to that described in any Taxpayer Alerts, Public Rulings and Practical Compliance Guidelines. If yes

- identify the relevant Taxpayer Alert, Public Rulings and Practical Compliance Guidelines
- provide a brief description of the arrangement and the GST position taken
- provide documentation, including but not limited to risk register, relevant minutes and emails of board's endorsement for GST positions adopted by management.

12. Significant and new business transactions

- Describe your criteria for classifying a transaction as significant
- Detail assurance processes or controls currently in place to identify, process and review significant and new transactions to ensure the correct GST classification is applied
- Provide details of any significant and /or new transactions for the review period, such as
 - significant capital acquisitions
 - restructures
 - new products, services, business lines and divisions
 - international dealings
 - financial supplies including capital structures and financing.

13. Alignment between accounting and tax results

- Provide a copy of your most recent externally audited financial statements.
- Detail processes in place to reconcile GST figures reported on your BAS to accounting figures reported on financial statements. If conducted, provide the reconciliation for the most recent accounting year.
- Identify how you monitor BAS reporting trends, including changes in the mix of supply classification and reconciliation of unexpected variances.

- Describe the process to escalate any significant deviations/trends or unexpected variances to senior management.

Other questions

We might ask additional questions about known industry risks or significant issues which may only be relevant to your business (for example financial supplies, GST on low value imported goods, digital supplies).

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What we look for to obtain assurance

What we look for to obtain assurance in a Top 1000 streamlined assurance review.

30 May 2019

As part of our Top 1,000 Tax Performance program, we carry out income tax streamlined assurance reviews to help us establish justified trust.

To achieve justified trust, we seek objective evidence that would lead a reasonable person to positively conclude you have paid the right amount of tax. We need to obtain assurance over the whole of your business and economic activities connected or linked to Australia.

To do this, we look for the following details from you during our reviews.

Financial information and tax reconciliation

- A detailed statement of taxable income with supporting working papers which indicate the nature of adjustments made to accounting profit to determine taxable income.

- Explanation around the nature of adjustments where income tax adjustments are specific to your industry, business or a particular transaction.
- An explanation of
 - the differences between accounting and tax groups
 - why the starting profit in the tax return differs from the audited financial statements.

Supporting working papers to the tax return, schedules and disclosures

- Tax return working papers which show how disclosures were prepared and any supporting calculations. Supporting work papers include those that are internally produced (hand written or excel spreadsheets) or calculation work papers created using tax return preparation software.
- International dealings schedule working papers which breakdown all related party transactions into their respective types, the relevant offshore counterparty, the actual value of the transactions and how they are priced.
- Thin capitalisation calculations which include a balance sheet for the tax consolidated group (TCG) or multiple entry consolidated (MEC) group which shows how average assets, non-debt liabilities and average adjusted debt is calculated. You should supply working papers that show how debt deductions were calculated.
- A summary of the fixed asset register and any relevant policies and procedures, including
 - how effective lives are determined and reviewed for each major class of asset
 - a reconciliation between the tax and accounting fixed asset register.

Tax effect accounting

- Tax effect accounting working papers.
- An explanation of why deferred tax balances have been recognised and any reconciliation of tax effect working papers to the tax effect disclosures made in the financial statements.

Tax governance and risk management

- Responses that have considered our **guidance** and have undertaken a gap analysis of current policies and procedures against our guide.
- Analysis which explains why policies and procedures differ from our guidance.
- Evidence that controls have been designed and were operating effectively during the review period. This could be shown by internal or external reviews testing the controls, provided the reviews are conducted by a party independent of the tax team.

Group structure

- A diagram or written explanation showing
 - all related entities operating in Australia even if outside of the tax consolidated or MEC group
 - overseas subsidiaries or permanent establishments of the Australian group
 - all intermediary holding companies of the Australian group
 - other offshore related entities who transact with the Australian group.

New businesses and transactions

- Responses which explain the nature of any new business or transactions and the treatment of any income or expenses arising from the new activities.

Restructures

An explanation of

- the nature of any restructures (whether they are domestic or cross border)
- the treatment of any income, or expenses / losses arising from the restructure itself (if any)
- changes in underlying income and expenditure as a result of the restructure.

Acquisition of an interest in another entity

- Where an acquisition results in an entity joining a TCG or MEC group, provide sufficient information which demonstrates how tax values of assets owned by joining entities have been determined.
- Where the acquisition is part of a global acquisition, provide evidence which shows the relative market value of the Australian entity or business acquired.

Asset disposal

- Provide evidence of both the proceeds and how the cost base was determined.
- Where there is a disparity between the accounting gain or loss on disposal and the tax gain or loss on disposal, provide an explanation of why there is a differential.

Funding

- Where funding is vanilla (eg loans with third party banks or ordinary equity), provide a very brief response confirming these facts.
- Where the funding involves more complicated or unusual financial arrangements or related parties, a more detailed response is required, which includes a summary of
 - the relevant term
 - the accounting and tax treatments and
 - the legal documentation.

Taxation of financial arrangements (TOFA)

- A table listing the different types/categories of financial arrangements in place in each review year, and the associated gains and losses recognised each financial year for each type / category.
- Where the TOFA treatment is different from the accounting treatment, provide an explanation of how the gains and losses are identified or calculated.

Tax losses

- A detailed summary of any available and / or utilised tax losses showing year of incurrence / utilisation and whether these are group losses or transferred losses.
- Where losses are utilised during the period of review, but those tax losses arose in respect of income years which have not previously been reviewed by us, an explanation to support the validity of those losses.
- Detailed work papers to support the satisfaction of either the continuity of ownership test (COT) or same business test (SBT).
- Where losses have been transferred in during the review period, an analysis supporting the transfer of the tax losses and any calculation of the available fraction, including
 - how underlying market valuations were calculated or
 - valuation reports.

Controlled foreign companies (CFCs)

- Working papers which support the attribution of income, or explaining why no attribution is necessary, in respect of each CFC.
- Sufficient information about the type and source of income of the CFC to allow confirmation that such income is not eligible designated concession income (EDCI) (listed country CFC's) or that the active income test is passed (or not) and whether such income is passive or is tainted.

Offshore branches or permanent establishments (PE's)

- An explanation of why a PE exists (eg there is a fixed place of business overseas etc).
- Transfer pricing documentation in respect of PE's.
- Advising whether any of the arrangements of the type described in Taxpayer Alert 2016/7 exist in dealings with the PE.

Transfer pricing (TP) documents

- Unless covered by country by country reporting, contemporaneous TP documentation for each year of review. This documentation should cover all offshore related party transactions including financing transactions and dealings with offshore permanent establishments.

See also:

- Top 1,000 Tax Performance Program
- Typical questions in a Top 1000 combined assurance review

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Top 1,000 – what attracts our attention

Guide for large public and multinational companies covered by the Top 1,000 programs to prepare for engagement with us.

16 July 2021

We know most large businesses want to do the right thing and we're often asked how they can improve their assurance ratings.

This guide is for large public and multinational companies covered by the Top 1,000 tax performance program. It aims to help you:

- understand what attracts our attention
- prepare for engagement with us
- address recommendations made in assurance reviews
- improve confidence in your tax outcomes.

This guide is based on our observations from Top 1,000 assurance reviews and sets out the standard of information and documentation we typically look for to obtain assurance.

By following our guidance and recommendations in previous assurance reviews, taxpayers are less likely to experience protracted combined assurance reviews or follow-on compliance activity.

We will continue to update this information to address additional issues that attract our attention.

See also:

- Top 1,000 combined assurance program
- Top 1,000 next actions program
- Typical questions in a Top 1,000 combined assurance review
- What we look for to obtain assurance

Capital allowances

From our engagements, the most common issues we find with capital allowances claims include:

- [Insufficient documentation or information](#)
- [Self-assessed effective lives](#)
- [Exploration expenditure.](#)

The information below outlines strategies you can put in place to obtain assurance.

Insufficient documentation or information

The most common reason for not achieving assurance for capital allowance claims is insufficient supporting information and documents to show the deductions claimed are correct.

This may result in us seeking further information or escalating the matter for further review.

The documents and information that we look for include:

- detailed fixed tax asset register, including for each asset
 - asset description and name
 - date the asset was installed ready for use
 - cost (including additional costs for the assets)
 - effective life
 - rate of depreciation
 - depreciation method used (diminishing value method or prime cost method)
 - opening adjustable value
 - written down value or closing value
 - decline in value amount claimed for the year
- asset register summaries
- working papers to support specific capital allowances tax return disclosures
- reconciliations between capital allowances tax return disclosures and the fixed asset register
- internal policies and procedures for determining depreciation for tax, including how effective lives are determined and reviewed for each major class of assets
- evidence substantiating the original cost of assets such as invoices, contracts, supplier agreements, independent valuations and audit reports.

During a review, we may ask for a sample of this information to obtain assurance over the capital allowance deductions claimed during the review period. The size of the sample depends on the size of the claim, with larger claims requiring a larger sample to obtain assurance. When requesting information, our case team will advise you what an appropriate sample size is in your circumstances.

Self-assessed effective lives

Maintain a detailed analysis to support any effective lives which you have self-assessed. This should include why you have chosen to use an effective life that is different to the Commissioner's published effective life, and evidence to support your conclusions.

Exploration expenditure

Documents and information that can help support our assessment of assurance relating to exploration expenditure include:

- project and tax level governance frameworks consistent with PCG 2016/17 – a governance process which highlights expenditure that may be considered high risk may indicate a more robust governance framework
- contemporaneous documentation that evidences the tax characterisation process and claiming of deductions.

See also:

- PCG 2016/17 *ATO compliance approach – exploration expenditure deductions*
- TR 2019/5 *Income tax: effective life of depreciating assets*
- Uniform capital allowance system – Changing a depreciating asset's effective life
- Record keeping for capital expenses

Research and development

The most common issues we find with research and development (R&D) tax incentive claims include:

- [Eligibility of R&D tax incentive activities – notional deductions](#)
- [Ineligible expenditure and inappropriate apportionment methodology](#)
- [Poor corporate governance](#)
- [Contract expenditure](#)
- [Salary expenditure](#)

- [Other matters.](#)

The information below outlines strategies you can put in place to obtain assurance.

Eligibility of R&D tax incentive activities – notional deductions

The R&D tax incentive is jointly administered by the ATO and AusIndustry.

For assurance of eligibility, we look at expenses claimed as a notional deduction under the R&D tax incentive to the extent that the expenditure is incurred on 'R&D activities' (section 355-205 of the ITAA 1997) and those activities are registered with AusIndustry.

In some cases, we may also refer activities for review to AusIndustry where concerns are identified.

You can only register eligible R&D activities. If you are unsure whether your activities constitute R&D activities, we strongly encourage you to contact [AusIndustry](#) [↗](#).

See also:

- Eligible activities.

Ineligible expenditure and inappropriate apportionment methodology

We check whether the notional deductions claimed by you under Division 355 of the ITAA 1997 are:

- actually incurred on one or more R&D activities (as defined), and
- allocated using a methodology that is reasonable (see **Methods of apportionment**).

Expenditure claimed must be incurred on registered R&D activities and not related to ordinary business activities. Claimants need to:

- distinguish between expenditure incurred on eligible R&D activities and expenses that relate to ordinary business activities
- demonstrate the required nexus exists between the registered R&D activities and expenditure claimed.

There must also be sufficient evidence to demonstrate that the methodology used to apportion expenses (such as overhead expenditure and fixed costs) between eligible R&D activities and non-eligible R&D activities is appropriate.

Poor corporate governance

Due to a lack of adequate corporate governance, some taxpayers claim R&D offsets for activities that are not eligible R&D activities.

We recommend that good corporate governance include controls to:

- review your registered activities and the claims you make for the R&D tax incentive
- distinguish ordinary business activities from your eligible R&D activities
- identify when R&D activities have transitioned to ordinary business activities.

Contract expenditure

We may review a sample of 'contract expenditure'. The contracts need to show the nature of the work and its relation to the R&D activities.

We may need to review further records to understand how work under the contract relates to the R&D activities. For example, we may ask for minutes of any meetings between the client and contractor and progress reports from the contractor. If certain activities undertaken by the contracting company were not eligible R&D activities (or specifically excluded activities), we will need to understand how the contracted amount is apportioned between eligible and ineligible expenditure and the basis of the apportionment methodology.

See also:

- Expenditure you incur under contract to other parties.
- Contract expenditure you incur to an RSP

Salary expenditure

We review salary amounts to ensure that this expenditure is only claimed to the extent that it is incurred on eligible R&D activities.

If you have an employee working on eligible R&D activities, we will accept expenditure on the actual time spent on R&D activities as a proportion of the employee's actual hours worked, and the employee's actual salary.

Overinflated salary claims can also be a result of poor governance practices and apportionment methodologies.

See also:

- Amounts you can claim – Salary expenditure.

Other matters

The Research and Development Tax Incentive reforms announced in the 2020–21 Budget that will apply from the first income year commencing on or after 1 July 2021 are outlined in *Better targeting the research and development tax incentive*.

See also:

- Apportionment
- Other R&D expenditure
- Keeping records and calculating your notional deductions
- *TA 2017/5 Claiming the Research and Development Tax Incentive for software development activities*
- *TA 2017/4 Claiming the Research and Development Tax Incentive for agricultural activities*
- *TA 2017/3 Claiming the Research and Development Tax Incentive for ordinary business activities*
- *TA 2017/2 Claiming the Research and Development Tax Incentive for construction activities*
- *TA 2015/3 Accessing the R&D Tax Incentive for ineligible broadacre farming activities*
- *TR 2013/3 Income tax: research and development tax offsets: feedstock adjustments*
TD 2014/15 Income tax: when is Design Expenditure incurred by an R&D entity included in the first element of the cost of a tangible depreciating asset for the purposes of paragraph 355-225(1)(b) of the Income Tax Assessment Act 1997 (and therefore not able to be deducted under section 355-205)?

Tax losses

The most common issues we find with tax losses include:

- [Continuity of ownership test](#)
- [Business continuity test](#)
- [Consolidated groups – transfers of tax losses and available fraction calculations](#)
- [Origin of tax losses.](#)

The information below outlines strategies you can put in place to obtain assurance.

Continuity of ownership test

We frequently review the utilisation of carried forward losses. The continuity of ownership test (COT) is our primary test for the deduction of prior-year losses.

The most common reason for not obtaining assurance is that the COT analysis information and documents provided to us are incomplete, insufficient or cannot be verified.

Assurance often cannot be obtained due to the taxpayer's inability to trace through the shareholdings of interposed entities to verify ultimate beneficial shareholders. This is a common issue when a nominee company has a stake in a taxpayer company and limited information has been obtained regarding the nominee company's shareholders.

The documents and information we look for include:

- a detailed and complete COT analysis detailing the legislative provisions relied on to determine the ownership test period or ownership test times, as applicable
- contemporaneous supporting information and documents to substantiate your COT analysis, including
 - working papers
 - share registers
 - Australian Securities & Investments Commission (ASIC) notices regarding changes to member and share structure details

- memoranda and agreements regarding corporate change events, as defined in **Section 166-175** of the ITAA 1997 (if relevant)
 - other relevant information or documents produced in, or relevant to, majority shareholdings during the applicable ownership test period or ownership test times
- additional information (including publicly available information) that will assist us in verifying your analysis, supporting documentation and underlying facts, and assumptions including annual reports, financial statements, industry reports.

If you have utilised any transferred losses, you will need to provide the analysis performed to transfer the losses into the tax consolidated or multiple entry consolidated (MEC) group and the working papers used to calculate the available fraction for each bundle of losses (see [Consolidated groups – transfer of tax losses and available fraction calculations](#)).

Business continuity test

We review the application of the business continuity test (BCT) (formerly known as same business test) in connection with the utilisation of carried forward losses. Taxpayers may apply the BCT to deduct prior-year losses where the COT is failed, or it is not practicable for the taxpayer to meet the conditions of the COT.

The most common reason for not achieving assurance is that the BCT analysis information and documents provided to us are incomplete, insufficient or cannot be verified. It is difficult to obtain assurance that taxpayers have satisfied the BCT, as this requires a rigorous qualitative assessment of a taxpayer's BCT analysis and verification of the facts or assumptions underlying the analysis.

When reviewing whether the BCT has been satisfied, we look for:

- a detailed and complete BCT analysis which has regard to the legislative provisions relied upon and the factors outlined in
 - *TR 1999/9 Income tax: the operation of sections 165-13 and 165-210, paragraph 165-35(b), section 165-126 and section 165-132*
 - *LCR 2019/1 The business continuity test – carrying on a similar business*

- contemporaneous supporting information and documents (including publicly available information) to substantiate your BCT analysis, including
 - working papers
 - financial statements
 - correspondence
 - reports
 - ASX disclosures
 - ASIC documents
 - investor relation announcements
 - other information or documents relevant to your business operations.

If you have utilised any transferred losses, you will need to provide the analysis performed to transfer the losses into the tax consolidated or MEC group and the working papers used to calculate the available fraction for each bundle of losses.

Consolidated groups – transfers of tax losses and available fraction calculations

We review whether the COT or BCT (or modified COT or BCT) has been satisfied in the context of the transfer of losses into tax consolidated groups and MEC groups.

For transfers of tax losses, it is difficult to obtain assurance where there is a significant period between the transfer of losses into a consolidated group and the utilisation of those losses. To achieve assurance, you need to provide sufficient analysis and corroborating information and documents to verify that the relevant transferred losses were in accordance with the relevant provisions.

See [continuity of ownership test](#) and [business continuity test](#) for information and documentation required to substantiate the application of the modified COT and BCT on transferred losses.

We also review taxpayer's available fraction calculations. The most common reason for not achieving assurance is deficiencies in or, an

absence of, information and documents to verify a taxpayer's calculations – for example, no analysis to support the joining entity's market value.

The documents and information we look for include:

- the calculation of the available fraction for each bundle of losses transferred to the (provisional) head company of the tax consolidated or MEC group, including any adjustments to the available fraction after joining the consolidated or MEC group under subsection 707-320(2) of the ITAA 1997
- sufficient contemporaneous supporting information and documents to substantiate your available fraction calculation including working papers, valuation reports and advice
- additional information (including publicly available information) that will assist us in verifying your calculation, supporting documentation and underlying facts and assumptions including annual reports, ASIC disclosures, ASX announcements, financial statements and industry reports
- verification of any apportionment of the transferred losses which were utilised in the joining or formation year.

Origin of tax losses

When reviewing how carried-forward losses are used, we may look for the origin of the losses.

The documents and information we look for include:

- a detailed explanation of the source of the relevant losses
- sufficient contemporaneous supporting information and documents to substantiate your explanation of the validity of relevant losses, including annual reports, financial statements, and other relevant information or documents produced in, or relevant to, the years the relevant losses were incurred.

See also:

- Keep records longer for losses
- Claiming business tax losses from previous years
- Loss carry back tax offset

Consolidations

We assess your compliance relating to issues that commonly arise in relation to tax consolidated groups and multiple entry consolidated (MEC) groups.

There are typically tax consequences when a tax consolidated group or MEC group:

- is formed
- acquires or disposes of the membership interests (for example, shares) in an entity resulting in it joining or leaving the group
- acquires another tax consolidated group or MEC group
- is restructured.

The most common issues we find with consolidated groups include:

- [Tax cost setting on entry](#)
- [Tax cost setting on exit](#)
- [Valuations for calculating the entry ACA and TCSAs](#)
- [Restructures involving MEC groups.](#)

Tax cost setting on entry

The most common issues we encounter when obtaining assurance on the tax cost setting process on entry include:

- no entry allocable cost amount (ACA) calculation was provided
- no supporting documentation to verify the amounts included in the ACA calculation – for example, failure to provide the share purchase agreement disclosing the amount paid for the shares in the joining company or the completion accounts showing the accounting liabilities held at the joining time
- intangible assets that are not CGT assets, such as customer relationships and customer lists, being incorrectly recognised, or failure to recognise and value of other intangible assets that are CGT assets, such as trademarks or pre-1 July 2001 mining rights
- non-recognition of the goodwill of the acquired joining entity, without sufficient explanation or supporting documentation to support this position

- inadequate or no documentation provided to substantiate the market value of reset cost base assets.

To obtain assurance, we recommend that you provide:

- the entry ACA calculation and tax cost setting amount (TCSA) working papers supporting your allocation across retained and reset cost base assets
- the executed share purchase agreements and any purchase price adjustment working papers
- if you did not recognise goodwill in the joining entity, an explanation with relevant documentation to support this position
- financial statements (balance sheet) of the joining entity at the joining time
 - ensure the financial statements contain sufficient information for us to verify every step (such as Step 2 accounting liabilities, including those that are deductible and excluded from Step 2) relevant to your entry ACA calculation
 - ensure the values in the ACA calculation broadly align with the asset valuations in your financial statements.

Tax cost setting on exit

The most common issues we encounter when obtaining assurance on the tax cost setting process on exit include:

- no exit ACA calculation was completed
- only a draft or incomplete exit ACA position was available
- when we can't verify the amounts included in the exit ACA, such as the terminating values of all the assets at leaving time, due to incomplete working papers and insufficient supporting documentation
- when we can't verify the amounts on exit due to being unable to assure the leaving entity's initial entry ACA and TCSA calculations for its assets on joining the consolidated group.

In order to obtain assurance, we recommend you provide the final exit ACA calculation and TCSA working papers, including financial

statements (balance sheet) for the leaving entity at the exit time.

Valuations for calculating the entry ACA and TCSAs

The most common reasons we are unable to provide assurance in relation to valuations connected with entry or exit ACA, and TCSA calculations are:

- no contemporaneous valuation documentation was provided
- no valuation advice or documentation was provided to support the related party transaction.

To obtain assurance, we recommend that you provide:

- valuation documentation for all (significant) reset cost base assets of the joining entity (for which comparable sales evidence of the market value at the joining time is not publicly available), unless you are eligible to use one of the valuation short-cut options (see **Market valuation for tax purposes**)
- valuation documentation to support the entry or exit ACA calculations if a joining entity was acquired from, or an existing entity was sold to, a related party.

Restructures involving MEC groups

The most common reasons we are unable to provide assurance in relation to restructuring involving MEC groups include:

- the commercial rationale for the restructure, or relevant steps in the structure was not provided
- the commercial rationale provided for the restructure was not substantiated with contemporaneous analysis, information and documents
- the arrangements involved were complex and more information is required to understand the income tax implications
- we are unable to review the restructure holistically in the assurance review.

The documents and information that we look for include:

- a copy of the restructure step plan, including details of the date and the actual transactions undertaken in each step of the restructure

- documents outlining the potential tax implications and rationale for the structure or arrangement implemented
- copies of any advice, reports or documents produced in connection with the restructure
- group structure diagrams for the period before and after the restructure.

See also:

- TR 2004/13 *Income tax: the meaning of an asset for the purposes of Part 3-90 of the Income Tax Assessment Act 1997* (taking into account the amendments made by *Tax Laws Amendment (2012 Measures No 2) Act 2012* (the Prospective Rules)
- TR 2005/17 *Income tax: goodwill: identification and tax cost setting for the purposes of Part 3-90 of the Income Tax Assessment Act 1997*
- TR 2006/6 *Income tax: Recognising and measuring the liabilities of a joining entity under subsection 705-70(1) of the Income Tax Assessment Act 1997* (taking into account the amendments made by *Treasury Laws Amendment (Income Tax Consolidation Integrity) Act 2018* (the deductible liability amendments)
- TR 2007/7 *Income tax: consolidation: errors in tax cost setting amounts of reset cost base assets*
- TA 2020/4 *Multiple entry consolidated groups avoiding capital gains tax through the transfer of assets to an eligible tier-1 company prior to divestment*
- Market valuation for tax purposes
- Consolidation reference manual

Valuations

The most common issues we encounter when obtaining assurance on valuations include:

- missing valuation reports
- valuation instructions
- valuation process

- valuation report detail and substantiation.

Missing valuation reports

A common reason for not achieving assurance on valuations is due to the absence of a valuation report to substantiate a value.

The absence of a valuation report may result in us seeking further information or escalating the matter for further review.

To ensure you don't receive a low assurance rating when a tax outcome has relied on a valuation, we recommend you provide complete valuation reports that have been prepared in accordance with relevant professional standards.

See also:

- Market valuation for tax purposes

Valuation instructions

Inappropriate valuation report purpose and valuer instructions can reduce the level of assurance associated with valuations. From our engagements, we have identified the following common issues with valuation report purpose and instruction:

- incorrect valuation date (the 'as at' date of the valuation)
- incorrect valuation subject – the subject for which a value has been determined within a valuation report was inconsistent with the tax asset for which a value was required
- inappropriate restrictions to the scope of the valuation, including restrictions that
 - impact the type of valuation service undertaken by a valuer
 - reduce the valuer's freedom to employ the most appropriate valuation methodology
- erroneous valuation assumptions, including assumptions that don't accord with the provisions of the law under which the valuation is required
- insufficient verification of key valuation inputs.

See also:

- Market valuation for tax purposes

Valuation process

From our engagements, we have identified the following common issues that restrict our ability to understand the process followed by the valuer:

- inadequately documented valuation process – a valuation should be replicable, in effect, this means the valuation should be documented and explained well enough that another person or valuer can understand how the value was determined
- insufficient use of supporting valuation methods (cross-checks)
- deviation from professional standards.

See also:

- Market valuation for tax purposes

Valuation report detail and substantiation

From our engagements, we have identified the most common issues with valuation reports, as well as strategies you can put in place to avoid a low assurance rating.

The valuation report detail we look for can include:

- a clearly defined and characterised subject (or subject asset)
- detail of objective evidence relied upon by the valuer for the substantiation of key valuation inputs and assumptions, including
 - sources relied on for cost estimates where a cost approach is utilised
 - detail of any market-based evidence where a market approach is utilised
 - basis and reasoning for assumed growth rates in forecast earnings
- relevant appendices, including
 - valuer engagement letter
 - schedule of market-based evidence where applicable

- relevant financial statements where applicable
- third-party advice relied upon in the valuation where applicable
- valuation calculations.

See also:

- Market valuation for tax purposes

Making a voluntary disclosure

We encourage you to review your tax affairs regularly and make a voluntary disclosure to us as soon as you identify any errors, omissions or false or misleading information in returns or statements you've lodged.

You can make a voluntary disclosure at any time but disclosing as soon as possible will reduce your penalty exposure.

If you make a voluntary disclosure before we have contacted you about an issue, we will generally exercise our discretion to remit any applicable shortfall penalty to nil, unless you have acted recklessly or intentionally disregarded the law.

We may recommend that you make a voluntary disclosure if we find potential errors or omissions or identify tax risks as part of a Top 1,000 assurance review.

When tailoring our engagement with you, we look at what steps you've taken to address our previous recommendations.

Reduced penalties during a review

We are likely to exercise our discretion to reduce any shortfall penalties by at least 80% if you voluntarily:

- disclose an error or omission to us during your Top 1,000 assurance review
- action the recommendations from your Top 1,000 review before a Next Actions review has commenced.

A penalty reduction may not be available once you've been notified that a Next Actions review or an audit will commence.

How to avoid a delay

To ensure that your voluntary disclosure is considered as quickly as possible, it should be provided in the **approved form**.

Avoid delays in having your voluntary disclosure assessed by providing:

- detail of any amendments to your income tax returns, schedules and activity statements to correct the error or omission, including
 - relevant time periods
 - original amount
 - amount of the adjustment
 - which label on the return, schedule or activity statement you are amending
 - a detailed breakdown if a label is being amended for multiple issues
- detailed analysis of the original amount or omission, including
 - how it was worked out
 - why it is incorrect
 - whether it impacts on related parties or entities
 - supporting documentation
- how the new amount is worked out and supporting documentation to verify the new amount
- any information or documents to help us consider remitting penalties or interest charges.

How to submit a voluntary disclosure

To submit a voluntary disclosure:

- email Top1000NextActions@ato.gov.au using the **approved form**, or
- contact the tax officer conducting your Top 1,000 assurance or Next Actions risk review.

If you need to amend a return, see [Objections and amendments](#) (for large business).

See also:

- [Make a voluntary disclosure](#)
- [Voluntary disclosures in the approved form](#)
- [Interest and penalties](#)
- [Request remission of interest or penalties](#)
- [Miscellaneous Taxation Ruling MT 2012/3 *Administrative penalties voluntary disclosures*](#)

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Findings report – Top 1,000 income tax and GST assurance programs

Findings from the Top 1,000 income tax performance, combined assurance review and GST assurance review programs.

13 October 2022

About this report

This is the fourth year we are publishing our findings report for the Top 1,000 assurance program for income tax. It is the second year we are including insights from the Top 1,000 goods and services tax (GST) assurance program.

For income tax and GST assurance reviews completed to 30 June 2022, this report:

- outlines our key findings and observations
- explains 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 GST, or

- identify areas of tax risk for further action
- enables businesses to understand how their tax risk profile compares to their peers.

We will continue to publish updated findings from the Top 1,000 assurance review programs in future findings reports.

The justified trust program benefits Top 1,000 taxpayers, their shareholders, other key stakeholders, and the wider community.

The program provides the ATO a holistic understanding of the taxpayer's business operations and financial performance which:

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

Top 1,000 engagement

The Top 1,000 population consists of:

- public and multinational businesses and super funds that have substantial economic activity related to Australia
- large contributors to corporate income tax, excise, and petroleum resource rent tax collections
- some of the largest remitters of GST.

Based on 2021 tax returns, Top 1,000 taxpayers paid about \$20.4 billion or 19% of all corporate income tax. The 10 largest groups in the Top 1,000 population paid \$3 billion or 15% of the Top 1,000 company tax and the 100 largest groups in the Top 1,000 population paid \$11.5 billion or 56% of the Top 1,000 company tax.

The Top 1,000 taxpayers reported \$24.1 billion of net GST or 36% of total GST collections.

Top 1,000 taxpayers are initially identified as members of large public and multinational corporate groups with a group turnover greater than \$250 million and not covered by the **Top 100 Program**. They are diverse in terms of their ownership, business models, industries, and size.

As Top 1,000 taxpayers can have a significant impact on the health of our tax system, we engage with them on a periodic basis to manage their compliance and assure their tax performance. We aim to review Top 1,000 taxpayers once every 4 years.

Where the economic group has more than one taxpayer, we usually review the taxpayer with turnover above \$250 million for income tax and the largest GST group for GST.

Our engagement with Top 1,000 taxpayers is tailored based on the **Action Differentiation Framework**.

Our understanding is informed by:

- their size
- the transparency of their engagement with us
- the choices and behaviours evidenced in
 - their tax affairs
 - the level of risk they exhibit, and
 - the level of assurance we have previously obtained.

We have now completed 1,174 assurance reviews on 1,031 taxpayers covering income tax. 143 taxpayers have had their income tax outcomes reviewed for a second time. We have reviewed 444 taxpayers covering GST (this includes GST assurance reviews and combined assurance reviews).

We have seen a positive shift in the market's perception of justified trust and the 'currency' associated with our assurance ratings is becoming highly regarded.

We record tax assured on all focus areas that have achieved high assurance. To date we have assured around \$69.9 billion in income tax for Top 1,000 taxpayers since we started assurance reviews in 2016 for the high assurance items. As most of our population are not yet at high

assurance overall, we are still working to increase our level of assurance through the periodic reviews and increase the tax assured.

Justified trust and transparency

Tax compliance is becoming an important part of the increasing focus among boards, investors, customers or consumers, suppliers, community groups and other stakeholders of how organisations contribute to the communities in which they operate, with many seeing this as an important component of Environmental, Social and Governance (ESG) performance indicators.

Societal attitudes and expectations in Australia and globally are increasingly encouraging organisations to make more transparent and sustainable business decisions that can lead to long-term growth benefiting all stakeholders. There continues to be calls for organisations to be more transparent about their operations and tax contributions, and to demonstrate that they are participating fairly in the economy.

Our justified trust ratings are expected to be increasingly used and leveraged by organisations to support their community and ESG credentials as part of their broader social licence to operate. The objective principles used in the justified trust initiative also serve to enhance the community's understanding about large market compliance, and their ability to differentiate good corporate tax citizens from others. Although there remains a level of non-compliance by some in this population which we continue to robustly address, the overall level of compliance is very high, and probably much higher than the current broader community understanding. Sharing these ratings can help address this gap for those organisations which have achieved high assurance.

We have seen a small number of Top 1,000 sign up to the voluntary tax transparency code. We encourage the continued adoption of tax transparency practices (including the disclosure of assurance ratings) which builds and maintains community confidence that the largest taxpayers are paying the right amount of tax.

Taxpayers who attained overall high assurance are generally able to experience a tangible change in the intensity of reviews leading to savings in time and compliance costs, to the benefit of both the taxpayer and the ATO.

Our approach

Justified trust is a concept from the Organisation for Economic Cooperation and Development (OECD).

We introduced the justified trust concept in 2016 and commenced the Top 1,000 income tax assurance program as part of the Tax Avoidance Taskforce.

We apply the justified trust methodology and seek to obtain assurance of 4 focus areas.

1. That appropriate tax risk and governance frameworks exist and are applied in practice. This includes the design of business systems to create, capture and report transactions correctly for GST purposes.
2. That none of the specific income tax or GST risks we have flagged to the market are present.
3. That tax outcomes of atypical, new, or large transactions are appropriate.
4. That we understand why the accounting and tax results vary. We analyse the various streams of economic activity and how they are treated for taxation purposes. We also analyse the sales, acquisitions, and other data, and compare this to net GST paid.

The program has evolved:

- In 2019 we expanded the program to cover GST when we commenced the Top 1,000 GST assurance program. This program was replaced in 2022 with the expansion of the combined assurance review program.
- In September 2020 we introduced integrated income tax assurance and GST risk reviews through the Top 1,000 combined assurance review program.
- In April 2022 we expanded the combined assurance review program to undertake GST assurance (instead of a risk review). The combined assurance review will be the primary assurance review for Top 1,000 taxpayers for both income tax and GST.

Selection process for a combined assurance review

When selecting taxpayers for a Top 1,000 combined assurance review, we use guiding principles which have regard to taxpayers'

circumstances, such as previous ATO engagements and lodgment history.

This may include taxpayers who have never been reviewed in an assurance review or are new entrants into the Top 1,000 population.

Where a taxpayer has previously been subject to an assurance review, we will consider the years that were previously assured, and the number of subsequent years which have passed since the last review. Generally, we seek to review at least the last 3 income tax years which have not yet been subject to an assurance review.

Going forward we aim to undertake combined assurance reviews on around 250 businesses per annum in relation to both income tax and GST. Practically, this means that Top 1,000 taxpayers can expect a review at least once every 4 years.

Undertaking a combined assurance review

The combined assurance review program delivers a tailored experience for clients influenced by their overall assurance ratings attained in any earlier assurance review. As we continue our coverage of the Top 1,000 and start to review more taxpayers for a second time, we are starting to see more understanding in the market of justified trust and the benefits. This is translating to a general trend of faster and more efficient reviews and in some cases, improved assurance ratings.

In the past few years, we have focused on the criticality of a good, lived, tax governance framework, and encouraging self-assessment against the ATO's 'better practices'. We have provided additional tax governance guidance for taxpayers preparing for a combined assurance review.

We have continued to ensure we articulate:

- those areas where we have high assurance that the right amount of tax has been paid or the right GST outcomes have been reported
- areas where we have concerns and what steps can be taken to obtain a higher level of assurance
- where we are going to engage further through ATO next actions
- our tailored approach in second time reviews, particularly where recommendations have been actioned and complete information has been provided – where we review a taxpayer a second time, we

build on the levels of trust gained through the initial review and look for improvements.

The program provides taxpayers with an opportunity to improve assurance ratings obtained under their first Top 1,000 review – we review improvements and remediation activities undertaken following that first Top 1,000 review.

Taxpayers we review a second time are experiencing less intense reviews. This is compared to a new entrant taxpayer of similar size and complexity. We are able to leverage off the knowledge we have already gained from a previous assurance review, which means that subsequent reviews typically require less resourcing for both the taxpayer and the ATO.

Where we are undertaking subsequent reviews for both income tax and/or GST, typically, we do not require the same level of information in the second Top 1,000 review as for the first review unless there are significant changes in the taxpayer's business or tax treatment.

Completion of the combined assurance review and next actions

At the end of the review, we provide a combined assurance report to the taxpayer that covers income tax and GST. Up to June 2022 we provided assurance ratings for income tax but not for GST. From June 2022 the combined assurance reports include assurance ratings for both income tax and GST.

Where applicable, the report includes detailed next steps for the taxpayer to action to improve their ratings in relation to their tax control frameworks and identified income tax or GST areas of concern. These are referred to as 'client next actions'. We will follow up and confirm the steps taken to address our concerns, which may be in the next review or a specific follow up enquiry. The report will clearly outline the expected timing for this follow up enquiry.

'ATO next actions' refer to those situations where we have identified income tax or GST risks that require us to work with the taxpayer to resolve through a separate product (such as a risk review or audit).

Since the start of the income tax assurance programs, about 10% of taxpayers have required further intervention through an ATO next action. However, in the combined assurance review program for income tax and GST, we are currently seeing about 5% of taxpayers as

requiring further ATO next action. This reflects, in part, that we have a large proportion of taxpayers where we have already established some assurance previously.

We advise the taxpayer at the end of their review where there are concerns requiring ATO investigation and therefore will be progressed to an ATO next action. We will provide detailed insights in relation to our concerns, including where applicable the recommended steps for taxpayers to take in order to address our concerns.

Top 1,000 income tax assurance

In this section


- [Overall levels of assurance](#)
- [Tax risk management and governance](#)
- [Significant and new transactions and specific tax risks](#)
- [Alignment of tax and accounting outcomes](#)
- [High assurance and tailoring our engagement](#)

Overall levels of assurance

We have now completed 1,174 assurance reviews on 1,031 taxpayers. The 1,174 reviews include 271 combined assurance reviews. We are now starting to review more taxpayers for a second time and have completed second reviews for 143 taxpayers by 30 June 2022.

The population for Top 1,000 is never static and we will continue to see a portion of our program comprising of new entrants to the population that we are reviewing for the first time.

Graph 1: overall assurance ratings for all taxpayers as at their last review, as of 30 June 2022




Pie chart showing percentage of assurance with 23% high assurance, 61% medium assurance and 16% low assurance.

Of the 1,031 taxpayers reviewed, 23% of taxpayers have achieved overall high assurance as at their last review. This means we have assurance that these taxpayers have paid the right amount of Australian income tax for the income years reviewed. Most taxpayers (61%) have achieved an overall medium assurance rating.

The overall level of assurance is based on an objective view (having regard to objective evidence) as to whether the taxpayer is considered to have paid the right amount of tax.


Ratings

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


 Green dot denotes High assurance rating	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.
 Yellow dot denotes medium assurance rating	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.
 Orange dot denotes low assurance rating	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 reviews completed up to the end of June 2022 resulted in the following ratings for taxpayers after their first review and the taxpayers after their second review.

Graph 2: Overall assurance ratings for first review of all taxpayers and overall ratings for taxpayers after their second review, as of 30 June 2022

 Bar charts showing percentage of assurance ratings. From first reviews with 1,031 taxpayers: 24% high, 60% medium and 16% low assurance. From second reviews with 143 taxpayers: 34% high, 59% medium and 7% low assurance.

Graph 3: Comparison of overall assurance ratings for the taxpayers that had a second review, as of 30 June 2022


 Bar chart showing overall assurance ratings for taxpayers that had a second review. First review: 43% high, 53% medium and 4% low assurance. Second review: 34% high, 59% medium and 7% low assurance.

As at 30 June 2022, we had only reviewed a relatively small number of taxpayers for a second time. As such, any general comparison between overall ratings is impacted by the profile of the taxpayers reviewed. Therefore, we consider it too early to make any general findings about the shift in ratings from first to second review at this stage. However, we do offer some general observations below.

Of the taxpayers that have had a second review, 34% have obtained overall high assurance (justified trust) for income tax. In comparison, 24% of all taxpayers have obtained high assurance overall after their first assurance review.

When comparing the overall ratings between first and second reviews of the 143 taxpayers that had a second review, we see a shift in the number of taxpayers achieving a high assurance rating from 43% to 34%. There is also a shift in the number of taxpayers with low assurance from 4% to 7%.

Graph 4: Overall assurance rating for reviews completed by industry as of 30 June 2022 split by all first review outcomes and second time review outcomes.

 Bar chart showing overall assurance by industry. Chart shows percentages of low, medium and high assurance across the four industry segments mentioned below.

Note:

- These groupings align with the industry segments used by the ATO as part of the Corporate Tax Transparency Reporting except where we have amalgamated the Banking, Finance and Investment (BFI), Insurance (ISR) and Superannuation (SUP) segments into a Financial Services (FS) segment.
- The groupings are
 - banking, finance and investment, superfunds and insurance (FS)
 - manufacturing, construction and agriculture (MCA)
 - mining, energy and water (MIN)
 - wholesale, retail and services (WRS).

Observations

As we continue our coverage of the Top 1,000, we are observing an increase in the number of taxpayers obtaining an overall high assurance rating, and a reduction in the number of taxpayers obtaining overall low assurance. The number of taxpayers obtaining an overall medium assurance remains consistent.

When considering the outcomes for the 143 taxpayers that have had a second review, we saw a reduction in the number of high assurance ratings, and a slight increase in the number of low assurance ratings. This outcome is impacted by a number of factors including:

- the changed requirement that a taxpayer obtain a stage 2 rating for governance to obtain an overall high assurance rating
- risk areas present or multiple areas reviewed were not at high assurance preventing an overall high assurance rating
- the profile of those selected for a second review, whereby 43% had a high assurance rating in their first review
- the relatively small number of second reviews undertaken to date.

These taxpayers were selected for a second review based on our selection criteria, primarily due to there being three years that had not been reviewed since their initial assurance review. Selecting taxpayers that had obtained a variety of assurance ratings in their first review also enabled the development of the tailored approach for subsequent reviews, ensuring a more streamlined approach.

We will continue to monitor this trend as we progress with reviewing the population for a second time. We anticipate that, with the ongoing improvements in the tax governance ratings, we will see an increase in the number of taxpayers achieving overall high assurance.

We will continue to seek to better understand how we can assist taxpayers to move to overall high assurance. For many taxpayers, this is partly a reflection of their tax governance ratings being predominantly at stage 1 and/or their key risk areas not achieving a medium or high assurance rating.

Given the observation that a main blocker to taxpayers achieving overall high assurance was demonstrating a stage 2 rating for tax governance (design effectiveness of their governance framework), we

published **Income tax risk management and governance guidance for top 1,000 taxpayers**. Since the publication of this practical guidance, we have observed an increase in taxpayers being able to achieve a stage 2 rating for their tax governance.

Where a taxpayer has not achieved high assurance, we set out in the taxpayer's report the recommended steps for the taxpayer to take in order to improve their ratings. We encourage taxpayers to action these recommendations and we will follow up either in the next assurance review or through a specific follow up enquiry (which may include an ATO next action review).

Tax risk management and governance

Tax governance framework

Tax governance is a key focus area under the justified trust methodology for large public and multinational businesses.

Documented tax control frameworks that are designed effectively provide the foundation for our assurance that the taxpayer has paid the right amount of tax.

We look to see whether you have a fit-for-purpose governance framework in place, it is lived by the organisation, and you test regularly to ensure that it is operating as intended.

We use the following guidance material to consider the existence, design and operation of a tax control framework for income tax and GST focusing on the 8 controls (collectively, the Guides):

- **Tax Risk Management and Governance Review guide**
- **GST Governance, Data testing and Transaction Testing Guide**
- the recently published **Income tax risk management and governance guidance for top 1,000 taxpayers**.

The 8 controls are:

1. Board-level control 1: Formalised tax control framework
2. Board-level control 3: The board is appropriately informed
3. Board-level control 4: Periodic internal control testing
4. Managerial-level control 1: Roles and responsibilities are clearly understood

5. Managerial-level control 3: Significant transactions are identified
6. Managerial-level control 4: Controls in place for data (GST only)
7. Managerial-level control 6: Documented control frameworks
8. Managerial-level control 7: Procedures to explain significant differences.




The Guides:


- set out principles for board-level and managerial-level responsibilities, with examples of evidence that demonstrate the design and operational effectiveness of tax control frameworks
- focus 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.

The Income tax risk management and governance guidance for top 1,000 taxpayers is designed to provide practical assistance for Top 1,000 taxpayers preparing for a combined assurance review.

Ratings


We apply a consistent rating system when reviewing and assessing tax governance. For more information about how we review tax governance, see [Reviewing tax governance for large public and multinational businesses](#).

 Green dot denotes Stage 3 rating	Stage 3	You provided evidence to demonstrate that a tax control framework exists, has been designed effectively and is operating effectively in practice.
 Yellow dot denotes Stage 2 rating	Stage 2	You provided evidence to demonstrate that a tax control framework exists and has been designed effectively.
 Orange dot denotes Stage 1 rating	Stage 1	You provided evidence to demonstrate a tax control framework exists.

 Red dot denotes not evidenced or concerns	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.
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All assurance reviews completed up to the end of June 2022 resulted in the following ratings for tax governance for income tax.

Graph 5: overall governance ratings for all taxpayers as at their last review, as of 30 June 2022


 Pie chart showing percentage of overall governance ratings: 1% stage 3, 29% stage 2, 63% stage 1, 5% red flag and 2% not rated.

As at their last review, 63% of taxpayers were at a stage 1 rating for governance, with 30% being at a stage 2 or 3 overall rating.


Graph 6: Overall governance ratings for first review of all taxpayers and overall ratings for taxpayers after their second review, as of 30 June 2022

 Bar graph showing outcomes from first and second reviews. Key outcomes from first reviews: 26% stage 2 and 67% stage 1. Key outcomes from second reviews: 44% stage 2 and 44% stage 1.

Graph 7: Comparison of governance ratings for the taxpayers that have had a second review, as of 30 June 2022

 Bar chart showing governance ratings compared from first to second review. Key outcomes for first review 21% stage 2 and 71% stage 1. Key outcomes for second review: 44% stage 2 and 44% stage 1.

Graph 8: Overall governance rating for all assurance reviews completed by industry as of 30 June 2022 spilt by first time and second time reviews.

 Bar chart showing overall governance rating by industry. Chart shows percentages of low, medium and high assurance across the four industry segments.

Observations

From 2020, we changed our qualifying factors to achieving overall high assurance by requiring taxpayers to obtain a minimum stage 2 rating

for tax risk management and governance.

In February 2022, we published governance guidance tailored for Top 1,000 taxpayers. Given the variety of businesses within the Top 1,000, this guidance assists taxpayers to apply the ATO's governance requirements having regard to different structures and models. This publication has made it easier for taxpayers to understand the ATO expectations and take action to ensure they have the minimum requirements for a tax governance framework that is designed effectively and is fit for purpose. The guide also allows ATO staff to be confident about how to tailor the governance assessment having regard to differences in business structure, size and scale.

Stage 1 rating

The most common tax risk management and governance rating for taxpayers who have engaged with the program for the first time is a stage 1 rating. We will continue to work with taxpayers to seek to improve this rating to at least a stage 2, which is one of the criteria to achieving overall high assurance.

Our observation based on the results to date is that large businesses who come into the Top 1,000 program are still in the process of documenting and formalising their tax control frameworks and/or are unable to provide the required objective evidence to demonstrate that their tax control framework is designed effectively.

We expect to see continued improvements in the governance ratings as taxpayers develop a better understanding of the governance principles and make efforts to provide objective evidence to support a higher rating.

While most taxpayers in the Top 1,000 program are now demonstrating that they have a tax governance framework in place, we are still seeing that taxpayers are not achieving a stage 2 rating for the following reasons.

- Some taxpayers have provided their various policies as part of the assurance review information request but do not have an overarching framework that incorporates the separate policies. This does not demonstrate a governance framework that is designed effectively for the Australian business is in place.
- Adoption of a global tax policy which does not adequately address Australian tax risks. Our focus is on a 'fit for purpose' tax

governance framework but it needs to be clear how the global tax policy applies in Australia.

- A commitment to undertake periodic control testing (board level control 4) is provided but there is a lack of evidence to demonstrate the existence and design effectiveness of all the 7 key controls. This is a requirement to obtain a Stage 2 rating overall. The commitment to testing should only occur at a time when all key controls exist and are designed effectively.
- We have seen for management level control 6 (documented control frameworks) evidence is sometimes provided on how certain adjustments are made, but not the procedure that sets out how to determine whether an account requires an adjustment. If advisors are undertaking reviews of the income tax return or the tax effect accounting preparation, we expect to see the scope of the advisor review, not just notes that they completed it.
- The board level control 3 requires that the board (or sub-committee) must be appropriately informed of the tax risks in the organisation and the effectiveness of their tax control framework. We are seeing that the minimum matters that should be included for consideration by the board are not included in report templates such as the potential or actual tax risks arising from significant transactions.
- For board level control 4 (periodic internal control testing) some taxpayers have relied on existing financial reporting controls testing. For example, SOX testing and other processes adopted at a global level, rather than a commitment to testing the Australian governance controls.
- 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 and 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 supplement existing policies and frameworks, so their tax risk management and governance framework meets the recommendations in the Guide.

Stage 2 rating

A Stage 2 rating is required to obtain overall high assurance. A Stage 2 rating gives taxpayers, and us, confidence that the tax control framework is effective.

For taxpayers we have reviewed a second time, we have seen taxpayers make improvements to their tax control framework and therefore an improvement in the outcomes for their governance ratings. We expect this trend to continue as the number of taxpayers that have had a second review increases.

In respect to the taxpayers that have had a second review, we have seen an increase in the number obtaining a Stage 2 rating. Of these taxpayers, 21% obtained a Stage 2 rating in their first review. This increased to 44% obtaining a Stage 2 rating in their second review.

To obtain a Stage 2 rating for tax governance, evidence must be provided to demonstrate that the tax control framework is designed effectively. This requires taxpayers to have addressed all relevant key controls in their tax control framework.

Our practical guidance sets out 3 potential pathways (depending on the profile of the taxpayer) to obtaining a Stage 2 rating. There is a particular focus on how the commitment to conduct periodic internal controls testing of the key controls can be evidenced. There must be a testing plan endorsed by senior management or a definite commitment to undertake periodic control testing, ideally within the tax governance framework. We have seen an increase in taxpayers updating their tax governance framework to include a periodic control testing plan or the provision of the commitment.

The guidance also provides examples of different types of businesses and how different businesses might be able to evidence the key controls to qualify for a Stage 2 rating. The guidance has also assisted ATO staff in their reviews of the governance documentation resulting in more consistent decisions and confidence in our ratings.

Stage 3 rating

We have seen a small number of Top 1,000 taxpayers achieve a Stage 3 rating, with some of those having occurred since our practical guidance was released in February 2022. We support taxpayers aspiring to achieve a Stage 3 rating, however a Stage 3 is not required in order to achieve high assurance. We anticipate that the number of taxpayers achieving Stage 3 will increase when we conduct third time reviews.

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 Top 1,000 taxpayers can provide evidence that an appropriately qualified independent reviewer (for example, independent of the tax control owner – internal risk or audit function or a third party) has conducted a review and tested the design/operating effectiveness of key controls.

This stage requires evidence in the form of a report of findings (describing the outcomes of the testing) by an independent reviewer who has tested the operation of all their key controls 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.

We need to be provided with the outcomes of the testing, including:

- testing methodology
- sample sizes selected
- types of source documents relied upon by the tester
- final test results
- steps taken to address issues identified
- Board (or Board delegate) acknowledgement of the test results
- actions to be taken to address any adverse findings or issues identified.

Those taxpayers that have provided a testing plan usually test within a rolling 3 to 5 year period. Frequency of the retesting varies according to the characteristics of the organisation and the outcomes of prior tax control testing.

Due to the frequency of testing by taxpayers and the periodic nature of the combined assurance reviews, we expect it will take a number of years for shifts to Stage 3 to be seen in our findings report outcomes.

Red flag rating

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

as evidenced by:

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

A small number of taxpayers obtained red flag ratings. We saw some taxpayers maintain their red flag ratings in the second reviews as well as some instances where the ratings decreased from a Stage 1 to a red flag. Most commonly, there wasn't sufficient evidence to demonstrate the existence of the minimum Stage 1 requirements. To obtain a Stage 1 rating, documentation evidencing a tax control framework (BLC1), or tax return preparation processes (MLC6) is required. If the taxpayer cannot demonstrate the existence of either of those controls, a red flag may be appropriate.

The taxpayers obtaining a red flag continue to remain a small percentage of the overall Top 1,000 population. However, it does raise concerns when a taxpayer decreases to red flag or maintains a red flag in the second review. Those taxpayers can expect that a higher intensity of review is required for their assurance review as we cannot rely on their governance processes to result in correct tax outcomes.

Red flag ratings are quite rare and usually occur where:

- a global policy with little reference to the Australian taxpayer is produced, and
- the taxpayer has been unable to provide sufficient evidence to demonstrate they have a documented end-to-end process for the income tax return.

This scenario is one of the examples included in our governance guidance which can assist taxpayers to ensure they have a fit for purpose tax governance framework in place for the Australian business.

Not rated

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

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.

As part of our assurance reviews, we check the accuracy and completeness of:

- disclosures made in tax returns
- accompanying schedules (including the Reportable Tax Position Schedule)
- country-by-country (CBC) reporting statements.

Many Top 1,000 taxpayers have arrangements that are covered by a public advice and guidance product (such as a Practical Compliance Guideline, Taxpayer Alert or Public Ruling). Where a public advice and guidance product may be applicable, our approach is to seek to understand the arrangement to determine the presence of risk and the tax treatment the taxpayer has taken.

Where a taxpayer is in a higher risk zone of a Practical Compliance Guideline or meets the elements of a taxpayer alert, we will apply a greater level of intensity to review this area for assurance.

We have published a **guide to help Top 1,000 taxpayers to:**





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

The latest **Findings report RTP – Public and multinational businesses** provides the aggregated disclosures made by companies for the 2020-21 income year. The report provides insights into the types of arrangements large companies are entering into, including other arrangements which are not outlined below.

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.

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

Observations

Outcomes from the review of significant and new transactions and specific risks tend to have a significant impact on the overall assurance ratings for taxpayers.

The number and type of transactions varies between taxpayers. This, along with the level of evidence supplied may impact the intensity and length of the review.

Most taxpayers are achieving a medium or high assurance rating for the specific risks, significant and new transactions reviewed. We have seen improvements in some specific risk area ratings in second time reviews as outlined below.

There has been a small number of taxpayers decrease ratings for specific risk areas in their second reviews. We are still seeing some areas of concern with low or red flag assurance ratings. We have observed that a lack of documentation or evidence to support the tax position a taxpayer has taken is a frequent cause for a low or red flag assurance rating.

We will continue to provide recommendations to taxpayers on how to improve and what next steps they should take. Matters may also be referred for further ATO investigation as part of our next action program where the identified concern is assessed as requiring intervention to resolve (through review or audit).

On average approximately 10% of all taxpayers we have reviewed have been referred to the ATO next actions program.

Our observations about specific risks and areas of concern, assurance ratings and any changes in the ratings between the first and second reviews are contained below. The statistics we have provided in this section are based on combined assurance review data but is broadly consistent with the outcomes from the tax performance program.

Financing (including transfer pricing financing)

Of the taxpayers that have had a combined assurance reviews, 44% had a financing area of assurance with the majority involving related party arrangements. This includes the following types of arrangements or transactions:

- interest bearing loans
- cash pooling
- redeemable preference shares (RPS)
- interest free loans
- derivatives
- guarantee fees
- debt forgiveness

- convertible notes
- cross border round robin financing arrangements (loan backs).

Interest bearing loans was the largest category of financing risk reviewed.

Financing assurance areas had a higher amount of low and red flag assurance ratings (24%) compared to other areas reviewed. It also had the lowest percentage of high assurance outcomes (19%). Most outcomes for this area was a medium assurance rating (55%).

For second time reviews we are seeing some taxpayers improve their financing rating from their first review particularly moving from low to medium assurance. Some of the reasons for improvement include:

- actioning recommendations from the previous review
- providing their self-assessment against PCG 2017/4 and supporting documentation
- changing or ending higher risk arrangements

Of the low and red flag ratings for financing risks the following arrangements were the most common:

- interest bearing loans
- RPS
- cash pooling
- convertible notes
- concerns about debt/equity characterisation (Division 974)
- interest bearing loans and RPS.

Financing arrangements/transactions constitute one of the key areas that is resulting in ATO next actions.

We apply the risk assessment framework published in PCG 2017/4, as well as consider the analysis prepared in transfer pricing documentation to review the arm's length nature of these arrangements. We continue to observe higher risk arrangements where the structuring and pricing of related party transactions is not consistent with third-party transactions, including transactions conducted by the taxpayer or the multinational group to which it

belongs. We expect taxpayers to provide contemporaneous evidence to support the commercial nature of their arrangements.

Category C RTP Schedule disclosures by Top 1,000 businesses for 2020–21 on related party financing arm's length conditions shows that 15% of disclosures were assessed as falling in the high-risk zone. The majority were disclosed as low risk. We have seen a general increase in category C disclosures that are considered low risk since 2017–18.

Transfer mispricing (other than financing)

In the combined assurance reviews, about 62% of taxpayers had non-financing related transfer pricing arrangements reviewed. This is the most common area of assurance that we see in the reviews.

The inbound or outbound sale and/or purchase of tangible goods was the largest category of issues reviewed within transfer pricing.

Arrangements that were commonly covered in transfer pricing assurance areas were:

- inbound and outbound sale and purchase of tangible goods
- management and administration services
- intellectual property and royalties
- licence fees
- sales marketing procurement and shipping arrangements
- provision and receipt of technical services
- software and IT charges
- rent or leasing
- insurance
- logistics
- research and development services
- Treasury related services.

Most taxpayers (54%) with this area reviewed obtained medium assurance for the transfer pricing arrangements, which is one of the criteria to be able to obtain overall high assurance. We did see 24% of taxpayers obtain high assurance for their arrangements but about 21%

obtained low assurance. We have not seen any red flag ratings in the combined assurance reviews for the year ended 30 June 2022.

Most taxpayers with a second review maintained their previous medium or high assurance or increased their rating from low or medium. However, we did see some taxpayers decrease their rating, due to changes to arrangements or pricing since the last review, which is a concern. These changes in arrangements are likely to be subject to further ATO review.

One of the most common areas that requires intervention through ATO next action includes profit shifting through transfer mispricing and tax avoidance. More specifically:

- licence fees and royalties
- inbound and outbound supplies of goods and services.

About 40% of the ATO next action cases that result in an audit are due to transfer pricing (other than financing).

We are focussed on whether sufficient benefit is being received by Australian operations to justify the payments of licence fees and royalties to international related parties. We expect taxpayers to provide an analysis of these benefits in their transfer pricing documentation with specific reference to their Australian operations.

For inbound and outbound supplies of goods and services, we:

- apply the risk assessment frameworks published in PCG 2019/1 and PCG 2017/1
- consider the analysis prepared in contemporaneous transfer pricing documentation to support the arm's length nature of these transactions, and their resulting profit outcomes.

Specifically, where a taxpayer has elected to apply the Simplified Transfer Pricing Record Keeping (STPRK) rules, we seek to verify the appropriateness of that application.

Practical Compliance Guideline **PCG 2019/1** provides a framework for taxpayers to assess the transfer pricing risk of their inbound distribution arrangements. We are continuing to see disclosures made in Category C of the RTP for inbound distribution arrangements that are high risk.

When applying the PCGs, taxpayers should be prepared to evidence how they arrived at their relevant risk rating.

Category C RTP Schedule disclosures by Top 1,000 businesses for 2020-21 on inbound distribution arrangements show that:

- 19% of disclosures were assessed as falling in the high-risk zone
- the majority (50%) did not disclose a rating – that is, they included the question in their RTP but did not include the valid sub-category on their schedule.

These taxpayers will be required to provide objective evidence to support their arrangements.

We commonly see the use of blanket allocation keys for all services provided, which may not be appropriate for each type of service. The selection of allocation keys should be justified for each category of costs they related to. Further, the inclusion of calculations of the cost base of services within transfer pricing documentation would enable us to verify the cost base of services provided, which may lead to higher levels of assurance achieved for services transactions.

Hybrid mismatch

We are starting to see more reviews that include the hybrid mismatch rules as an assurance area. This is due to the hybrid mismatch rules taking effect in the most recent income tax returns lodged.

In this respect, 14% of taxpayers have had a hybrid mismatch area of assurance reviewed with imported hybrid mismatch arrangements being the largest component of this area.

Of the hybrid mismatch areas reviewed, only 29% were rated high assurance and 29% were low assurance, which is the area with the lowest ratings compared to other risks. A small number of these taxpayers who achieved low assurance also had concerns that required further ATO next actions.

We are observing that Top 1,000 Category C RTP disclosures for hybrid arrangements are reported as low risk. We will discuss with a taxpayer if we consider an arrangement is not low risk or if sufficient evidence has not been supplied to support the taxpayer's assessment of low risk which may result in recommendations for client next action or ATO next actions.

One key reason for low assurance in this risk area is that we continue to see inadequate evidence to support the processes and procedures taxpayers are taking to ensure compliance with the law. In this respect, for the imported hybrid mismatch rule and preparing for assurance

reviews, taxpayers should review PCG 2021/5 and document the enquiries made and responses received which demonstrate they have complied with the law.

Furthermore, we have seen instances of taxpayers restructuring out of hybrid mismatch arrangements in a manner that does not qualify as low risk under PCG 2018/7.

We will continue to focus on this area to assist taxpayers to improve ratings. For information about how the hybrid mismatch rules work and when they apply, see [hybrid mismatch rules](#).

Losses

Losses (revenue and capital) continue to be an area that we review for assurance with revenue losses being the largest component of that category.

Of the losses reviewed the majority (65%) achieved high assurance, 23% medium assurance and 10% were rated low assurance.

The key issues looked at for losses include:

- use of losses (continuity of ownership and business continuity test)
- transfer of losses
- available fraction calculations
- the origination or source of the losses.

For the taxpayers reviewed a second time, most maintained their previous rating with the majority of those being a high assurance.

Where a taxpayer has received a low assurance, it was often due to insufficient evidence to support the utilisation of the loss, in particular the evidence needed to support the same business test had been met.

Tax consolidations including multiple entry consolidated (MEC) group restructuring, acquisition and disposals

We will always review consolidation and structuring arrangements in assurance reviews, with 43% of taxpayers with this area reviewed.

Most assurance ratings for this area were high (57%) or medium (24%). A small percentage (10%) of taxpayers with this area reviewed achieved a low assurance. There were concerns about structured arrangements designed to avoid Australian tax, which meant we considered ATO next actions was needed to review further. Anti-

avoidance including MEC restructuring made up about 10% of the audits that were conducted by ATO next action teams following an assurance review.

Some of the issues that concern us include:

- 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
- contrived related party financing arrangements, including the use of financing transactions with special terms designed to
 - artificially defer or avoid interest withholding tax while obtaining annual Australian income tax deductions
 - avoid dividend withholding tax upon repayment/redemption of contrived related party financing arrangements, and/or
 - otherwise obtain deductions or avoid assessable income using arrangements designed to circumvent specific anti-avoidance rules such as thin capitalisation and the hybrid mismatch integrity rule, and debt/equity classification rules
- migration of Australian generated intangible assets to overseas related parties to reduce Australian taxable income or withholding tax
- arrangements or variation of arrangements of the kind described in Taxpayer Alert 2020/4 – these arrangements broadly involve the transfer of assets to an eligible Tier 1 (ET-1) and an ET-1 company leaving, or anticipating to leave, the multiple entry consolidated (MEC) group
- ‘inversion’ or ‘top-hatting’ arrangements, or the interposition of partnerships or other entities, designed to

- shift recognition of income and/or change or mischaracterise the nature of income
- facilitate related party transactions to obtain Australian tax deductions
- reduce or eliminate withholding tax
- avoid the application of targeted anti-avoidance measures.

We are also seeing some key issues for acquisitions and the allocable cost amount (ACA) calculations.

These include:

- inadequate documentation to support the ACA calculations
- acquisition costs incorrectly excluded from the Step 1 amount and treated as blackhole expenditure
- asset characterisation for the purposes of allocating the entry ACA, including
 - the treatment of customer relationships and customer contracts as separate assets for tax consolidation purposes
 - other intangible assets which would more appropriately be classified as goodwill but being classified as separate assets for tax consolidation purposes.

Withholding tax

Withholding tax is another risk area that we commonly see in the assurance reviews (40% in combined assurance reviews). This includes withholding tax for interest, royalty and dividends.

Most assurance ratings for this area were high (78%) and medium (12%). For the small number that received low assurance (9%), concerns related to:

- the characterisation (or mischaracterisation) of the payments
- contrived related party financing arrangements including the use of financing transactions with special terms designed to artificially defer or avoid interest withholding tax while obtaining annual Australian income tax deductions

- incorrect application of section 128F exemption.

These concerns are typically referred to the ATO next actions program for further investigation.

For the second review taxpayers, we did see that most maintained their previous high assurance rating or increased their assurance rating to high. We did see a small number decrease their assurance rating from high to medium due to changes in their arrangements.

Revenue versus capital

Revenue versus capital characterisation continues to feature in our reviews. We are concerned taxpayers are not undertaking a detailed consideration of the revenue vs capital risk on significant arrangements. This includes consideration of recent court cases.

While questions of expenses being revenue or capital in nature are fact and circumstance specific, we have identified similar arrangements and fact patterns that have arisen in our reviews to those in recent court cases. Where we identify that the case law has not been appropriately considered and applied, we may ask for more information. Alternatively, we may refer the matter to the ATO next action program.

We encourage taxpayers to undertake a review of their contractual arrangements including sign-on fees, incentives and payments for cancellations in the context of the recent case law on the revenue vs capital risk. If you have reviewed your arrangements recently then provide that information during your assurance review to assist us to understand your position.

Research and development claims

Of the taxpayers reviewed in a combined assurance reviews, 24% had research and development (R&D) claims reviewed.

Most assurance ratings achieved for this area was medium (68%), 17% achieved high assurance and 15% were rated as low assurance. Of the low assurance ratings there were none considered to have concerns that needed ATO next actions, instead the ATO provided taxpayers with recommendations for further action. The ATO will follow these recommendations up with taxpayers.

For the taxpayers who were reviewed a second time, most maintained their previous assurance rating for R&D, but we did notice as small

number of those reviewed had a decrease in their assurance rating. We provided client next actions for those taxpayers.

Key focus areas include:

- governance processes in respect of R&D expenditure
- nexus of expenditure to R&D activities
- apportionment methodology applied in calculating R&D expenditure.

Capital gains tax

40% of taxpayers reviewed had a capital gains tax (CGT) event that was reviewed.

Most of the assurance ratings for this area achieved high (62%) and 26% achieved a medium assurance for the treatment of their CGT events. Of the 10% of CGT events that achieved low assurance the issues included:

- concerns of the rollover exemptions or reductions
- cost base reductions
- active foreign business asset exemption – Subdivision 768-G
- the calculation (or evidence) of proceeds and insufficient evidence to support the CGT calculation.

Of the second review taxpayers, we did see most with a previous high assurance maintain their rating for new events reviewed or increase their rating. We did note a small number reduced their rating to either a medium or low assurance.

Thin capitalisation

About 48% of taxpayer's reviewed had a thin capitalisation risk. This is a risk area that had a higher percentage of high assurance ratings (77%). The majority of taxpayers are utilising the safe harbour test and were able to evidence the calculations and are either within the maximum allowable debt threshold or are denying deductions where applicable.

The 12% of taxpayers that obtained low or red flag ratings for their thin capitalisation risk were due to some of the following reasons:

- unable to provide evidence for the safe harbour calculations or incorrectly calculated their safe harbour

- contrary interpretative positions, inadequate documentation, and insufficient evidence to support the use of the arm's length debt test or worldwide gearing method
- changes in the method used to determine maximum allowable debt, particularly away from safe harbour in favour of the arm's length debt test or worldwide gearing.

Where the arm's length debt test has been used, we will review whether the taxpayer has self-assessed against **PCG 2020/7 ATO compliance approach to the arm's length debt test**.

Uniform capital allowances (UCA)

When assuring capital allowance claims, we consider the systems and governance processes adopted, as well as the supporting evidence provided (including working papers). About 69% of taxpayers had a capital allowance claim reviewed. Of these reviews, 51% obtained high assurance and 36% obtained medium assurance.

We did see most taxpayers after their second review maintain their high assurance rating or increase their rating.

Where automated software tools are used to prepare claims, we will evaluate the level of 'human intervention' that confirmed revised claims have satisfied the law. In addition, when taxpayers review past claims, we expect a 'two-way' analysis – identifying capital items which could have been expensed and identifying where expensed items might be more appropriately capitalised.

Of the 13% that obtained low or red flag ratings most were provided with recommendations for client next action.

The issues that were rated as low or red flag included:

- blackhole expenditure
- classification of assets, including distinction between Division 40 depreciating assets and Division 43 deduction for capital works
- division 40 and Division 43 assets claimed as section 8-1 deductions
- exploration expenditure
- capital improvements vs repairs and maintenance

governance processes in respect of capital allowance claims.

Controlled foreign company (CFC)

This is not an area that is common to most taxpayers but is an area we will review if applicable. It was encouraging to see that 75% of taxpayers with CFCs did achieve a high assurance for this risk area and taxpayers maintained their ratings in the second reviews.

Some of the key focus areas include:

- governance processes in respect of attribution of CFC income
- satisfaction of the active income test
- confirmation that listed country CFCs do not have eligible designated concession income.

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.

Some more common examples where we may get to medium assurance, but availability of evidence or additional intensive review is required to get high assurance include:

- transfer pricing
- valuations
- historic tax loss generation.

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

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
- 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
- valuations


Alignment of tax and accounting outcomes

We analyse the differences between the accounting and tax results. 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.

 Green dot denotes High assurance rating	High	We understand and can explain the various streams of economic activity and why the accounting and income tax results vary.
 Yellow dot denotes medium assurance rating	Medium	Further analysis and explanation are required to understand the various streams of economic activity and/or why the accounting and tax results vary.
 Orange dot denotes low assurance rating	Low	We identified concerns from our analysis of the various streams of economic activity and/or why accounting and tax results vary.


 Red dot denotes not evidenced or concerns	Red flag	We do not understand and cannot explain the various streams of economic activity and/or why accounting and tax results vary.
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The assurance reviews completed to the end of June 2022 resulted in the following ratings for alignment between accounting and tax for first time and second time reviews.

Graph 9: Alignment of tax and accounting ratings for first review of all taxpayers and alignment of tax and accounting ratings for taxpayers after their second review, as of 30 June 2022

 Bar graph showing percentage of alignment with assurance ratings. Both first and second reviews show percentages predominantly as high assurance.

Graph 10: Comparison of alignment of tax and accounting ratings for the taxpayers that have had a second review, as of 30 June 2022

 Bar chart showing comparison of alignment of tax and accounting ratings for those who have had a second review. The percentage is predominantly high assurance across both bars.

Observations

Most of the Top 1,000 taxpayers have achieved a high assurance rating for the alignment between accounting and tax. Even though we have a high percentage getting high assurance in the first review (87%) we have still seen improvement in ratings for those taxpayers completing a second review (97%). There have been no low assurance ratings for this area for second time reviews.

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

- most taxpayers have audited financial statements
- we can review the reconciliation between financial statements with the starting profit and loss disclosed in the relevant tax return.

We are also seeing good procedures for calculating taxable income from accounting results. This allows us to gain confidence that the adjustments from accounting results are correct to calculate the taxable income and tax payable figures.

This is more challenging for MEC groups, foreign bank branches and stapled groups but we find that taxpayers have been able to provide sufficient evidence for us to understand the variances between the accounting and tax results.

We encourage taxpayers to undertake the Effective tax borne calculation (ETB) where they have international related party dealings, and we will review this during our reviews if completed.

We consider that ETB is a part of good governance. Boards and tax representatives of corporate groups should understand their ETB calculation and discuss the results (including underlying proxies and assumptions) with us. We particularly encourage taxpayers to provide information around their global value chains and foreign taxes paid on Australian linked activity.

The ETB analysis provides a good cross-check or confirmation in relation to our analysis and assurance over related party dealings. The adjustments made (or not made) in the ETB calculation for related party dealings, goes to supporting the analysis and assurance ratings for these transactions more broadly.

High assurance and tailoring our engagement

When we are finalising an assurance review, we look to ensure that the following criteria have been met to obtain high assurance overall. As we start to see more taxpayers improving their tax governance frameworks and move to stage 2 ratings, we expect to see more taxpayers achieving overall high assurance.

Obtaining high assurance

In the Top 1,000 program, we apply a principled approach to reaching overall high assurance (justified trust).

This is based on 2 elements:

1. a quantitative threshold of more than 90% tax assured and economic activity correctly reported
2. an objective assessment of 7 qualifying factors.

The 7 qualifying factors are outlined below.

1. Governance

Governance has been rated at least a stage 2 in the assurance report.

2. Tax risks flagged to market and significant transactions

Any material or significant tax risks flagged to market (PCGs, tax alerts, public rulings, including those set out in the RTP Category C disclosures) have been rated at least a medium level of assurance and are not identified as necessitating further action based on the information provided.

3. International related party dealings and CFCs

Any material or significant international related party dealings, profit attribution to permanent establishments and CFCs have received at least a medium level of assurance in the report and are not identified as necessitating further action based on the information provided.

4. Losses

Losses, if applicable, have received at least a medium level of assurance. This includes that the commerciality of tax losses has been appropriately verified.

5. Effective Tax Borne (ETB)

The ETB calculation and any underlying assumptions or proxies have been verified with the taxpayer. The ETB calculation has not highlighted any new areas of concern for us, including, for example, holding overseas interests in jurisdictions where there is not a substantiated commercial purpose. Completion of an ETB calculation will be viewed favourably by the ATO. Where the ETB calculation has not been prepared by the taxpayer, a high assurance rating for alignment between accounting and tax results will be required.

6. Reportable tax position schedule

There are no inconsistencies in RTP schedule disclosures which are identified between lodgment of the tax return and finalisation of the review.

7. Cooperative and collaborative behaviour

It has been a cooperative and collaborative process and working with a taxpayer we have not observed any non-cooperative behaviour.

An overall provisional high assurance (justified trust) rating may be possible in limited circumstances. Such circumstances may include where the taxpayer has provided an undertaking and is actively

working on addressing a specific design gap in their tax governance framework or there is ongoing compliance activity. Where there is ongoing compliance activity, provided the quantitative threshold is met (inclusive of that unassured issue), the availability of a provisional rating will depend on the nature and stage of the compliance activity.

Tailoring our engagement

We tailor the combined assurance review to your circumstances having regard to:

- your assurance outcomes from any previous income tax or GST assurance engagement
- the steps you have taken to address recommendations in previous income tax or GST assurance engagement
- how you have applied our published guidance – we ask whether you have considered and applied our public guidance relevant to your circumstances including, reviewing your tax governance using our
 - Tax risk management and governance review guide
 - GST Governance, Data Testing and Transaction Testing Guide
- how you responded to our request for information for your combined assurance review – you should provide us with timely, accurate and complete responses to our questions.

Over 50% of second review taxpayers were triaged for shorter, less intense reviews based on their previous assurance ratings and the other factors outlined above. This means the ATO and taxpayers were able to invest less resources in the review.

We tailor our approach having regard to the previous assurance rating and changes in business to 'top-up' our assurance. Where a taxpayer has previously achieved high assurance and there are no significant changes in business or structure we take a lighter touch approach. In these cases, we typically do not require information beyond our standard initial information request. About 12% of second review taxpayers experienced a lighter touch intensity.

We also undertake a targeted intensity approach in subsequent reviews for taxpayers where limited follow up information was requested on targeted areas. About 27% of the taxpayers experienced a targeted intensity approach for their second review.

As a result, the second review taxpayers have had a shorter review timeframe compared to new entrant taxpayers who undertake a standard intensity review.

About 15% of taxpayers experienced a second review with the same intensity as a new entrant review due to their circumstances.

We do have some taxpayers that have complex business arrangements, structures or with numerous transactions that we need to review for assurance. In these cases, we may require more time compared to a taxpayer undertaking a second review or standard new entrant.

When a Top 1,000 taxpayer attains an overall high assurance rating under our justified trust assurance program, this means that we have confidence that they have complied with Australian income tax laws and have paid the right amount of tax.

In recognition of the level of trust we have in the reported tax outcomes of these taxpayers, we will tailor our engagement approach to focus on maintaining our high level of confidence. In the absence of significant business changes or tax treatment, this results in shorter and lighter intensity assurance reviews in the future.

Next actions program

During the review and at the end of the review we will notify taxpayers of any concerns that have been identified. We will determine what type of next action is required and the next steps.

We may make recommendations for the taxpayer to action which will be documented in the combined assurance report. If we provide client next action recommendations, we will follow up and check the steps taken to address our recommendations next time we engage with the taxpayer. This could be through the next assurance review or a specific enquiry.

If we identify concerns that require further intervention, we may undertake this through a risk review or audit after the assurance review has been completed. We will indicate our intentions to engage further in relation to particular concerns in the assurance report.

We will notify taxpayers at the end of the combined assurance review if we are going to conduct further investigations through the ATO next actions program. We provide guidance to taxpayers as to how to

prepare for the follow up engagement and what to expect. Preparation will assist with the earlier resolution of the matter.

ATO next actions are not assurance reviews. Next actions are a more intensive ATO investigation and can include specific or comprehensive income tax risk reviews and audits.

When we engage with a taxpayer for ATO next actions, we focus on the issues that are of the greatest concern to us, such as issues that received a red flag or low assurance rating in the taxpayer's assurance report.

Next action outcomes

For combined assurance reviews currently in progress, we are observing approximately 5% of cases that require ATO next actions. This low rate of follow up action reflects, in part, the high levels of assurance already obtained by taxpayers that were selected for second reviews. As the composition of our Top 1,000 taxpayer pool changes, the follow up rate may vary.

For approximately half of those taxpayers with concerns requiring ATO intervention, the ATO intervention is still in progress. Those that are still in progress about 80% are risk reviews and 20% are audits.

Of the taxpayers that have had an ATO next action completed about 55% were resolved without a financial adjustment. This may have been due to:

- taxpayer provided more information and addressed our concern
- education was provided for future lodgments
- the issue was assessed as not warranting further investigation
- on further engagement, the ATO's concern that a risk might exist was not correct.

We expect the rate of referrals to the next action program that result in no financial adjustment to decrease over time. This is the result of the increasing sophistication and tailoring of the program.

45% of the ATO next actions that have been completed resulted in a financial adjustment.

How to prepare for an ATO next actions engagement

We encourage taxpayers to prepare for their ATO next actions engagement. This includes preparing evidence to demonstrate they have addressed the actions noted in their assurance report and documented the steps that they have taken.

Taxpayers that choose not to adopt the recommendations in their assurance reports are encouraged to prepare evidence supporting their position.

The better prepared a taxpayer is, the more likely the next actions engagement can be resolved within a shorter timeframe, the taxpayer can reduce their penalty exposure and the less likely the matter will become an audit.

Most taxpayers do work with us to resolve the identified concern. The following are factors which are more likely to expedite resolution.

- Provision of additional evidence requested in the Top 1,000 combined assurance report.
- Amending the tax outcomes associated with the arrangement to reflect the ATO view. For example, moving to low-risk zones on areas covered by our practical compliance guides (provided no deeper structural issues exist).

The following are some factors which we are seeing that are more likely to entrench dispute or delay resolution.

- General statements of commercial purpose particularly where debt is introduced, or business operations are fundamentally changed.
- Vague or contestable evidence supporting classification of payment streams.
- Offers to reprice arrangements in exchange for not considering anti-avoidance rules; anti-avoidance rules are not used as a negotiation point. Where anti-avoidance concerns are raised, full and detailed analysis will be needed (supported by provision of evidence).

Top 1,000 GST assurance

Overall levels of assurance

The Top 1,000 population is the largest contributor to GST and makes up about 36% of the total GST collections. We have completed 444 reviews for GST through 2 Top 1,000 programs:

- the GST assurance program
- the combined assurance reviews.

The GST assurance program completed 173 reviews and provided assurance outcomes. The combined assurance review program completed 271 assurance reviews which included GST (but did not provide an assurance rating).

The assurance rating outcomes are compiled from the results of the GST assurance reviews but the observations are consistent with what we have observed in the GST component of the combined assurance review.

The majority of taxpayers are achieving a medium or high assurance overall rating for GST. However, we are seeing over 40% of taxpayers making voluntary disclosures when they are notified of a GST review or during the review. We are also seeing that some taxpayers are providing more than one disclosure for the same issue or different issues. We expect taxpayers to be reviewing their GST outcomes regularly as part of good governance and not waiting until they are notified of an assurance review.




Where a voluntary disclosure has been made, we look to ensure that the system or processes that have led to the error have been updated to ensure the risk of the error occurring again has been mitigated. The overall assurance outcome may be impacted if the reason for the error has not been addressed by the taxpayer.

When determining assurance ratings, we consider whether enough objective evidence has been obtained that would lead a reasonable person to conclude the taxpayer reported the right amount of GST according to the law. The overall level of assurance is based on an objective view (having regard to objective evidence) of whether the taxpayer is considered to have reported the right amount of GST.

We review the 4 focus areas with a strong focus on the GST governance and control framework. These GST governance frameworks and controls are fundamental to the correct reporting of GST. We often see the correlation between poor governance and inadvertent or system errors that result in GST reporting mistakes and GST lodgment revisions.


Ratings

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


 Green dot denotes High assurance rating	High	We obtained assurance that the taxpayer paid the right amount of GST for the scope and period of this review. This means we are unlikely to contact you again in relation to the scope and period reviewed unless something new comes to our attention.
 Yellow dot denotes medium assurance rating	Medium	We obtained assurance in relation to some but not all areas within the scope reviewed. For those areas not yet assured, further evidence and/or analysis will be required before we obtain assurance that the taxpayer paid the right amount of GST.
 Orange dot denotes low assurance rating	Low	We have specific concerns around the taxpayer's compliance with the GST laws and the amount of GST paid relevant to the period and scope of this review.

There were 173 GST assurance reviews completed up to the end of June 2022 and 46 assurance reviews completed in the last 12 months. The results of the last 12 months are shown below compared to the total results as at the end of June 2022.


Graph 11: Overall assurance ratings for all GST assurance reviews completed as of 30 June 2022

 Pie chart showing assurance percentages for GST assurance reviews: 26% high, 69% medium and 5% low assurance.

Graph 12: Overall GST assurance ratings for all assurance reviews completed in the past 12 months from July 2021 to 30 June 2022

 Pie chart showing overall GST assurance ratings from assurance reviews: 47% high, 50% medium and 3% low assurance.

Graph 13: Overall GST assurance ratings by industry split between all outcomes up to June 2022 and outcomes for the last 12 months (July 2021 to June 2022)

 Bar graph showing the overall GST assurance rating by industry. The bars show breakdown of low, medium and high assurance across the 4 industry segments mentioned below.

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

- manufacturing, construction and agriculture (MCA)
- financial services (FS) (banking, finance and investment, superfunds, and insurance) Note: No FS reviews were completed in the 2022 financial year
- wholesale, retail and services (WRS)
- mining, energy and water (MIN).

To date 26% of taxpayers have obtained an overall high assurance outcome. This is an increase from last year's results where 21% of taxpayers obtained an overall high assurance for GST. For those taxpayers that have achieved high assurance it means we obtained assurance that these taxpayers have correctly reported the right amount of GST for the years reviewed.

In the last 12 months we have completed 46 assurance reviews and 47% of those taxpayers have obtained overall high assurance for GST.

The key reason for the recent increase in overall high assurance ratings is mostly due to the increase in the number of taxpayers achieving stage 2 ratings for GST governance. The stage 2 ratings increased from 22% last year to 28% this year for all taxpayers reviewed to June 2022. In the past 12 months, 50% of taxpayers reviewed have obtained a stage 2 rating.

Most Top 1,000 taxpayers reviewed are achieving a medium assurance overall. One of the key reasons that prevented medium assurance taxpayers from achieving high assurance overall is due to their GST governance outcomes only being a stage 1 rating.

Overall low assurance ratings have remained constant but is still a small number of the overall Top 1,000 population. The low assurance overall often corresponds with an absence of evidence of an effective tax governance framework or tax control frameworks. A small number of taxpayers have specific GST risks assigned with red flag ratings. These taxpayers usually also have a stage 1 or red flag rating for governance.

We set out in taxpayers tax assurance reports the steps for the taxpayer to take to obtain high assurance next time we review their tax affairs. We encourage taxpayers to initiate and action these recommendations.

How we engage with taxpayers for GST assurance has changed recently. The combined assurance review will be the primary GST assurance review program for Top 1,000 taxpayers. In the combined assurance review, we work collaboratively with both income tax and GST specialist teams to review a taxpayer holistically for income tax and GST.

We have been providing risk ratings rather than assurance ratings for the GST component of the combined assurance review. We have since changed the program to be able to provide assurance ratings for both income tax and GST. We will not be starting any new GST assurance reviews (except in very limited circumstances) and we only have a small number of GST assurance reviews that were started this year.

Tax risk management and governance

Tax governance is a key focus area. As a transactional tax that is data driven, it is important that there is a strong, board-endorsed tax governance framework, and that it is 'lived' in practice.

We consider the existence, design and operation of a tax control framework for GST focusing on the 8 controls set out in the:

- **GST Governance, Data Testing and Transaction Testing Guide**
- **Director's summary in the Tax Risk Management and Governance Review guide**
- **Income tax risk management and governance guidance for top 1,000 taxpayers (collectively, the Guides).**

The **GST Governance, Data Testing and Transaction Testing Guide** (GST Guide) provides guidance to help taxpayers conduct a self-review of their tax control frameworks for GST purposes. The guidance also explains how to undertake data and transaction testing to ensure your business systems are creating, capturing and correctly reporting GST.

While we encourage taxpayers to consider all the controls set out in the guides, our reviews focus on the following controls aligned with the justified trust objectives:

- Board-level control 1: Formalised tax control framework
- Board-level control 3: The board is appropriately informed
- Board-level control 4: Periodic internal control testing
- Managerial-level control 1: Roles and responsibilities are clearly understood
- Managerial-level control 3: Significant transactions are identified
- Managerial-level control 4: Controls in place for data
- Managerial-level control 6: Documented control frameworks
- Managerial-level control 7: Procedures to explain significant differences.


We consider 3 of the controls to be fundamental for GST as they directly impact the correct reporting of GST.




These 3 fundamental controls are:

1. Board-level control 4: Periodic internal control testing
2. Managerial-level control 4: Controls in place for data
3. Managerial-level control 6: Documented control frameworks.

Ratings


We apply a consistent rating system when reviewing and assessing tax governance. We consider the existence, design and operation of a tax control framework for GST. During the review, we refer to the initial areas of focus set out in the **GST Governance, Data Testing and Transaction Testing Guide**. We recommend taxpayers review and apply the GST Guide before their review starts.

 Green dot denotes High assurance rating	Stage 3	You provided evidence to demonstrate that a tax control framework exists, has been designed effectively and is operating effectively in practice.
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 Yellow dot denotes medium assurance rating	Stage 2	You provided evidence to demonstrate that a tax control framework exists and has been designed effectively.
 Orange dot denotes low assurance rating	Stage 1	You provided evidence to demonstrate a tax control framework exists.
 Red dot denotes not evidenced or concerns	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.

The tax governance ratings for the GST assurance reviews completed up to the end of June 2022 are depicted in the following assurance ratings.

Graph 14: GST governance assurance ratings for all GST assurance reviews completed up to 30 June 2022

 Pie chart showing GST assurance ratings for all GST assurance reviews: 1% stage 3, 28% stage 2, 70% stage 1 and 1% no evidence or concerns.

Graph 15: GST governance assurance ratings for assurance reviews completed in the past 12 months from July 2021 to June 2022

 Pie chart showing GST governance ratings for assurance reviews completed in the last 12 months: 50% stage 1 and 50% stage 2.

Observations

Most taxpayers (70%) have been achieving a stage 1 for GST tax governance. We have seen an increase in the last 12 months of the percentage of taxpayers achieving a stage 2 for tax governance.

Over 20% of taxpayers reviewed under the GST assurance program had identified errors due to system errors and manual adjustments (compared to 40% in the combined assurance review program). Having

a tax governance system that is designed and operating effectively gives us greater confidence that errors like this are minimised.

Whilst the statistics provided are from assurance reviews where ratings were provided, the observations below are consistent with recommendations provided in both the GST assurance review program and the combined assurance review program.

Stage 1

Positively, in the 2022 financial year we saw an improvement in governance ratings with the number of taxpayers achieving stage 1 moving from 76% to 50%. This is largely attributable to taxpayers implementing an organisational level commitment to undertake periodic control testing (BLC 4) and consequently achieving a higher overall rating for governance that is, a stage 2.

Outlined below are some of the main reasons that taxpayer's governance frameworks are not achieving a stage 2.

- BLC 4: Periodic internal control testing
 - BLC4 (periodic internal control testing) is a fundamental control requirement and remains the main fundamental control that taxpayers do not have in their tax governance framework. However, the number of taxpayers committing at the board level to implement controls testing program/plan has increased significantly in 2022 and was the main contributing factor for the shift from a stage 1 to a stage 2 rating.
 - Where taxpayers have put a plan in place, we have seen a few with gaps in their documentation, for example, where the testing plan does not cover all the controls.
- BLC 3: The board is appropriately informed
 - Concerns with BLC3 include that the process for reporting material matters or risks to the Board is not always tailored for GST, it is not always clear how risks are escalated (that is, what documentation is used to capture risks) and what is the escalation mechanism to present these risks to the board.
- MLC 3: Significant transactions are identified

- We have observed taxpayers achieving stage 1 rating where there are no documented procedures for the business to determine whether GST signoff is required, the threshold to quantify what is a significant transaction, and operational escalation procedures.
- MLC 4: Controls in place for data
 - We have observed that controls are in place for data but are missing certain fundamental documented procedures (for example, for manual adjustments/journals).

Stage 2

We have seen an increase in taxpayers achieving a stage 2 for governance and, given a stage 2 rating is required to achieve overall high assurance for GST, a consequential increase in taxpayers achieving an overall high assurance.

Previously 22% of taxpayers were achieving a stage 2 and in the last 12 months 50% have achieved a stage 2 for governance. This is a positive result, indicating a major shift in taxpayer's commitment to developing effectively designed tax control frameworks. It gives us confidence that we can rely on the taxpayer's governance going forward to ensure GST is being reported correctly.

Some examples of best practice that we see include the following.

- Documented work instructions in place for GST compliance procedures for the monthly preparation, review, and approval of BAS with supporting data analytics, such as exceptions, reporting and trend analysis.
- Evidence of manual controls and automated GST controls built into business systems as regarding the set-up, review and maintenance of tax codes, such as in ERP systems, and customer/vendor/product master files.
- A list of products and transactions that require sign off for GST, for example, new customer products and material business transactions.
- A well-designed controls testing program addressing the key requirements outlined in the GST guide.

Stage 3

Only a very small number of taxpayers to date have obtained a stage 3 rating and in the past 12 months we have not seen any taxpayers achieve a stage 3 rating for governance. To obtain a stage 3 rating for GST, we look for evidence that the documented tax control framework is both designed and operating effectively in practice.

Stage 3 requires evidence in the form of a report of findings that taxpayers have independently tested the operation of the framework in practice across all the controls.

We do expect to see more taxpayers with updated GST governance documentation going forward obtaining a stage 2 and therefore start to undertake the testing of the operation of their framework as per their internal periodic control testing plan.

We will work with taxpayers during our reviews that have undertaken the periodic control testing to achieve stage 3.

Red flag rating

This rating has only been applied to a small number of taxpayers. In the rare instances where this has occurred, they have been due to not having documentation to evidence that a tax control framework exists for GST and significant identified errors were identified as a result.





Significant and new transactions and specific tax risks

We seek to understand and review the GST 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.

The **GST Governance, Data Testing and Transaction Testing Guide** also provides detailed guidance on how to undertake data and transaction testing, to ensure that your business systems are creating, capturing and correctly reporting GST. This guide was recently supplemented by the **Guide to Independent Data Testing by Third Party Advisors** which is designed to assist taxpayers that may be contemplating engaging the services of a third-party adviser to undertake independent data testing.

Ratings

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

 Green dot denotes High assurance rating	High	We obtained a high level of assurance that the right GST outcomes were reported in your BAS for the scope and period of this review. This means we are unlikely to contact you again in relation to these matters for the scope and period reviewed unless something new comes to our attention.
 Yellow dot denotes medium assurance rating	Medium	More evidence or analysis is required to establish a reasonable basis to obtain a high level of assurance.
 Orange dot denotes low assurance rating	Low	More evidence and/or analysis is required to determine whether a tax risk is present.
 Red dot denotes not evidenced or concerns	Red flag	We have concerns there is non-compliance with the GST law.
–	Out of scope	We have not evaluated this item and not expressed a rating.

Observations

In our GST assurance reviews specialists assess the tax risks flagged to market, the significant and new transactions and specific tax risks. In the combined assurance reviews, we have not provided assurance ratings for these areas for GST. However, the observations are based on what we have reviewed in both the combined assurance reviews and the GST assurance reviews to date. We will be providing

assurance ratings for GST risk areas in the combined assurance reviews from June 2022.

We have identified some improvements in assurance ratings across the different risk areas and a reduction in red flag ratings in the last twelve months. However, we continue to see voluntary disclosures frequently being provided at the beginning of a review or during a review.

The following areas are concerns or areas that we focus on during our GST assurance reviews. These may not apply to all taxpayers.

Incorrect reporting

The most common GST risk continues to be incorrect reporting from inadvertent errors. At least 50% of those errors relate to system reconciliation or system errors. These errors are usually identified as part of data and transaction testing or from taxpayers self-reviewing and providing voluntary disclosures of the errors at the start of the review. Whilst the disclosures for these inadvertent errors are not usually material in dollar terms, it is important for business to have governance and control frameworks in place that detect and remediate errors on a regular basis. The transactional nature of GST means that undetected errors can compound to material amounts unless identified and addressed.

Governance and system related issues that drive errors in GST reporting include:

- errors because of poor tax governance
- processing and systems errors
- one-off transactions where human intervention is required, and processes are not sufficient for correct reporting
- incorrect classification and apportionment methodologies.

Material voluntary disclosures received usually relate to one-off transactions that are not core business activities where the GST law has been incorrectly applied. This could be due to staff uncertainty regarding the operation of the law or incorrect interpretation through lack of knowledge or capability involving one-off business transactions.

Key GST risk areas

The following areas are the key GST risk areas that result in corrections to returns and lower assurance ratings.

Financial supplies

Where businesses engage in mergers, demergers, company acquisitions or other similar activities, these activities may give rise to input taxed financial supplies. As such, there is a need to consider restricting input tax recovery on attributable costs where the Financial Acquisitions Threshold (FAT) is exceeded and if so, to also consider whether any Reduced Input Tax Credits (RITCs) are available.

The most common error we have identified when reviewing financial services risks relates to the failure to undertake the FAT test monthly. There is a risk that taxpayers are recovering input tax credits to which they are not entitled. In addition, we have observed taxpayers seeking to recover RITCs on all related costs without fully considering whether those costs align to those eligible for a RITC.

Another key area is in relation to the application of the reverse charge provisions to cross-border transactions. These provisions are relevant to a range of entities, including:

- banks
- financial technology entities
- life insurers
- superannuation funds
- other funds.

We have published guidance, **Application of the reverse charge provisions - findings of reviews**, which draws on our observations to provide examples of what errors we have seen, as well as examples of best practice. The guidance provides our expectations and a set of recommendations that can help financial suppliers to reduce their GST compliance risk in this area.

GST food classification

We are seeing classification of products by suppliers/wholesalers and retailers that are not consistent with the ATO view.

Errors are generally attributable to gaps in governance controls, such as:

- taxpayers not undertaking regular reviews of their product master data
- taxpayers' reliance on a supplier's classification without undertaking due diligence to determine the correct GST classification of the products being supplied.

Property

The property risk concerns the incorrect claiming of GST credits and the failure by taxpayers to correctly report the sale, transfer or acquisition of real property, leading to reduced collection of GST. The risk addresses the construction/development of real property but excludes the behaviour of those who work in the industry, such as sub-contractors.

Some of the key risk areas for real property include:

- eligibility and application of the margin scheme where taxpayers have chosen to use this methodology
- incorrectly claiming of GST credits due to misclassification of supplies in relation to residential accommodation and/or commercial residential premises
- other issues, including
 - supplies of a going concern
 - unreported sales of real property
 - agency issues in relation to who is making the supply
 - failure to consider adjustments due to adjustment events.

Recipient created tax invoices (RCTI)

In the assurance reviews we have seen some of the following issues when reviewing RCTI:

- valid agreements are not in place
- incorrect suppliers have been issued the RCTIs
- suppliers are not registered for GST or no longer registered and have been issued with RCTIs

- non existing or non-compliant recipient created tax invoice agreements.

Acquisitions

Creditable acquisitions is a common area to review for GST assurance reviews. About 72% of taxpayers that have had their creditable acquisitions assured have achieved high assurance. Of the 14% that achieved low assurance we saw some of the following issues:

- incorrectly treating an acquisition as creditable (e.g. non-deductible entertainment expenses)
- incorrectly claiming input tax credits where suppliers have either no GST registration, no ABN, an invalid ABN, or a cancelled ABN
- tax coding/system setup errors.

Supplies

GST treatment of supplies is another area that is common to review for GST and most taxpayers achieve high assurance for this area (72%).

The following were some of the reasons that 13% of taxpayers achieved low assurance for their supplies:

- Incorrectly classifying taxable products as GST-free (for example, health and food products).
- Attribution errors (for example, periodic/progressive supplies, 4-4-5 reporting method).

Data and transaction testing

Data and transaction testing is used to assess correct reporting in the GST assurance reviews. Data testing involves running several pre-determined tests (including bespoke testing for more complex industries) against a defined data set to identify reporting errors and exceptions for further investigation or correction. Transaction testing involves tracing an identified transaction from its source documentation through to the financial reports to confirm the accuracy of the GST treatment, calculation and reporting of the transaction. Where errors and exceptions are identified, further investigation will be necessary or correction may be required.

We will be undertaking the data and transaction testing for entities that predominantly make input taxed supplies, such as financial




services and insurance industry taxpayers, in the combined assurance reviews from June 2022. For all other taxpayers, we will be using the GST analytical tool to identify key risk areas and areas where further transaction testing may be required.

Alignment of tax and accounting outcomes

We analyse the differences between the BAS outcomes and accounting outcomes and seek to understand and explain the various streams of economic activity and how they are treated for GST, which may include applying the GST analytical tool (GAT). 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.

 Green dot denotes High assurance rating	Stage 3	We understand why accounting and GST results vary and this understanding is sufficiently supported by objective evidence.
 Yellow dot denotes medium assurance rating	Stage 2	We do not fully understand why accounting and GST results vary or this understanding is not sufficiently supported by objective evidence.
 Orange dot denotes low assurance rating	Stage 1	We do not understand why accounting and GST results vary.
NR	Not rated	We have not assessed why accounting and GST results vary

The ratings for the alignment between tax and accounting area arising in the GST assurance reviews completed are shown below.

Graph 16: GST alignment between accounting and tax assurance ratings for all assurance reviews completed as of 30 June 2022

 Pie chart showing GST alignment between accounting and tax assurance ratings for all reviews completed: 69% stage 3, 25% stage 2 and 6% stage 1.

The GST analytical tool (GAT) is one tool we use to help us better understand why accounting and GST results vary. The GAT also helps us identify where we need to ask more questions. We apply the GAT to all GST assurance reviews (excluding those with predominately input taxed supply businesses) and will apply the GAT in our combined assurance reviews going forward.

The GAT uses a standard method statement applying a 'top-down' approach to identify and understand variances between accounting figures reported in audited financial statements and GST reported on the BAS.

The method statement starts with the revenue and expenses reported in your profit and loss statement. It works through a series of adjustments to compare this information with your annualised BAS covering your financial reporting year.

There is an expectation as part of good GST governance that a taxpayer has a process in place to explain:

- BAS reporting of GST payable and receivable compared to business outcomes
- variances in comparison to financial statements.

This process for reconciliation back to financials may be the GAT, which we consider to be best practice for organisations. We are now seeing an increasing number of taxpayers embedding the GAT into their processes.

This helps us to understand whether key variances are supported by appropriate evidence.

The GAT is not intended for use by taxpayers with predominantly input taxed supplies. We will undertake a bespoke data testing approach for these taxpayers in the combined assurance reviews.

We have published guidance which may also help you when considering the application of the GAT in preparation for an assurance review or if considering implementing into your processes:

- GST Analytical Tool (GAT) FAQ
- Top 1,000 GAT example

Observations

The GAT has provided benefits to the assurance reviews by increasing the understanding of a taxpayer's GST profile and assurance of the GST outcomes of their economic performance.

We use the GAT to:

- provide an understanding of a taxpayer's GST profile
- identify key drivers of GST performance
- potentially highlight areas of (greater or lesser) focus. For example
 - to assist in identifying areas of focus to be examined as part of the broader assurance review such as further transactional data testing
 - to increase our confidence that non-routine transactions are captured within the broader assurance review and that the BAS outcomes are consistent with the financial statement disclosures. The GAT also provides insights into adjustment events that may not be routinely tested through data testing. Usually, data testing only focuses on accounts payable / accounts receivable modules
 - to assist to assure the GST outcome of transactions from information set out in the audited financial statements such as Income Statement, Balance sheet, Cash Flow Statement and notes to the accounts.

Completion of the GAT is integral to our combined assurance review going forward. A higher GAT rating will contribute positively towards a taxpayer's overall GST assurance rating. It will also identify transactions or adjustments to focus on in the assurance review. This may lead to less intensity in follow up information requests for transaction testing if variances are understood and evidenced.

Most taxpayers (69%) achieved the highest rating, a stage 3 for the alignment between accounting and GST.

We are seeing that where a taxpayer has undertaken the GAT or similar approach as part of their procedures, the outcomes are usually a stage 3. We also see that the more input from a taxpayer into the GAT analysis during the review (to explain the variances and help us understand their financials and proxies that may be used) also leads to better ratings.

We do not expect taxpayers to reconcile the audited financial statements to the annualised BAS figures dollar for dollar but to be able to explain and provide evidence to support any variances. Those taxpayers that have worked with us to identify the adjustments from the financials and evidence their GST adjustments have usually been able to achieve a stage 3.

The taxpayers that had a GAT applied and obtained a stage 2 rating (25%) usually have a small number of variances where supporting evidence was not provided to explain the difference. For example, we received information to identify the variance and had confidence that the adjustments were understood. However, not enough evidence was available to verify the explanation.

We have some challenges applying the GAT to complex grouping structures where:

- there is misalignment between the accounting and the GST group structures
- quantification of differences such as long-term construction contracts or mixed accounts where GST-bearing or non-GST bearing amounts are difficult to separate and quantify.

These have usually been overcome by the taxpayer and the ATO working together.

GST next actions

At the conclusion of a combined assurance review, if we have identified areas of concern, we will either provide recommendations for the taxpayer to undertake or we may consider intervention through ATO next actions.

As the GST assurance program is concluding in 2022, we will undertake assurance for GST in the combined assurance reviews. If we identify a concern that we consider needs ATO next actions, this will be through a GST risk review or audit.

Less than 3% of taxpayers reviewed to date in the combined assurance review program or GST assurance reviews have been advised that we require further engagement through ATO next actions.

Where a specific error or risk has been identified, we expect taxpayers to work with us to provide evidence to support their position or to demonstrate any steps they have taken to address our concerns.

Where we make recommendations for the taxpayer to action (referred to as a client next action), we will follow up and check the steps taken to address our recommendations next time we engage with the taxpayer. This could be through the next assurance review or a specific enquiry.

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