The Tax Summit

Session 15.1: How big-end rules are reshaping SME compliance

Presented at Melbourne Convention and Exhibition Centre (MCEC) 3-5 September 2025

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1. Introduction

This paper on “how big-end rules’ are reshaping SME compliance” is broken down into two parts:

1. how modified approaches to reviews and audits developed for the “big end” (public groups) are being applied in small business and private wealth reviews and audits; and
2. how tax rules, perhaps perceived as being for the “big end”, can apply to small business and private wealth clients.

This paper is practical, rather than technical, and aims to give practitioners tools to help manage an Australian Taxation Office (**ATO**) review and / or “issue spot” with clients either as part of normal work practice or ahead of a review or audit.

The paper is structured into the following:

1. definitional – what does the ATO mean by “public groups”, “small business”, and “private wealth”;
2. “big end” audit approaches being applied in the small business and private wealth context; and
3. “big end” tax rules that may have application to small business or private wealth clients:
    - the thin capitalisation rules in Division 820 of the *Income Tax Assessment Act 1997* (**ITAA 1997**);
    - the debt deduction creation rules in Subdivision 820-EAA of the ITAA 1997;
    - the transfer pricing rules in Division 815 of the ITAA 1997;
    - the hybrid mismatch rules in Division 832 of the ITAA 1997; and
    - the taxation of financial arrangements rules in Division 230 of the ITAA 1997.

With item 3, the paper does not “deep dive” into those rules, instead the paper will allow advisors to “issue spot” to conduct further research and investigation into the client’s affairs or to recommend specialist advice.

2. Definitional issues

The ATO regularly updates its organisational chart. As at 28 July 2025, the ATO organisational chart was:

This paper concerns itself with "Small Business" and "Private Wealth" in the above chart while the "big end" is "Public Groups"

2.1 ATO categorisation as small business

The ATO views a small business as a sole trader, company, trust or partnership that both:

- operates a business for all or part of the financial year
- has an aggregated annual turnover of less than $10 million.

Aggregated turnover is defined in section 328-115 of the ITAA 1997 as, broadly, the ordinary income derived in the ordinary course of carrying on a business for an income year of the entity together with its connected entities and affiliates.

2.2 ATO categorisation as private wealth

The ATO view privately owned and wealthy groups as:

- companies and their associated subsidiaries (often referred to as economic groups) with an annual turnover of more than $10 million and that are not public groups or foreign owned
- Australian resident individuals who, together with their business associates, control net wealth over $5 million.

The ATO's privately owned and wealthy groups tax performance programs are tailored to 3 key segments:

- Top 500
- Next 5,000
- Medium and emerging private groups

The ATO says these populations are not mutually exclusive – some associated entities belong to more than one group.

2.2.1 Top 500

The Top 500 include private groups that are **not** public groups **or** foreign owned that:

- have over $250 million in turnover, regardless of net asset value
- have over $500 million in net assets, regardless of turnover
- have over $100 million in turnover and over $250 million in net assets
- are market leaders or of specific interest.

The ATO says that it engages directly with these groups from year to year.[1]

[1] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/privately-owned-and-wealthy-groups/what-you-should-know/tax-performance-programs-for-private-groups, accessed 24 August 2025.

2.2.2 Next 5,000

The Next 5,000 include entities linked to Australian resident individuals who, together with their associates, control wealth of more than $50 million and are not included in the Top 500 population.

The ATO says that it aims to increase ongoing willing participation by:[2]

- applying its justified trust methodology in its one-to-one tailored engagements
- engaging through tailored reviews that apply a risk-based approach
- providing certainty on significant commercial deals through early engagement and pre-lodgment agreements.

2.2.3 Medium and emerging private groups

Medium and emerging private groups include:

- private groups linked to an Australian resident individual who, together with their associates, control wealth between $5 million and $50 million
- Australian businesses with annual turnover of more than $10 million that are not public or foreign-owned and not linked to a high wealth private group.

The ATO says medium and emerging private groups represent most of the total private groups in the privately owned and wealthy groups population. The ATO uses "*enhanced data and analytics to understand the operating environment of these groups, identify and address tax risks and design tailored approaches to mitigate those risks*". [3]

2.3 Foreign owned groups

As set out above, foreign owned groups do not form part of private wealth. Tax compliance for those groups falls within the ATO's "public groups and multinationals" area.

Within that area, the ATO has a "Medium public and multinational business engagement program" for groups that includes taxpayers who are part of an economic group controlled by a public or multinational entity with a combined Australian turnover of less than $250 million. Foreign controlled private groups could fall within this area.[4]

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[2] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/privately-owned-and-wealthy-groups/what-you-should-know/tax-performance-programs-for-private-groups, accessed 24 August 2025.
[3] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/privately-owned-and-wealthy-groups/what-you-should-know/tax-performance-programs-for-private-groups, accessed 24 August 2025.
[4] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/public-business-and-international/medium-public-and-multinational-business-engagement-program accessed 24 August 2025.

3. ATO compliance model and approach

3.1 ATO compliance model

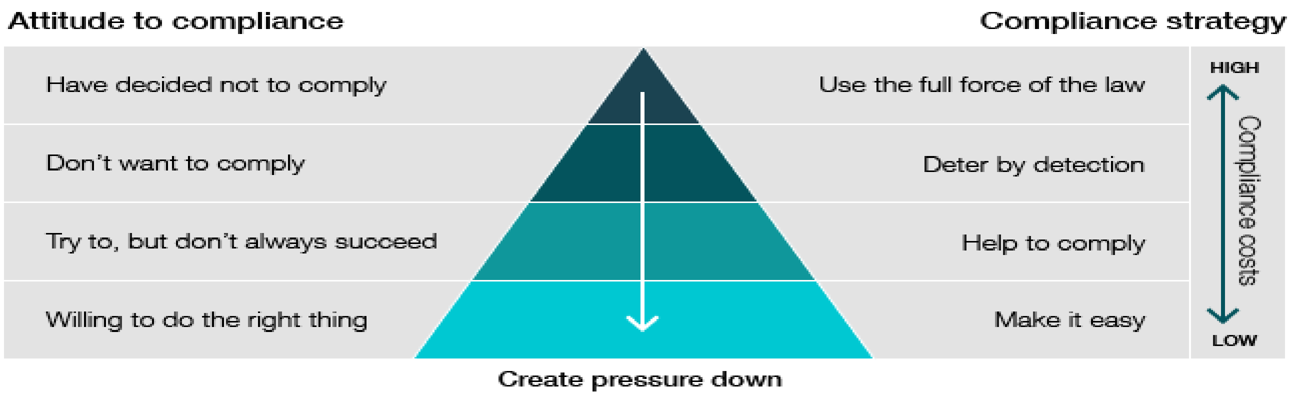
The ATO compliance model is a structured way of understanding and improving taxpayer's compliance. It helps the ATO to understand the factors that influence taxpayer behaviour and to apply the most appropriate compliance strategy.[5]

Taxpayer behaviour is influenced by business, industry, technology and data, sociological, economic and psychological factors.

Factors that influence client behaviour

The ATO compliance model shows a continuum of taxpayer attitudes towards compliance. At the base of the continuum, taxpayers have the desired attitude of being 'willing to do the right thing'. At the other extreme, taxpayers have decided not to comply - choosing to evade or opt out of the tax system.

The ATO compliance model also summarises the different sorts of support and intervention that the ATO may need to provide to collect revenue. The model suggests that the ATO can influence client behaviour through its response and interaction.



[5] ATO website, https://www.ato.gov.au/about-ato/managing-the-tax-and-super-system/how-we-help-and-influence-taxpayers accessed 24 August 2025. The ATO use "client" to refer to "taxpayer".

3.2 Core concepts – justified trust

The ATO compliance approach of "justified trust" had its origins with public groups in 2016 with the ATO modifying that approach in 2017 for the Top 500 in private wealth and in 2019 for the Next 5000. These moves marked a step away from purely retrospective audits and toward assurance that the right governance frameworks exist to deliver the right tax answers.

After phasing in programs for the Top 500 and then the Next 5,000, the ATO released its dedicated "*Tax Governance Guide for Privately Owned Groups*" (the **Governance Guide**) in late 2021.[6]

While "tax governance" can still feel abstract for private groups, it is now a practical necessity. This paper sets out the contemporary **why**, **when**, and **how** of effective tax governance for Australian private groups.

3.2.1 What is "tax governance"?

There is no single universal definition. In substance, the ATO characterises tax governance as the presence of clear, documented processes and controls - embedded within a broader corporate governance framework - that support sound tax decisions and the management of tax risk. For private groups, governance is **effective** when those processes repeatedly produce correct outcomes and help the group meet its obligations. Collectively, those processes comprise the group's **tax governance framework**.

The principles of good governance (for example, risk management, accountability, oversight) apply equally to private groups and listed companies, but implementation typically looks different in the private setting due to:

- Board oversight that may be concentrated in founders or a family advisory board
- Leaner internal resources and heavier reliance on external advisors
- Less formal or comprehensive documentation
- A focus on value creation and extraction for owners
- Extensive related-party dealings across the group

The Governance Guide acknowledges these realities and expressly rejects a one-size-fits-all model, advocating a proportionate and tailored approach for private groups.

3.2.2 What does the ATO mean by "tax risk"?

Within a governance context, tax risk is the possibility that a group pays or reports the wrong amount of tax (direct or indirect) or adopts positions that fall outside the risk appetite authorised by those charged with governance. It is useful to group tax risks into four broad types:

- **Compliance risk** - failures to meet obligations (errors, omissions, misinterpretations) leading to incorrect reporting or payment.
- **Financial risk** - monetary consequences of tax issues, including primary tax, interest, penalties, advisor costs, and remediation expenses.
- **Operational risk** - process, systems, or people failures that cause tax mistakes or non-compliance.

[6] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/privately-owned-and-wealthy-groups/tax-governance/tax-governance-guide-for-privately-owned-groups accessed 24 August 2025.

- **Reputational risk** - stakeholder, brand, or community-trust impacts from tax positions or behaviours, including where positions are lawful but perceived as aggressive.

Tax risk therefore extends well beyond “did the ATO review our return?”

3.2.3 “Justified trust” in brief

Emerging from the OECD’s co-operative compliance thinking in the early 2010s, justified trust seeks a more efficient, trust-based model of tax administration. The premise: sound governance should produce sound tax. For a revenue authority to hold justified trust in a taxpayer, it must see evidence that would lead a reasonable person to conclude the right amount of tax has been paid.

3.2.4 Why should private groups invest in tax governance?

The key questions are: *Why now? What’s the payoff?* Key benefits include:

1. **Lighter ATO touch (outside “medium and emerging” settings):** Effective governance can support reduced intensity and frequency of ATO engagement, saving time and cost.
2. **Better risk visibility and mitigation:** Frameworks force structured identification, assessment, and management of risks.
3. **Error prevention and fewer recurrences:** The ATO’s Top 500 findings indicate that groups with minimal or no tax governance are far more likely to need voluntary disclosures (around two-thirds) and to have additional liabilities raised at audit (about nine-tenths).
4. **Lower key-person dependency:** Documented know-how allows continuity when roles change.
5. **Sharper decision-making:** Documented processes give owners clearer line-of-sight on position, risk, and strategy.
6. **Deal-readiness:** Strong governance tends to streamline due diligence and can bolster value at exit or sale.
7. **Reputation and ethics:** Demonstrates responsible corporate citizenship - important for customers, talent, lenders, and investors.
8. **Stronger overall governance:** Tax is a critical risk area; embedding it reinforces broader control and oversight.

3.3 The ATO’s approach

3.3.1 Origins and evolution

The ATO was an early adopter of justified trust and has been a prominent global proponent. After commencing with the Top 100 public groups (2016), the program expanded to the **Top 1,000** (2017), and - recognising the significance of private wealth to Australia’s tax base - to the Top 500 private groups (2017) and Next 5,000 (2019). For private groups, this journey culminated in the Governance Guide.

The policy drivers include revenue protection and tax-gap reduction, encouraging proactive compliance, and sustaining community confidence. In practice, the ATO seeks assurance across four core areas at a whole-of-group level:

1. Effective tax governance
2. Tax risks flagged to market (that is, positions the ATO has publicly warned about)
3. Significant or new transactions and how their tax outcomes are managed
4. Tax calculation-the reliability of the accounting-to-tax outcome

3.3.2 The Governance Guide for private groups

The Governance Guide is deliberately practical. It provides examples, templates, and prompts that private groups can scale to their structure, size, complexity, and industry. It attempts to translate justified trust from principle into actions a private group can adopt and evidence.

Seven principles of effective tax governance

The Governance Guide organises effective governance for private groups around seven principles - the pathway to justified trust. In a private-group context they typically mean:

- **Principle 1: accountable management and oversight**

Clarify who is responsible for tax decision-making and administration (inside and outside the group). Useful documents include responsibility maps and role descriptions with signoffs for key deliverables: lodgment/payment calendars with process-management checklists; and advisor engagement letters that spell out scope, handovers, and check points mirrored in internal procedures.

- **Principle 2: recognise tax issues and risks**

Adopt an upfront “environment scan” to catalogue routine tax issues (often in a tax issues register). Define materiality thresholds - qualitative and quantitative, and calibrated for active vs passive entities - to determine which issues require documented processes. Document tax lodgment procedures (checklists, decision trees) and establish a policy for atypical transactions covering approval thresholds, escalation, advisor involvement, and contemporaneous documentation of facts and positions.

- **Principle 3: seek advice (and engage early where appropriate)**

Set clear triggers for external advice and ATO engagement. Establish escalation levels, periodic check-ins with advisors, responsibilities for updating advisors on group changes or unusual deals, and checks that the facts and / or assumptions underlying advice remain accurate and current. Consider the ATO’s published guidance and whether certainty mechanisms, such as a private ruling, are warranted.

- **Principle 4: integrity in reporting**

Ensure tax lodgements are built on reliable data and reconciliations from accounting to tax. Where advisors prepare lodgments, reflect responsibilities and handoffs in both the governance framework and the advisor’s scope. Aim for process discipline that drives correct, consistent returns and activity statements.

- **Principle 5: professional, productive ATO relationship**

Have an open, timely, and respectful engagement style with the ATO to identify and resolve issues early, reduce disputes, and keep interactions efficient.

- **Principle 6: timely lodgments and payments**

Demonstrate procedural capability by lodging and paying on time. Robust systems reduce administrative friction and penalty risk and build trust with the ATO. Plan for contingencies that could affect timeliness.

- **Principle 7: ethical and responsible behaviour**

Identify and apply a tax risk appetite consistent with commercial substance and community expectations. Avoid strategies that are technically arguable but misaligned with the group's ethics, risk tolerance, or long-term reputation.

3.3.3 Bringing it together: the why/when/how of tax governance for private groups

- **Why:** Lighter regulatory touch, fewer errors, better decisions, enhanced value, stronger reputation.
- **When:** Now - start with a proportionate approach that suits the group's scale and complexity.
- **How:** Use the Governance Guide as a scaffold: map accountabilities; build an issues register; set materiality and escalation rules; document lodgments and atypical-transaction pathways; formalise advisor and ATO engagement protocols; institute reporting integrity checks; and embed timeliness and ethical settings.

3.4 Top 500 tax performance programme

The ATO's Top 500 private groups tax performance program uses a "*one-to-one approach to collaborative engagements, with the aim to increase willing participation through a focus on prevention rather than correction*."

Launched in mid-2017, the Top 500 is the ATO's flagship engagement for large private and wealthy groups. The program aims to build community confidence that Australia's largest privately owned groups are paying the right amount of tax, using a collaborative model that emphasises governance and prevention over after-the-fact correction. The assurance lens is the ATO's justified trust methodology, applied through the seven governance principles (see above).

A private group will fall within the Top 500 population if it meets one of the following:

- have over $250 million in turnover, regardless of net asset value
- have over $500 million in net assets, regardless of turnover
- have over $100 million in turnover and over $250 million in net assets
- are market leaders or of specific interest.

Within the Top 500, groups are further classified as **Significant** or **General** - with Significant groups making up roughly one-third of the population. Factors include overall wealth, industry leadership, and specific risk features.

3.4.1 Engagement approach

Each engagement is tailored to the group, considering qualitative factors such as the quality of tax governance - both current and forward-looking. Reviews cover the four justified trust “key areas” (see 3.3.1 above), with governance described in the Governance Guide as the foundation for demonstrating the other three areas (flagged risks, significant transactions, and tax calculation).

Although the ATO will consider all seven governance principles, greater weight is placed on the first four in Top 500 work.

When evaluating governance, the ATO looks for evidence of:

- **Existence** of policies, procedures, and documentation;
- **Design effectiveness** (fit-for-purpose design that should achieve the stated control objective); and
- **Operating effectiveness** (evidence the controls work in practice).

A group’s ratings for tax governance may range from ‘very high’ to ‘very low’, as set out below:

- **Very high** - Evidence shows a framework exists, is well designed, and is operating effectively.
- **High** - As above, but with a small number of improvement items.
- **Medium** - Framework exists and is largely well designed, but there are design and operating gaps to address.
- **Low** - A framework exists, yet significant design and operating improvements are needed.
- **Very low** - Insufficient evidence of a framework, or serious concerns about tax risk management.

3.4.2 What’s required to reach “High” (and thereby unlock justified trust)?

To achieve at least High - the minimum governance outcome for Top 500 justified trust - a group must demonstrate that all required items in the Governance Guide (covering the first four principles) are implemented and effective (by design and, where relevant, in operation), and that at least three additional items have also been implemented and are effective.

After you achieve justified trust

On attaining justified trust, a group typically moves into a three-year monitoring and maintenance phase. During this period the ATO generally relies on the group’s governance framework to manage risk, meaning materially reduced interaction and cost for both sides. After the cycle, the ATO conducts a justified trust refresh, leveraging existing evidence and knowledge of the group - again designed to keep the resource burden low.

If justified trust is not achieved

Groups that do not reach justified trust usually remain in annual assurance cycles until they do. They may also face further review activity or escalation to audit. An exception exists where a group has achieved full tax assurance on the reviewed period (correct tax paid) but lacks adequate governance; if it commits to implement governance within a set timeframe, the ATO may grant provisional justified trust - a temporary pause in assurance activity.

Passive investor variant

For groups whose income is predominantly passive (for example, property leasing, interest, listed shares), the ATO applies a tailored approach. In April 2024 the ATO published a passive-investor supplement to the Governance Guide specifically for Top 500 private groups in this cohort.[7]

3.5 Next 5,000 program

The Next 5,000 program has a similar public-confidence objective: ensuring Australia's largest privately owned groups (outside the Top 500) are reporting and paying the correct tax. Despite the name, recent ATO commentary indicates the program currently covers close to 10,000 groups.[8]

The Next 5,000 includes groups controlled by Australian-resident individuals whose wealth (including associates) exceeds A$50 million, excluding groups already in the Top 500.

3.5.1 How engagements work

Engagement type depends on size, structural complexity, and ATO data-analytics outputs. The three main pathways are:

- **Streamlined assurance reviews** (the focus here), applying justified trust methods;
- **Risk-specific reviews**; and
- **Pre-lodgement compliance agreements** for deals or restructures.

Streamlined assurance reviews aim to resolve matters quickly and transparently. The ATO considers significant events, transactions and activities across the group and trading entities, applying the four key areas of justified trust. However, these reviews differ from the Top 500 in important ways:

- **Governance scope**: Focus is on the existence and design effectiveness of governance (that is, documented processes intended to work). Operating effectiveness is not tested. Coverage is generally limited to the first three principles.
- **Documentation expectations**: The ATO looks for fit-for-purpose governance scaled to the group's complexity - recognising many groups have processes that are not yet fully documented.
- **Supportive posture**: A key aim is to encourage documentation of key roles, responsibilities, return-preparation steps, and material-transaction processes. No formal governance rating is issued at the end of a Next 5,000 review.
- **Outcome format**: Next 5,000 reviews do not confer justified trust status. Instead, the ATO issues a streamlined tax assurance report summarising findings, corrections and recommended improvements.

Where the ATO remains concerned about a group's risk posture, it may extend the review to address issues collaboratively, escalate to a more comprehensive review or commence an **audit**.

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[7] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/privately-owned-and-wealthy-groups/what-you-should-know/tax-performance-programs-for-private-groups/top-500-private-groups-tax-performance-program/effective-tax-governance-criteria-for-top-500-private-groups/passive-investor-guide-for-top-500-private-groups accessed 24 August 2025.

[8] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/privately-owned-and-wealthy-groups/findings-from-the-next-5000-tax-performance-program/next-5000-groups-and-how-we-engage accessed 24 August 2025.

Key difference: Top 500 reviews target full justified trust (or tax assurance as a pathway), whereas Next 5,000 reviews target assurance on specific periods/issues and promote practical governance improvements rather than end-to-end justified trust.

3.6 Medium and emerging program

The medium and emerging stream is a newer ATO initiative intended to reinforce community confidence among smaller private groups. Unlike Top 500 and Next 5,000, these engagements are typically issue-based, which sits somewhat apart from the ATO's broader justified trust emphasis.

The ATO estimates the medium and emerging stream covers roughly 273,000 private groups that are:

- linked to Australian-resident individuals with A$5m to A$50m in wealth (including associates); or
- Australian businesses with turnover > A$10m that are not public or foreign-owned and not already within the Next 5,000 or Top 500.

3.6.1 Engagement style and current focus

Reviews are driven by ATO analytics, profiling and intelligence, and commonly include:

- reviews of group-specific reporting risks;
- pre-lodgement agreements for transactions/restructures; and
- leveraged engagements to resolve narrower risks efficiently.

Current areas of interest include:

- unreported income detected via third-party data;
- non-lodgment leading to tax shortfalls;
- late/incorrect returns, schedules or activity statements;
- situations where declared income appears insufficient to fund expenses or asset acquisitions;
- inappropriate access to concessions, credits or offsets;
- large or unusual transactions, including wealth transfers; and
- Trust structures and wealth extraction (for example, Division 7A).

The ATO **does not** assess tax governance in these reviews. Nonetheless, the Governance Guide highlights the benefits of a robust framework even for this cohort - both to prevent issues compounding over time and because growing groups may graduate into the Next 5,000, where governance expectations are more explicit.

3.7 Summary of ATO tax performance programs

The following table seeks to summarise the key features of the ATO's three tax performance programs for private groups.[9]

Feature	Top 500	Next 5,000	Medium and emerging
Population	Australia's largest private groups	Private groups linked to Australian resident individuals controlling net wealth >A$50m, excluding Top 500 private groups.	Private groups linked to Australian resident individuals controlling net wealth of between $5m and A$50m and/or businesses with annual turnover > A$10m that are not public of foreign owned or linked to Top 500 or Next 5,000 private groups.
Engagement model	Ongoing, one-to-one tailored engagements.	Streamlined assurance reviews, as well as risk-based reviews on specific issues and pre-lodgment compliance agreements.	Risk-based reviews and audits.
Justified Trust	Full application of Justified Trust approach. Assurance sought across all four 'key areas', including operational effectiveness of tax governance.	Seeks assurance on specific reviewed items/ transactions, rather than holistic Justified Trust for the whole group.	Not a Justified Trust program. Focus is on encouraging good tax governance, promoting documentation, and addressing identified risk.
Tax governance	Existence, design effectiveness and operational effectiveness all assessed by reference to all seven principles, with emphasis on the first four.	Existence and design effectiveness considered by reference to first three principles.	Encouragement for basic tax governance, record-keeping, and understanding of tax obligations.
Review depth & scope	Comprehensive.	More targeted towards specific risks, significant transactions or common issues (e.g., wealth extraction, Division 7A).	Issues-based, with reviews typically by data analytics identifying specific anomalies or high-risk behaviours. Can be entity or group-level depending on issue.
Post-engagement	Formal assurance ratings provided for each 'key area' and overall. Attainment of Justified Trust or Tax Assurance possible.	Streamlined tax assurance report providing summarising findings and confirming correct reporting for reviewed items. No formal Justified Trust assessment.	Findings letter, potential amendments, or escalation to audit. Focus on resolving identified issues.

[9] Source, Liam Telford and Jacob Young, RSM Australia, "*Tax Governance for Private Groups*", WA Tax Retreat, 25 July 2025.

3.8 What does the ATO approach mean?

Most private groups do not maintain dedicated in-house tax or even full finance teams. That reality shapes the advisor's remit on tax governance.

In practice, advisors are central to:

- Educating owners and controllers about the ATO's expectations and why governance matters.
- Translating complexity into action, turning guidance into pragmatic, step-by-step processes that fit the group's structure and workflow.
- Explaining consequences, both obvious (tax, interest, penalties) and indirect (time cost, reputation, disrupted transactions) of weak or absent governance.

Because advisors typically sit close to a group's tax affairs and understand ATO practice, they are well placed to deliver enduring, non-commoditised value - from designing the framework to helping run and refine it.

3.8.1 Building the framework

A private group's tax governance framework is the bundle of policies, procedures and controls it uses to manage tax risk. At a minimum, it should be formally documented. Off-the-shelf templates rarely work: the ATO expects frameworks to be tailored to the group.

When shaping a proportionate framework, consider:

- **Scale and complexity.** Where does the group sit today (Medium and Emerging, Next 5,000, Top 500) and could that change soon?
- **Ownership and management dynamics.** Family involvement, segregation of duties, delegations, knowledge depth and bandwidth.
- **Operations and industry.** Sector-specific issues, transaction volume and profile, systems used.
- **Risk appetite and strategy.** What tax risk will the group accept, and how will that be communicated and enforced inside and outside the group?
- **What already exists.** Identify informal practices and existing documents - avoid rebuilding from scratch.
- **Resourcing.** Frameworks cost time and money to design, implement and maintain; pitch the depth to the budget and internal capacity.
- **Practicality.** Over-engineering kills adoption. Aim for clear, concise, usable materials. Treat the framework as living - it should adapt as the group and law change.

There is no one-size-fits-all. A small family enterprise will inevitably have a lighter, simpler framework than a Top 500 group - the Governance Guide acknowledges this.

3.8.2 Designing an effective framework

Design is more than writing down what happens today; it's about embedding proactive control over tax risk.

Evidence from Australian corporate tax governance research suggests effectiveness depends as much on culture and leadership - actively identifying and managing tax risk - as on documentation. In short, you need genuine buy-in from owners, directors and key staff or the framework will not deliver.

A practical design sequence:

1. **Understand the current state.** Map processes, controls, roles and documents (formal or informal).

2. **Run a gap analysis.** Benchmark against the ATO's expectations and the Governance Guide principles that are relevant to the group.

3. **Design the building blocks,** typically including:

   - **Roles and responsibilities.** Clear allocations for each tax process (including external advisors), escalation paths, reporting lines, and a delegation's matrix.

   - **Policies and procedures.** A concise tax strategy plus step-by-step procedures for key cycles (returns, BAS, PAYG, withholding, FBT, GST, payroll, etc.).

   - **Tax risk management.** A risk register (likelihood/impact, owners, treatments) and a method to assess risks from new transactions, products or law changes.

   - **Advice management.** Triggers and thresholds for seeking external advice or ATO engagement, and processes to validate facts, document advice and track implementation.

   - **Controls and assurance.** Segregation of duties, reconciliations, independent reviews, system controls, and (where appropriate) testing and board/owner reporting.

   - **Technology and data.** How systems feed tax reporting, data lineage, and data-quality measures.

   - **Training and communication.** Role-specific training and clear channels to surface issues promptly.

4. **Map components to the Governance Guide principles** to show coverage of what the ATO expects.

5. **Implement.** Finalise documents, roll out training, and integrate with systems and calendars.

3.8.3 Keeping it effective

A tax governance framework should evolve**.** Schedule periodic reviews to confirm it remains relevant as the group's footprint, systems and risk profile change. Advisors - given their expertise and proximity - are usually well placed to support this continuous-improvement cycle, subject to the client's preferences and capacity.

For Top 500 groups aiming for or maintaining Justified trust, periodic operational testing is expected to confirm controls work in practice (not just on paper). While advisors don't have to do that testing, they are often the most efficient choice. The Governance Guide includes suggested procedures that groups and advisors can adopt or adapt for this purpose.

3.9 ATO compliance activity - small business

The ATO compliance approach for small business is different to that of private wealth (above) that draws on the concept of justified trust that emanated from public groups.

With small business the ATO areas of focus are determined by what the ATO is seeing in its audits, coupled with data matching and resources to find businesses that are not correctly registered or are operating outside of the tax and super system.[10]

If the ATO find a concern, it will contact the small business owners' tax professional (or small business owner if they do not use an agent) for more information or clarification. This contact may be by:

- pre-issue contact to correct any claims before a refund is released
- phone calls direct to the small business owner's tax professional (or small business owner if they don't use an agent)
- issuing direct letters or emails to the small business owner's tax professional (or small business owner if they don't use an agent) on specific issues
- moving small businesses to monthly BAS reporting, rather than quarterly to get them back on track.

If the ATO finds a small business is deliberately avoiding it or their obligations, the ATO says it will take firm action to ensure that the correct amount of tax is paid. This may include:

- reviews or audits
- penalties and interest on any unpaid tax, plus debt collection activities
- applying administrative penalties, or seeking the application of civil or criminal sanctions in more serious cases

Behaviours that are attracting ATO attention are small businesses that:

- knowingly operate outside of the system, like not declaring all income and over-claiming expenses
- deliberately do not report or register correctly, and do not lodge and pay in full and on time
- do not know their tax and super obligations, including those of their employees
- employers who pay in cash and do not declare income to avoid their tax and super obligations
- use business funds and assets to support their personal lifestyle, tax-free
- have poor record keeping and/or cash flow management.

3.10 Foreign owned groups

As set out above, foreign owned groups do not form part of private wealth. Tax compliance for those groups falls within the ATO's "public groups and multinationals" area.

Within that area, the ATO has a "Medium public and multinational business engagement program" for groups that includes taxpayers who are part of an economic group controlled by a public or multinational entity with a combined Australian turnover of less than $250 million. Foreign controlled private groups could fall within this area.[11]

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[10] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/our-focus-areas-for-small-business/our-approach-for-small-business accessed 24 August 2025.
[11] ATO website, https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/public-business-and-international/medium-public-and-multinational-business-engagement-program accessed 24 August 2025.

The ATO uses intelligence and analytical models to improve its understanding of the taxpayer's business and the environment it operates in, including on:

- inappropriate access to tax incentives and concessions including the research and development tax incentive and concessions
- related party transactions where the ATO observe:
    - non-arm's length pricing in cross-border financing and inbound distribution arrangements
    - mischaracterisation of payments between Australian residents and related entities in other jurisdictions
- non-payment or incorrect payment of interest, dividend and royalty withholding tax
    - structuring and business events resulting in profit shifting and avoiding the taxation of capital gains including
    - payments that give rise to hybrid mismatch outcomes
- inappropriate access to tax treaty benefits.

When the ATO identify possible errors in tax disclosures, it will write to the group advising of the possible non-compliance. The ATO will engage seeking more information to either resolve its concerns or identify areas that need closer examination.

This may include a specific risk review, a comprehensive risk review or an audit if the ATO identify areas of concern that need an in-depth investigation.

When the ATO engage with taxpayers as part of this program, the ATO does not consider or review tax governance processes. However, the ATO says taxpayers who have good tax governance generally have a more streamlined and efficient review than those who do not.

4. Big end rules and private groups

This part of the paper looks at "big end" tax rules that may have application to small business or private wealth clients:

- the thin capitalisation rules in Division 820 of the ITAA 1997;
- the debt deduction creation rules in Subdivision 820-EAA of the ITAA 1997;
- the transfer pricing rules in Division 815 of the ITAA 1997;
- the hybrid mismatch rules in Division 832 of the ITAA 1997; and
- the taxation of financial arrangements rules in Division 230 of the ITAA 1997.

This paper does not "deep dive" into those rules, instead the paper will allow advisors to "issue spot" to conduct further research and investigation into the client's affairs or to recommend specialist advice. There are also many excellent papers at The Tax Institute website for those wishing to read further.

Not all these rules will be relevant to all groups – most of the rules have a 'foreign connection' requirement while others have de minimis tests.

4.1 The thin capitalisation rules

4.1.1 Overview

A key takeaway with the thin capitalisation rules is that the rules changed from an asset-based test to an earnings-based test from 1 July 2023.

Under the thin capitalisation rules, the debt deductions of certain foreign entities investing into Australia, Australian entities that are foreign controlled, and Australian entities investing overseas are limited.

A debt deduction is an expense an entity incurs including interest, an amount in the nature of interest, or any other amount that is economically equivalent to interest, where the expense is otherwise deductible if the thin capitalisation rules are disregarded.

The thin capitalisation rules apply to:

- Australian entities with specified overseas investments
- Australian entities that are foreign controlled
- foreign entities with certain investments in Australia, regardless of whether they hold the investments directly or through Australian entities.

For income years that commence on or after 1 July 2023, affected entities that are not financial entities or authorised deposit-taking institutions for a period that is all of part of the income year, are classified as "general class investors". This paper only looks at general class investors.

4.1.2 Exclusions

The thin capitalisation rules **do not** apply to an entity for an income year if:

1. the total debt deductions of the entity and all its associate entities for that year are **$2 million** or less.
2. the entity is an Australian entity with overseas operations or investments, or an associate of such an entity, that is not also foreign controlled and meets the assets threshold test of **>90% Australian assets**.
3. the entity is an insolvency-remote special purpose entity established to manage certain risks and the total value of debt interests in the entity is at least half of the total value of its assets.

For many private groups, the key exclusions – other than not being a general class investor (see below) – will be items 1 and 2. However, and importantly:

- the $2 million de minimis interest threshold is on an associate entity inclusive basis – it is not just the specific entity's debt deductions; and
- the 90% Australian asset test **only** applies to outward investing Australian entities who are **not** also foreign controlled.

4.1.3 What entities are affected by the thin capitalisation rules

An Australian entity may be affected by the thin capitalisation rules if it is any of the following. An:

- Australian controller of an Australian controlled foreign entity
- entity that carries on business through an overseas permanent establishment, such as a branch
- associate entity of either of the above.

An Australian controller includes:

- an Australian entity holding a control interest in an Australian controlled foreign entity of at least 10%
- an Australian entity that holds a control interest of at least 1% in a controlled foreign company (except a corporate limited partnership) and is one of 5 or fewer Australian entities that, together with associate entities, control the foreign company
- an Australian entity that is a general partner of a controlled foreign corporate limited partnership.

An entity may also be affected by the thin capitalisation rules if it is either of the following:

- an Australian entity controlled by a foreign entity; that is, a foreign controlled Australian entity
- a foreign entity (the thin capitalisation rules only affect those with Australian income-producing assets).

An example of the first type entity is an Australian company that is a subsidiary of a United States company. An example of the second type of entity is a foreign entity that owns a rental property located in Australia or a foreign entity that has a permanent establishment in Australia.

The thin capitalisation rules also affect associate entities of Australian entities with certain overseas operations. An associate entity is an entity (**Entity A**) that is an associate of another entity (**Entity B**) under section 318 of the ITAA 1936, and at least one of the following apply:

- Entity B holds an interest of 50% or more in Entity A

- Entity A (either directly or indirectly) is accustomed, under an obligation, or reasonably expected to act in accordance with the directions, instructions or wishes of Entity B in relation to whether Entity A retains or distributes its profits or its financial policies.

If Entity A is an associate entity of Entity B, Entity B is automatically an associate entity of Entity A. If 2 separate entities are both associate entities of the same entity, they are also associate entities of each other. An example of this is 2 companies that are subsidiaries of the same parent company. As they are both associate entities of the parent company, they are also associate entities of each other.

4.1.4 Control of Australian trusts

For Australian groups that include trusts, whether the group is subject to the thin capitalisation rules will depend on whether a trust is a "foreign controlled Australian trust".[12]

A trust is a foreign controlled Australian trust at a particular time if, at that time, it is an Australian trust to which **at least one** of the following applies:

1. A group of 5 or fewer foreign entities (each of which holds a control interest in the trust of at least 1%) holds a control interest of at least 50% in the Australian trust. For example, if 3 foreign residents are entitled to 30%, 10% and 10% respectively of an Australian trust's income, the trust is a foreign controlled Australian trust.
2. A single foreign entity holds a control interest of at least 40% in the Australian trust, and no other entity (except for an associate entity) controls the trust.
3. All the following apply
   - At least one of the objects or beneficiaries of the Australian trust is a foreign entity.
   - The trust has made at least one distribution of income or capital to that foreign entity (directly or indirectly) during the current income year or during the preceding 2 income years.
   - Australian entities hold control interests of 50% or less in the trust.
4. A foreign entity is in a position to control the trust.

Broadly, a foreign entity is in a position to control the Australian trust if **any** of the following apply:

- The foreign entity, or an associate entity of the foreign entity, can obtain the beneficial enjoyment of the trust's income or capital.
- The foreign entity, or an associate entity of the foreign entity, can control the application of the trust's income or capital.
- A trustee might reasonably be expected to act in accordance with directions of the foreign entity or an associate entity of the foreign entity.
- The foreign entity, or an associate entity of the foreign entity, can remove or appoint a trustee.

For a trust, the direct control interests are those interests in the income or corpus of trusts held by beneficiaries. Specifically, a direct control interest in a trust is the percentage of interest an entity holds, or is entitled to

[12] The tests for whether a company or a partnership are foreign controlled are broadly like tests 1 or 2 for trusts but adapted for companies and trusts.

acquire, in the income or corpus of the trust, whichever is the greater. Importantly, in applying tests 3 or 4 (above):

1. for test 3: a foreign entity that is an object of the trust at a particular time is taken to hold, at that time, a direct control interest in the trust that is equal to 100%; and
2. for test 4: a foreign entity that is in a position to control the trust at a particular time is taken to hold, at that time, a direct control interest in the trust that is equal to 100%.

Practically if an Australian trust has foreign beneficiaries, a foreign appointor, or a foreign controller then further analysis will be required to determine if the trust and other entities in the group are foreign controlled.

4.1.5 What if the rules apply?

The fixed ratio test is the default test that applies for general class investors that do not make a choice to use either the group ratio test or the third-party debt test.[13]

If the fixed ratio test applies, the amount of debt deductions of an entity for an income year that is disallowed is the amount by which the entity's net debt deductions exceed the entity's fixed ratio earnings limit for the income year. An entity's fixed ratio earnings limit for an income year is 30% of its tax EBITDA for that income year.

A special deduction allows general class investors to claim debt deductions that have been previously disallowed within the past 15 years under the fixed ratio test in a later income year.

For the special deduction to apply, the entity must be using the fixed ratio test for the income year and its fixed ratio earnings limit for the income year must exceed its net debt deductions. An amount of those previously disallowed debt deductions up to the excess amount may be able to be deducted, subject to satisfying further criteria. If net debt deductions are equal to or higher than the fixed ratio earnings limit, then no previously disallowed debt deductions can be deducted.

If an entity is a company or trust, it must pass the company or trust loss rules in relation to its fixed ratio test disallowed amounts, otherwise the entity cannot apply the amount.

4.2 The debt deduction creation rules

The debt deduction creation rules (**DDCR**) disallow debt deductions relating to certain related party financing arrangements. They apply to assessments for income years starting on or after **1 July 2024**. This includes debt deductions in relation to arrangements entered before or after 1 July 2024.[14]

If they apply, the DDCR **disallows** debt deductions for certain arrangements involving associates, including arrangements between Australian entities.

Importantly, several of the exclusions from the thin capitalisation rules do **not** apply to the DDCR:

- Section 820-37 of the ITAA 1997 (the 90% assets threshold test) excludes certain outward investing entities from the thin capitalisation rules for an income year. These entities are subject to the DDCR.
- Section 820-32 of the ITAA 1997 excludes the following from the thin capitalisation rules:

[13] This paper does not consider the group ratio test or the third-party debt test.
[14] The rules do not apply to an entity for an income year that has made a choice (including a deemed choice) to apply the third-party debt test under the thin capitalisation rules for the income year.

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- assets used (or held for use) wholly or principally for private or domestic purposes
- non-debt liabilities that are wholly or principally of a private or domestic nature.

These assets and liabilities are **not** excluded from the DDCR.

Of relevance to this paper, for any given income year, the DDCR applies to all or part of a debt deduction for an entity that is a general class investor with associate entity debt deductions >$2 million. That is, as relevant for this paper, the only exclusions from the DDCR are not being a general class investor and the $2 million de minimis.

The rules disallow debt deductions for certain arrangements involving associates, including arrangements between Australian entities

Complying loans under Division 7A of the ITAA 1936 are **not** excluded from the DDCR. That is, where DDCR conditions are satisfied, the DDCR will apply to disallow debt deductions for interest paid or payable under a complying Division 7A loan.

The DDCR rules apply before the thin capitalisation rules and, if the DDCR rules apply, there is an adjustment in applying the thin capitalisation rules.

The DDCR apply to the following 2 types of arrangements:

- Type 1: the Acquisition case, the DDCR will operate to disallow an entity's debt deductions referable to an amount paid, directly or indirectly, to an 'associate pair' to the extent they are in relation to the acquisition or holding of a CGT asset, or a legal or equitable obligation, directly or indirectly, from an 'associate pair'.
- Type 2: the Payment or distribution case, the DDCR will operate to disallow an entity's debt deductions referable to an amount paid, directly or indirectly, to an 'associate pair' in relation to a financial arrangement to the extent the arrangement is used to fund or facilitate funding of prescribed types of payments or distributions to an 'associate pair'.

An 'associate pair' is a new term introduced for the DDCR. It uses the pre-existing definition of associate in section 318 of the ITAA 1936.

An entity is an 'associate pair' of another entity if any of the following conditions are met:

- The entity is an associate of the other entity.
- The other entity is an associate of the entity.

The definition of 'associate pair' only requires that one of the entities is an associate of the entity. It is not necessary to test whether both entities satisfy the definition of associate.

The DDCR include a specific anti-avoidance rule in section 820-423D of the ITAA 1997.

Under this rule, the Commissioner may determine that Type 1 or Type 2 applies to relevant debt deductions if the Commissioner is satisfied that it is reasonable to conclude that one or more entities ('participants') entered into or carried out a scheme for the principal purpose of, or for more than one principal purpose that included the purpose of, achieving the result that either:

- Type 1: Acquisition case does not apply in relation to a debt deduction
- Type 2: Payment or distribution case does not apply in relation to a debt deduction.

This is the case whether or not:

- the debt deduction is a debt deduction of any of the participants of the scheme
- any of the participants carried out the scheme or any part of the scheme
- the scheme has been or is entered into or carried out in Australia or outside Australia, or partly in Australia and partly outside Australia.

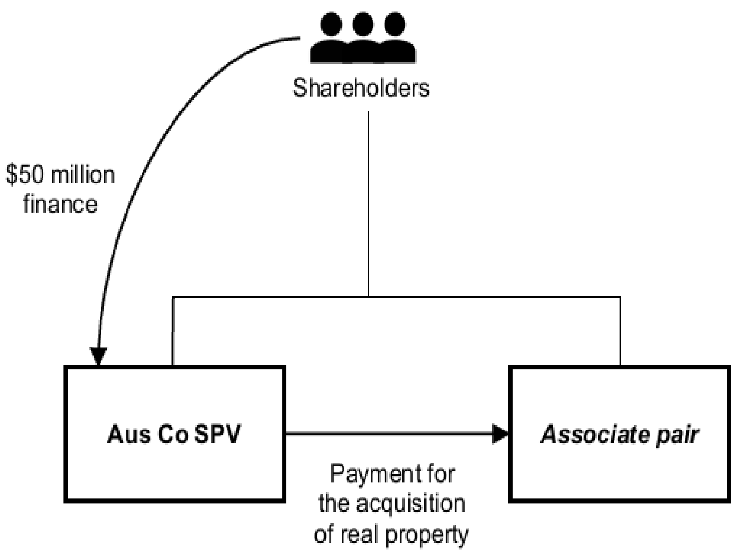
This means that if the Commissioner is satisfied that a principal purpose of one of the participants in the scheme was to avoid the application of the DDCR, it does not matter where the scheme was entered into or carried out.

4.2.1 The DDCR and private groups

The ATO has recently finalised Practical Compliance Guideline PCG 2025/2 that includes several examples of the ATO's compliance approach around the DDCR that are relevant to private groups. Some of these examples are extracted below.

Example 10 – related party financing of related party acquisition

Diagram 10: Related party financing of related party acquisition



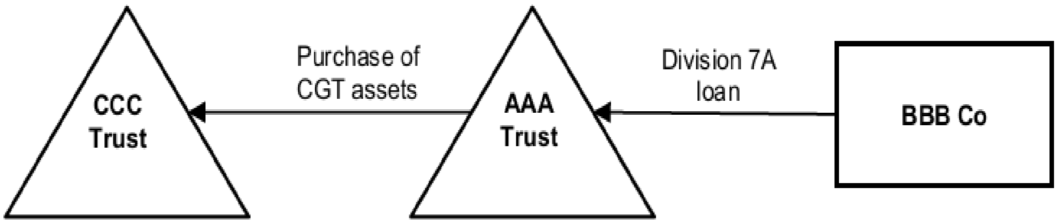
121. *Aus Co SPV is an Australian-incorporated entity and general class investor. It commences a new property project in Australia and acquires real property from an associate pair for approximately $300 million.*

122. *Debt interests of $50 million in total are issued by Aus Co SPV to SPV's shareholders which are an associate pair in relation to Aus Co SPV.*

123. *Aus Co SPV will need to consider the application of the DDCR to debt deductions arising in relation to the $50 million associate pair financing. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Example 12 – acquisition from a related trust

Diagram 12: Acquisition from a related trust



129. *AAA Trust is a general class investor and is part of a privately owned group which predominantly carries on business in Australia. AAA Trust, together with its associates, has more than $2 million in debt deductions in a single income year.*

130. *BBB Co is a private company that holds a significant amount of funds in the group.*

131. *CCC Trust is a trust that holds a CGT asset.*

132. *AAA Trust, BBB Co and CCC Trust are part of a privately owned group and are associate pairs of each other.*

133. *In the 2024–25 income year, the trustee of the AAA Trust acquires the CGT asset held by CCC Trust to be used in its business.*

134. *AAA Trust does not have sufficient working capital to both acquire the CGT asset and fund its business operations.*

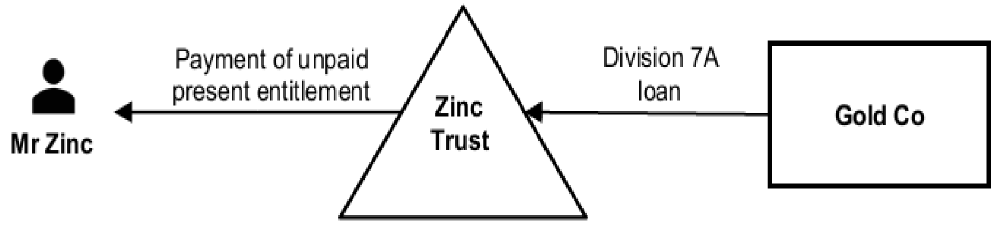
135. *The trustee of AAA Trust and BBB Co enters into a Division 7A (of the ITAA 1936) complying loan agreement*[26] *under which the trustee borrows an amount from BBB Co equal to the amount of the CGT asset's purchase price (Division 7A complying loan). The loan agreement stipulates that the trustee of AAA Trust must make minimum yearly repayments to BBB Co, and the rate of interest payable on the loan is equal to the benchmark interest rate for each year.*

136. *The trustee of AAA trust pays the CCC Trust the purchase price for the CGT asset using the funds provided under the Division 7A complying loan for the CGT asset acquired.*

137. *The trustee of AAA trust will need to consider the application of the DDCR to the debt deductions arising in relation to the acquisition from CCC Trust. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Example 13 – loan funding distribution by trustee

Diagram 13: Loan funding distribution by trustee



138. *Zinc Trust is a discretionary trust and a general class investor that, together with its associates, has more than $2 million in debt deductions.*

139. *Mr Zinc is the appointor and primary beneficiary of Zinc Trust.*

140. *Gold Co is a private company of which Mr Zinc is the sole director and shareholder.*

141. *The 2 entities are part of a privately owned group and are associate pairs of each other.*

142. *In the 2021–22 income year, the trustee of Zinc Trust makes Mr Zinc presently entitled to 100% of the trust income. Mr Zinc agrees for the trustee to retain the amount to which his present entitlement relates in Zinc Trust as working capital.*

143. *On 30 June 2023, Mr Zinc calls for payment of his unpaid present entitlement (UPE). After reviewing the financial affairs of the Zinc Trust, the trustee decides to refinance the amount contributed by Mr Zinc by borrowing the same amount from Gold Co rather than reducing the working capital of the business. The loan is structured in accordance with Division 7A of the ITAA 1936 complying terms. The rate of interest payable on the loan from Gold Co is equal to the benchmark interest rate for each year.*

144. *The trustee uses the amount borrowed from Gold Co to pay off Mr Zinc's UPE.*

145. *The trustee will need to consider the application of the DDCR to Zinc Trust's debt deductions arising in relation to the borrowing from Gold Co used to fund or facilitate the funding of the payment of Mr Zinc's UPE. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

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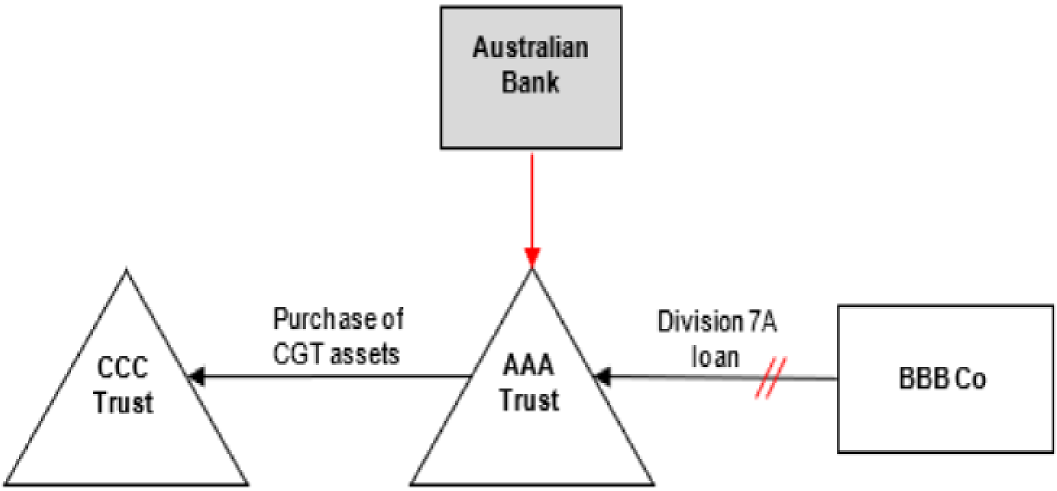
Example 21 – low risk: replacing Division 7A loan with third-party debt

Diagram 20: Low risk: replacing Division 7A with third-party debt



221. *Assume the same facts as Example 12 of this Guideline. Assume that AAA Trust is not otherwise indebted.*

222. *AAA Trust is not controlled by another entity and is not part of a broader economic group.*

223. *AAA Trust repays BBB Co the outstanding amount owing on the Division 7A complying loan. AAA Trust does not have the financial capacity to repay the loan itself due to its loss-making operations and obtains a third-party loan from Australian Bank in order to fund the repayment of the Division 7A loan. Australian Bank does not have any arrangements with any of AAA Trust's associates impacted by these arrangements.*

224. *AAA Trust will now incur interest expenditure due to the introduction in third-party borrowings and the restructure is not associated with:*

- *any broader group reorganisation or refinancing*
- *any back to back connected arrangements in connection with the loan from the Australian bank*
- *any associated reduction in any third-party debt owing by an associate of AAA Trust.*

225. *This is a low-risk restructure.*

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4.3 Transfer pricing

The transfer rules aim to make sure that businesses price their related-party international dealings in line with what is expected from independent parties in the same situation.

Pricing for international dealings between related parties should reflect the right return for the:

- activities carried out in Australia
- Australian assets used (whether sold, lent or licensed)
- risks assumed in carrying out these activities.

Pricing that does not comply with Australia's transfer pricing rules is often referred to as 'international profit shifting'.

Unlike thin capitalisation and the DDCR there are not de minimis type exclusions from the transfer pricing rules.

The key concept with transfer pricing is the ‘arm’s length principle’. The arm's length principle uses the behaviour of independent parties as a guide or benchmark to determine in international dealings between related parties:

- the pricing of goods and services
- how income and expenses are allocated.

It involves comparing what a business has done and what an independent party would have done in the same or similar circumstances.

Many factors may influence prices or margins, so you need to closely examine the dealings you are comparing and the circumstances of the parties involved. This comparison with arm's length activity means it is difficult to achieve absolute precision and certainty.

For dealings to be comparable:

- none of the differences between the situations should be material
- reasonably accurate adjustments can be made to eliminate the effect of any such differences
- the materiality of any differences depends on the facts and circumstances of each case and recognising that there's likely to be some uncertainty in the judgments that must be made.

In assessing compliance with the arm’s length principle, you should exercise commercial judgment about the nature and extent of documentation appropriate to your circumstances. Both the ATO and the OECD state that businesses only need to reasonably assess whether their dealings with related parties comply with the arm’s length principle. They should not be expected to prepare or obtain documents beyond the minimum needed to do this.

Businesses should consider the level of certainty they wish to achieve, considering the impact of international dealings with related parties on their overall business. This assessment will determine the level of risk to which a business is exposed.

Businesses risk having a transfer pricing audit if they do not have proper processes to determine arm's length prices and cannot demonstrate to us the methods they've used to determine their prices. They also risk a transfer pricing adjustment and penalties because of any audit.

There are several internationally accepted methodologies that you can use to comply with the arm's length principle. Australia's transfer pricing rules do not prescribe any particular methodology or preference to arrive at an arm's length outcome. You should seek to adopt the method that is best suited to the circumstances of each case. Taxation Ruling TR 97/20 has ATO views on transfer pricing methodologies.

Taxpayers must keep documentation that can substantiate compliance with the arm's length principle. Taxation Ruling TR 2014/8 provides information on the ATO views on how to demonstrate that you have complied with the principle. An entity cannot have a reasonably arguable position for the purposes of calculating penalties where it has not met the documentation requirements specific to transfer pricing penalties arising from the transfer pricing rules.[15]

If a business is engaged in international dealings with related parties and has more than $2 million of related-party dealings, it is required to complete an international dealings schedule (**IDS**) and lodge it with its income tax return for that year.

The IDS imposes obligations to disclose information about related-party international dealings, including:

- the nature and amount of certain categories of transactions
- details of dealings of a financial nature
- receipts or payments of non-monetary consideration
- details of restructuring events
- details of arm's length methodologies used
- the level of documentation held to support the selection and application of the most appropriate arm's length methodologies
- details of disposals or acquisitions of any interest in a capital asset.

The IDS allows you to notify the ATO if you are eligible and choosing to adopt any of the simplified transfer pricing record-keeping options (see below).

4.3.1 Transfer pricing and simplified record keeping

The ATO has developed some simplified transfer pricing record-keeping options (simplification options) so eligible businesses can opt to minimise record-keeping and compliance costs. These are set out in Practical Compliance Guideline PCG 2017/2.

The transfer pricing rules apply to you irrespective of whether you are eligible or choose to apply an option. The ATO expects when you lodge your return you do so on the basis you have applied the transfer pricing rules to any relevant transaction or arrangement you have undertaken.

If a taxpayer is eligible for a simplified option, the ATO will generally not review the covered transactions or arrangements to which the options apply for transfer pricing purposes, beyond conducting a check to confirm eligibility.

[15] The ATO views on transfer pricing penalties are in Law Administration Practice Statement PS LA 2014/2.

Applying a simplification option does not, of itself, meet the requirements of Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953* and Subdivisions 815-B or 815-C of ITAA 1997. Selecting an option does not limit or waive how the law operates, but demonstrates you have self-assessed your relevant transactions for compliance with the transfer pricing rules.

When you select an option, you do so on the basis you have done all you sensibly need to do in your circumstances to make sure your cross-border dealings satisfy the arm's length principle as set out in Subdivisions 815-B or 815-C of the ITAA 1997.

If you want to rely on any of the simplification options, the ATO expects you to self-assess your eligibility and keep contemporaneous documents that verify your eligibility. These do not need to be comprehensive, but they should simply and sensibly explain how and why you were eligible to apply any options. Self-assessment without corroborating documents is not enough.

4.3.2 Eligibility criteria

There are 7 simplified transfer pricing record-keeping options available:

- small taxpayers
- distributors
- low value adding intra-group services
- low-level inbound loans
- materiality
- technical services, and
- low-level outbound loans.

Small taxpayers

The annual turnover of the Australian economic group is under $50 million and the entity:

- has not made sustained losses
- has not undergone a restructure within the year
- does not have related-party dealings (either as expenses or as income) involving royalties, licence fees, or research and development (**R&D**) arrangements totalling greater than $500,000 combined
- does not have specified service related-party dealings (either as expenses or as income) greater than 15% of turnover
- is not a distributor, and
- has assessed compliance with the transfer pricing rules.

This option does not reduce the documentation requirements for the following transactions:

- international related-party dealings involving royalties, licence fees or R&D arrangements

- international related-party financial transactions (for example, loans and guarantees) and associated charges
- international related-party dealings of a capital nature.

Distributors

You are a distributor, and the annual turnover of the Australian economic group is under $50 million and the entity:

- does not have a profit-before-tax ratio of less than 3%
- has not undergone a restructure within the year
- does not have related-party dealings (either as expenses or as income) involving royalties, licence fees or R&D arrangements totalling greater than $500,000 combined, and
- has assessed compliance with the transfer pricing rules.

This option does not reduce the documentation requirements for the following transactions:

- international related-party dealings involving royalties, licence fees or R&D arrangements
- international related-party financial transactions (for example, loans and guarantees) and associated charges
- international related-party dealings of a capital nature.

Low value adding intra-group services

You have international related-party low value adding intra-group service dealings of either:

- $2 million or less combined value of services received and provided – the de minimis rule
- greater than $2 million, but
  - for services you receive – the total amount charged to you must not be more than 15% of the total expenses of your Australian economic group
  - for services you provide – the total amount derived by you must not be more than 15% of the total revenue of your Australian economic group

and you have:

- low value adding intra-group services expenses of not more than 25% of your pre-intra-group services charges profit
- a mark-up on costs of the relevant services of
  - 5% or less for services you receive
  - 5% or more for services you provide
- not made sustained losses

- not undergone a restructure within the year, and
- assessed your compliance with the transfer pricing rules.

This option does not reduce the documentation requirements for international related-party dealings that are not low value adding intra-group services.

Low level inbound loans

You have a combined cross-border loan balance of $50 million or less for your Australian economic group at all times throughout the financial year, and:

- for each of your inbound loans
  - your interest rate is no more than the following rate for each of the income years which the loan is in effect
    - 5.81% in the 2024 income year
    - 5.61% in the 2025 income year
  - the funds provided to you under the loan are Australian dollar funds and this is reflected in your loan agreements, and
  - your associated expenses are paid in Australian dollars

and you have:

- not made sustained losses
- not undergone a restructure within the year, and
- assessed your compliance with the transfer pricing rules.

This option only applies to eligible inbound loans and does not reduce the documentation requirements for other international related-party dealings including:

- outbound related-party interest-bearing loans and associated charges (see the low-level outbound loans option for eligibility)
- other international related-party financial transactions (for example, guarantees) and associated charges.

Materiality

Your total international related-party dealings represent less than or equal to 2.5% of total turnover for your Australian economic group and:

- the total turnover for your Australian economic group is not more than $100 million
- you do not have related-party dealings (either as expenses or as income) involving royalties, licence fees, or research and development arrangements totalling greater than $500,000 combined
- you have not made sustained losses
- you have not undergone a restructure within the year, and

- you have assessed your compliance with the transfer pricing rules.

This option does not reduce the documentation requirements for the following transactions:

- international related-party dealings involving royalties, licence fees, or research and development arrangements
- international related-party financial transactions (for example, loans and guarantees) and associated charges
- international related-party dealings of a capital nature.

Technical services

Your income from and expenditure on technical services must not be more than 50% of the total international related-party dealings of your Australian economic group and you have:

- a mark-up on costs of the relevant services of
  - 10% or less for services you receive
  - 10% or more for services you provide
- not made sustained losses
- not undergone a restructure within the year, and
- assessed your compliance with the transfer pricing rules.

This option does not reduce the documentation requirements for international related-party dealings that are not technical services dealings.

Low-level outbound loans

You have a combined cross-border loan balance of $50 million or less for your Australian economic group at all times throughout the financial year and:

- for each of your outbound loans
  - your interest rate is no less than the following rate for each of the income years which the loan is in effect
    - 5.81% in the 2024 income year
    - 5.61% in the 2025 income year
  - the funds actually provided by you under the loan are Australian dollar funds and this is reflected in your loan agreements
  - your associated expenses are paid in Australian dollars

and you have:

- not made sustained losses

- not undergone a restructure within the year, and
- assessed your compliance with the transfer pricing rules.

This option only applies to eligible outbound loans and does not reduce the documentation requirements for other international related-party dealings, including:

- inbound related-party interest-bearing loans and associated charges (see the low-level inbound loans option for eligibility)
- other international related-party financial transactions (for example, guarantees) and associated charges.

4.4 Hybrid mismatches

Hybrid mismatch arrangements exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions.

The rules apply to payments that give rise to hybrid mismatch outcomes which can be summarised as:

1. deduction or non-inclusion mismatches where a payment is deductible in one jurisdiction and non-assessable in the other jurisdiction
2. deduction or deduction mismatches where the one payment qualifies for a tax deduction in two jurisdictions
3. imported hybrid mismatches where receipts are sheltered from tax directly or indirectly by hybrid outcomes in a group of entities or a chain of transactions.

These rules operate in Australia to neutralise hybrid mismatches by cancelling deductions or including amounts in assessable income.

The rules also contain a targeted integrity provision that applies to certain deductible interest payments, or payments under a derivative, made to an interposed foreign entity where the rate of foreign income tax on the payment is 10% or less.

Subject to some exceptions, the rules apply to certain payments after 1 January 2019, and to income years commencing on or after 1 January 2019.

The rules apply to payments between:

- related parties
- members of a control group
- parties under a structured arrangement.

The hybrid mismatch rules do not have a de minimis or materiality threshold.

For advisors to private groups, 'issue spotting' will involve transactions between related entities that involve the three circumstances above.

4.5 Taxation of financial arrangements

For most private groups, unless they have made an election to apply the rules, the taxation of financial arrangements (**TOFA**) rules in Division 230 should not apply. However, for large private groups, say Top 500 groups, breaching the de minimis tests could be a ‘sleeper’ issue.

The following entities are subject to TOFA on a mandatory basis:

- an authorised deposit-taking institution (ADI), a securitisation vehicle or a financial sector entity with an aggregated turnover of $20 million or more
- a superannuation entity, a managed investment scheme or a similar scheme under a foreign law if the value of the entity's assets is $100 million or more
- any other entity (except an individual) that has the following:
  - aggregated turnover of $100 million or more
  - assets of $300 million or more
  - financial assets of $100 million or more.

In determining whether TOFA applies in a particular income year, the entity must determine whether it satisfies the thresholds at the end of the immediately preceding income year. However, if the entity is newly created, the thresholds are tested at the end of the year in which the entity comes into existence.

Once TOFA applies to an entity, it will continue to apply to that entity, even if its aggregated turnover, value of assets or value of financial assets subsequently falls below the requisite threshold.

5. Conclusion

The purpose of this paper was to give private groups and their advisers a clear, practical view of the why, when, and how of effective tax governance in Australia and to identify tax issues that are not just for the “big end of town”.

Beyond the drawcard of less ATO scrutiny (and the resulting time and cost savings), robust governance improves decision-making, reduces error and key-person risk, strengthens reputational standing, and supports transaction readiness. In combination, these benefits make the organisation run better.

With the “big end of town” tax rules, private wealth advisors do not need to be experts but need to be able to ‘issue spot’ to conduct further research and investigation into the client’s affairs or to recommend specialist advice.

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