

## Australian Taxation Office issues Taxpayer Alert on non-arm's length arrangements and schemes connected with the DEMPE of intangible assets

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The Australian Taxation Office (ATO) has issued the long-anticipated [Taxpayer Alert TA 2020/1](#), on aspects of intangibles migration out of Australia (TA 2020/1 "Non-arm's length arrangements and schemes connected with the development, enhancement, maintenance, protection and exploitation of intangible assets (DEMPE)").

In brief, the ATO has identified that Australian companies are entering into various arrangements with (typically related) foreign companies involving the transfer of intellectual property (IP) developed in Australia into foreign jurisdictions using techniques such as:

- ▶ Bifurcation of intangible assets where an Australian company transfers the rights to use existing IP to develop future IP to a related foreign company (and receives income derived from exploitation of the existing IP). In addition, the Australian company performs contract research and development (R&D) services for the foreign related company, which then owns the new IP and receives income from the exploitation of the new IP
- ▶ Cost contribution agreement
- ▶ Contract R&D for foreign companies

The ATO considers that Australian participants in these arrangements are not properly recognizing Australian obligations under transfer pricing rules, capital gains tax, outcomes under the capital allowance rules and the general anti-avoidance rule.

The following examples from the ATO Taxpayer Alert (see ATO Taxpayer Alert link above for illustrated versions) highlight the transactions that could be challenged from the perspective of the commercial nature of the arrangement to the Australian entity and/or not being aligned with OECD<sup>1</sup> guidelines on DEMPE.

► *Arrangement 1 - arrangements involving the bifurcation of intangible assets and mischaracterization of Australian DEMPE activities*

- AusCo continues to employ the same specialized staff and use its expertise and assets associated with the existing IP to manage, perform and control DEMPE activities associated with the new IP.
- ForCo manages and performs limited activities and assumes limited risks in connection with the new IP.
- At the time the contract R&D arrangement commences, ForCo does not have sufficient assets or employ sufficient suitably qualified staff to properly or primarily manage, perform or control the DEMPE of the new IP.
- AusCo is remunerated by ForCo on a cost plus basis.

► *Arrangement 2 - arrangements involving the non-recognition of Australian DEMPE activities*

- The expected benefits received by AusCo under the Cost Contribution Arrangement (CCA) Agreement do not reflect the value of AusCo's contributions to the CCA including the extent or character of functions performed, assets used and risks assumed by AusCo in connection with the intangible assets covered by the CCA.

- AusCo's proportionate share of overall contributions to the CCA is not consistent with the expected benefits received. Specifically, AusCo does not obtain benefits proportionate with its contributions to the derivation of global income from the exploitation of the IP assets covered by the CCA, where those intangible assets are used and exploited by ForCo and international related parties in other jurisdictions.

The underlying principles have already been identified in the ATO Diverted Profits Tax guidance (example 1 in particular is almost identical).

While these types of tax issues have been around for a long time, the Taxpayer Alert was likely brought on by a renewed ATO focus on IP as an area of risk and a perceived increase in these types of arrangements. It is also part of a broader more systematic ATO initiative foreshadowed during 2019, about offshore migration of IP out of Australia.

Further ATO guidance is expected in 2020 to outline the ATO's perception of risks related to intangibles migration, evidence the ATO expects that taxpayers should maintain and the practical application of the transfer pricing law to those high-risk arrangements. This will allow taxpayers to manage their risk profile related to IP migration.

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## Endnote

1. Organisation for Economic Co-operation and Development.

For additional information with respect to this Alert, please contact the following:

**Ernst & Young (Australia), Sydney**

- ▶ Sean Monahan                      sean.monahan@au.ey.com
- ▶ Anthony Seve                      anthony.seve@au.ey.com

**Ernst & Young (Australia), Perth**

- ▶ Andrew Nelson                      andrew.nelson@au.ey.com

**Ernst & Young LLP (United States), Australian Tax Desk, New York**

- ▶ David Burns                      david.burns1@ey.com

**Ernst & Young LLP (United Kingdom), Australian Tax Desk, London**

- ▶ Naomi Ross                      naomi.ross@uk.ey.com

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