Australia's Top 1,000 Combined Assurance Program: the evolving need for strong governance in tax

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The evolving compliance relationship for business taxpayers

The historical approach to business tax compliance – and the relationship between taxpayer and tax authority on which it is based – is evolving.

Alongside widespread digitalization of end-to-end compliance processes, a new approach to assessing compliance is being implemented by tax authorities in many, mainly mature, economies. These programs – which can be described broadly under the banner of "compliance assurance" aim to test several elements of a business taxpayer's approach to tax governance, tax planning and overall levels of tax compliance, all in the context of a wide-ranging review of often several tax years.

While these programs are currently the preserve of the largest and most sophisticated tax authorities, there should be no doubt that their incidence will increase over time.

The names of these programs vary and include the Top 1,000 Combined Assurance Program[1] (in which Combined Assurance Reviews (CARs) occur) in Australia, the Tax Compliance Management System (TCMS) program in Germany, the Tax Governance Framework (TGF), Tax Risk Management and Control Framework for Income Tax (CTRM) and Goods and Services Tax (GST) Assisted Compliance Assurance Programme (ACAP) in Singapore and the Business Risk Review Plus (BRR+) in the UK, among others.

[1] The Top 1,000 Combined (income tax and goods and services tax) Assurance Program was established to replace the Top 1,000 tax performance program that ended in December 2020.

Programs of this type, while involving close and detailed scrutiny of a taxpayers' affairs, are not, strictly speaking, tax audits. They are reviews, but companies should be under no false impressions: poor outcomes will undoubtedly lead to further compliance activity and potentially audit. Poor outcomes may also lead to increased level of scrutiny in subsequent reviews until such time as the company can improve its ratings with the revenue authorities – often during the course of a second review, a cycle that may take some years to occur.

In some cases – such as Singapore's ACAP (originally covering only GST, but now expanding with CTRM to cover corporate income taxes) the model is one of incentives for desired behavior and disincentives for non-desired behavior: businesses that achieve a certain status and act in a more transparent way with the Inland Revenue Authority of Singapore (IRAS) will typically experience a reduction of compliance interventions and inquiries, expedited tax refunds, and access to a dedicated team to handle rulings, for example. Not all such programs deliver such apparent incentives though; many feel compliance programs are all stick.

Interestingly, not all compliance programs are mandatory in nature. The Dutch Horizontal Monitoring and Singapore's ACAP and CTRM are voluntary. Others (such as Australia's Combined Assurance Program) and the UK Business BRR+ are not. Programs also differ in terms of which taxpayers they focus on. Virtually all include some kind of segmentation, applying different levels of scrutiny to different sizes of company, typically using annual group revenues as a threshold.

Wide ranging reviews of this nature are one of the fastest-growing tax issues impacting MNCs today. 2021 saw the first full year of Australia's Combined Assurance Program, while 1 July 2021 saw the introduction of the German program, and Singapore's ACAP supplemented by CTRM. Taxpayers should understand that such programs are bound to replicate to other countries in due course. A first stage of this will be for other large and mature economies (say, those in the G20, for example) to adopt them. Then, a second tier of jurisdictions – those smaller in size than the G20 nations in terms of GDP – are likely to adopt the approach.

Businesses should therefore assure they are aware of this evolving trend generally, understand the rules and approaches of jurisdictions specifically, and continue to assess the uptake of such programs as part of their ongoing monitoring of tax policy and administrative issues in the markets they operate in. There is an opportunity here to learn from the experiences of business in those jurisdictions with longer term and mature programs (by way of example, the Australian Combined Assurance Program is the successor to the Streamlined Assurance Review program that ran for several years). By doing so, taxpayers will be far better prepared for any scrutiny once it does commence. They will know what to expect, how to react and importantly, how to understand which cycle of review they are likely to be in. As an example, Australia's programs tend to run on a three-to-four-year cycle. Companies who have therefore not been reviewed in the previous three years should be well prepared and expect to receive such attention in year four.

Understanding the ATO’s broad objectives

The Australian Taxation Office (ATO) has a strong focus on the largest corporate groups operating in Australia, which they define as publicly listed, multinational enterprises and private companies with total Australian income of greater than AUD$250 million.

The ATO focuses on whole-of-taxpayer profiling and assurance approach using a methodology known as “justified trust” that helps them understand the taxpayer's business model, approach to identification and management of risk, and any planning opportunities the taxpayer may have. To achieve justified trust, the ATO seeks objective evidence that would lead a reasonable person to conclude a particular taxpayer paid the right amount of tax[2]. This is a higher level of assurance than an approach based upon identification and assessment of risk confirmation that certain risks do not arise. First defined by the OECD, Australia is one of several jurisdictions clearly leading the world’s tax authorities in making justified trust an operational concept.

Implicitly, a level of certainty can be ascertained from the CAR outcomes. The ATO assigns an assurance rating to each of several components of a taxpayer’s affairs they review, as well as an overall assurance rating, with the goal for taxpayers being a “high” assurance rating overall. Generally speaking, if a taxpayer achieves a “high” assurance rating, they should generally experience a lower level of compliance interventions between CAR cycles and a “lighter touch” CAR in subsequent years.

The Combined Assurance Program in more detail

Broadly, the Combined Assurance Program applies to the largest 1,000 business taxpayers operating in Australia – but excludes from this segment the largest 100 taxpayers, who are covered under a separate program involving continual, rolling reviews.

Under the program, the ATO will review a block of three to four years of income tax returns and one year of GST returns, and the ATO aims to complete the review within a six-month timeframe. This is the first cycle of the Combined Assurance Program, which is the successor to the Streamlined Assurance Review (SAR) program which initially targeted income tax but , with GST SARs commenced towards the conclusion of the program. It is understood that the ATO aims to conduct around 300 CARs each year.

Who’s in scope?

While not a bright line test, the Combined Assurance Program covers large public and multinational organizations with turnover in Australia in excess of A$250 million (approx. US$178 million). This also includes taxpayers that the ATO has engaged with through prior income tax and GST assurance reviews. As noted, it does not include taxpayers who are already reviewed in the ATO’s Top 100 Program[3] where they receive continual, rolling review.

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[2] https://www.ato.gov.au/business/large-business/justified-trust/

[3] https://www.ato.gov.au/Business/Large-business/Top-100-justified-trust-program/

Foundational pillars

The program focuses on and measures four key pillars that together form an integral part of justified trust:

1. **Understanding a taxpayer's tax governance framework:** can the taxpayer adequately confirm the existence, application and testing of a tax risk management and governance framework?

2. **Identifying tax risks flagged to the market:** to what degree has the taxpayer addressed risks or concerns that the ATO has communicated to taxpayers, for example, through taxpayer alerts, practical compliance guidelines or public rulings?

3. **Understanding significant and new transactions:** what significant or new transactions did the taxpayer experience or implement during the years being reviewed, and what were the tax outcomes?

4. **Understanding why the accounting and tax results vary:** what streams of economic activity does the taxpayer exhibit, and how has each been treated for taxation and excise purposes? In an income tax context, fundamental to this pillar is an examination of the taxpayer's workpapers for their income tax returns and associated schedules, as well as an understanding of adjustments made in the reconciliation of accounting profit to taxable income and related party dealings. The ATO may also review the Effective Tax Borne (ETB) and global value chain to understand why accounting and income tax results vary. In a GST context, this pillar involves comparing sales, acquisitions and other data to net GST paid, and reconciling the GST paid to the financial statements.

Differences in approach: income tax versus GST

In the income tax stream of the CAR, the approach taken by the ATO is assurance-based, with the ATO asking the question "are we assured that the taxpayer has paid the correct amount of income tax?" The GST stream takes a more risk-based approach, whereby the ATO are essentially triaging taxpayers for future GST assurance-based reviews.

The focus on tax governance

Governance is a fundamental pillar in the justified trust methodology. Indeed, governance outcomes can impact the level of assurance gained overall in the income tax stream of the CAR. If a taxpayer is unable to achieve a "Stage 2" rating for governance (see below for further detail), they will be unable to achieve a "high" level of assurance overall.

In reviewing governance frameworks, the ATO program guidance makes clear reference to the expectation that taxpayers will need to "have considered [ATO] guidance and have undertaken a gap analysis of current policies and procedures against [the ATO] guide".

This phenomenon is further illustrated in guidance provided to company Directors:

> *"If we need to assess your tax governance processes, having a strong tax control framework within the company gives us confidence that tax risks are well managed. This means it may take less time to assess whether your controls align with the principles outlined in this guide. Alternatively, the absence of a strong tax control framework may signal to us that more resources are necessary to fully assess tax risks."*

In fact, the Combined Assurance Program utilizes a distinct rating system when assessing each company:

- Stage 1: A tax control framework exists
- Stage 2: The tax control framework is designed effectively
- Stage 3: The tax control framework is working in practice
- Red flag: The tax control framework is not evidenced, or the ATO has significant concerns

The governance stages in detail

Taxpayers reach Stage 1 when they can provide the ATO with objective evidence that a tax control framework exists. This includes one or more of the following elements:

- A board endorsed tax policy documentation describing how the organization identifies and manages tax risk
- Documented procedures for preparing returns, including income tax returns and Business Activity Statements
- A testing program to validate the operating effectiveness of the tax control framework

Importantly, the ATO will not accept slide presentations, draft policies or narrative descriptions of the tax control framework as sufficient evidence that Stage 1 has been reached, instead looking for actual policies and procedures. In this regard, the ATO are seeking to be "shown" the governance framework exists, not "told".

If a company completes Stage 1, the ATO in Stage 2 will then look for objective evidence that the tax control framework is designed effectively, recommending that the taxpayer prepares a gap analysis that compares their existing framework against those controls set out in the ATO's *Tax Risk Management and Governance Review Guide*[4] and, for GST the ATO's *GST Governance, Tax Testing and Transaction Testing Guide*[5] . If gaps do exist, the taxpayer is asked to describe any compensating controls, as well as to document why particular aspects of the guidance may not be applicable to the company's circumstances.

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[4] Tax risk management and governance framework guide, ATO, April 2018: https://www.ato.gov.au/Business/Large-business/In-detail/Key-products-and-resources/Tax-risk-management-and-governance-review-guide/

[5] GST governance, data testing and transaction testing guide, ATO, November 2020: https://www.ato.gov.au/Business/Business-bulletins-newsroom/GST/GST-governance,-data-testing-and-transaction-testing-guide/

Stage 3 represents the ATO's highest rating for tax governance and provides a strong foundation for the ATO's overall level of confidence in the taxpayer, as well as "supporting less intense future engagements". To complete this stage, the taxpayer must be able to demonstrate that their tax control framework has not only been designed effectively but is also operating as intended. This stage, says the ATO, can be evidenced by the implementation of a periodic tax controls testing program and reports to the company Board describing the outcomes of such testing. The program scope should at a minimum include testing of the justified trust controls set out in the ATO guidance. Additionally, evidence of the program could also include:

- Reference to the tax internal controls testing program in the tax control framework
- An extract of the testing program for the next 3-5 years setting out the scope of tax controls testing (controls and taxes reviewed)
- Details of who is conducting the review (and the extent of their independence from the taxpayer)
- A description of the testing methodology to be applied to gather evidence
- The expectations of the Board with respect to reporting

Importantly, control owners (such as the company's tax or finance teams) testing their own controls does not provide the ATO with the required level of independence. The controls must be tested by a team independent of the control owner – for example by a statutory audit, internal audit or other external advisor.

The ATO may assign a "red flag" when they feel the taxpayer cannot provide evidence to demonstrate a tax control framework exists or if they have significant concerns with the effectiveness of the company's tax risk management and governance. Such concerns, says the ATO, may include the taxpayer's overall approach to tax compliance, for example, where there are significant errors that an in-place tax control framework is not detecting. Importantly, the ATO will communicate their concerns before issuing a red flag rating.

Timing and years covered in a CAR and review process

Under the Combined Assurance Program, the ATO typically reviews a block of three to four years of income tax returns and (typically) one year of GST returns. ATO program guidance states that taxpayer will be notified before a CAR commences and that the taxpayer will be sent a request for information to which they must respond. On receipt of the information, the ATO may ask additional questions where required.

At the outset of the review, the taxpayer is encouraged to consider whether to make a voluntary disclosure in respect of any errors or omissions in the returns that may have occurred within the scope of the years under review. Here, program guidance notes that the ATO may exercise its discretion to remit any applicable shortfall penalty to nil, unless the taxpayer is deemed to have acted recklessly or intentionally disregarded the law. Taxpayers may make a voluntary disclosure at any time during the program but disclosing as soon as possible may reduce the potential exposure.

What the taxpayer needs to share

In order to achieve high levels of assurance in the income tax stream, or low-risk ratings in the GST stream, it will be important for taxpayers to provide well thought-out and transparent responses that are supported by objective evidence. This requires a degree of preparation, which is made somewhat simpler by a level of predictability in the ATO's initial request for information.

For income tax, broadly, information required by the ATO spans 15 categories. Not all 15 categories will require detailed responses, depending on the taxpayer's industry and fact pattern during the period under review. The categories are as follows:

1. **Financial information and tax reconciliation** should be submitted, centering on a detailed statement of taxable income with supporting working papers which indicate the nature of adjustments made to accounting profit to determine taxable income. An explanation supporting the nature of adjustments where income tax adjustments are specific to the taxpayer's industry, business or a particular transaction should also be included. An explanation of the differences between accounting and tax groups and why the starting profit in the tax return differs from the audited financial statements (if it does) should further be provided.

2. **Supporting working papers to the tax return(s), schedules and disclosures** should be submitted. Working papers should show how disclosures were prepared, as well as any supporting calculations. Supporting work papers also include those for the international dealings schedule, 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 Capitalization calculations should include a balance sheet for the tax consolidated group (TCG) or multiple entry consolidated (MEC) group. This should show how average assets, non-debt liabilities and average adjusted debt are calculated, and working papers that show how debt deductions were calculated should be included.

   A summary of the fixed asset register and any relevant policies and procedures should be available, including how effective lives are determined and reviewed for each major class of asset, and a reconciliation between the tax and accounting fixed asset register.

3. **Tax effect accounting working papers** should be submitted, including an explanation of why deferred tax balances have been recognized and any reconciliation of tax effect working papers to the tax effect disclosures made in the financial statements, as well as an explanation for any unders or overs.

4. **Tax governance and risk management information is required.** The ATO notes that taxpayer responses should indicate whether the taxpayer has considered ATO guidance on tax governance[6] (as described extensively above), as well as whether the taxpayer has undertaken a gap analysis of current policies and procedures against the ATO guide. Responses should further consider why any policies and procedures differ from ATO guidance, as well as providing 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, says the ATO.

5. **A Group structure diagram** or a written explanation showing all related entities operating in Australia should be submitted, even if such entities are outside of the tax consolidated or multiple entry consolidated (MEC) group. These documents should also indicate any overseas subsidiaries or permanent establishments of the Australian group, all intermediary holding companies of the Australian group and any other offshore related entities who transact with the Australian group.

6. A description of any **new businesses and transactions,** and the treatment of any income or expenses arising from the new activities should be submitted.

7. Details of any **Restructures** should be submitted, if they occurred during the review period (whether they are domestic or cross border), the treatment of any income, or expenses / losses arising from the restructure itself (if any) and any changes in underlying income and expenditure as a result of the restructure.

8. **Acquisition of an interest in another entity must be reported.** Where an acquisition results in an entity joining a TCG or MEC group, information that demonstrates how tax values of assets owned by joining entities have been determined will be requested. Where the acquisition is part of a global acquisition, there may be a request for evidence indicating the relative market value of the Australian entity or business acquired.

9. **Asset disposals** must be documented. If assets were disposed of during the review period, evidence of both the proceeds and how the cost base was determined may be requested. Where there is a disparity between the accounting gain or loss on disposal and the tax gain or loss on disposal, an explanation of why there is a differential should also be included.

10. **Funding arrangements must be set out.** Where funding is what the ATO describes as “vanilla” (for example, loans with third party banks or ordinary equity), the taxpayer should provide a brief response confirming such facts. Where the funding involves more complicated or unusual financial arrangements or related parties, a more detailed response is required, including information detailing the relevant term, the accounting and tax treatments and any supporting legal documentation.

[6] https://www.ato.gov.au/business/large-business/in-detail/key-products-and-resources/tax-risk-management-and-governance-review-guide/

11. **Taxation of financial arrangements (TOFA) should be reported:** Where relevant, the taxpayer should provide a table listing the different types/categories of financial arrangements in place in each review year, and the associated gains and losses recognized each financial year for each type/category. Where the TOFA treatment is different from the accounting treatment, the taxpayer should provide additional explanation of how the gains and losses are identified or calculated.

12. Where **tax losses** have been incurred, the taxpayer under review should submit a detailed summary of any available and/or utilized tax losses showing year of incurrence, year of utilization, and whether these are group losses or transferred losses. Where losses were utilized during the period of review, but those tax losses arose in respect of income years which have not previously been reviewed by the ATO, the ATO may request additional explanation supporting the veracity of those losses.

    Further, detailed work papers that support the satisfaction of either the continuity of ownership test (COT) or same business test (SBT) should be submitted.

    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 should be submitted.

13. Where the taxpayer group includes **Controlled Foreign Companies** (CFCs), working papers supporting the attribution of income (or explaining why no attribution is necessary) should be submitted in respect of each CFC. Sufficient information should also be submitted regarding 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.

14. **Offshore branches or permanent establishments (PE's) should be reported:** Where offshore branches or PE's exist, the taxpayer is required to provide an explanation of why the PE exists, Transfer pricing documentation in respect of PE's. Commonly, information on whether any of the arrangements of the type described in Taxpayer Alert 2016/7 (*Arrangements involving offshore permanent establishments*[7]) exist in dealings with the PE will be requested.

15. **Transfer pricing documents** will often be requested. This documentation should cover all offshore-related party transactions including financing transactions and dealings with offshore PE's.

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[7] https://www.ato.gov.au/law/view/pdf/tpa/ta2016-007.pdf

For GST

In addition to the above information, the ATO will provide a list of tax alerts and practical compliance guidelines (similar ATO guidance) for both income tax and GST, requesting the taxpayer to explain whether the relevant guidance applies to their circumstances. In circumstances where the governance does not apply, it is important that rather than provide a minimalistic "no" response, a brief description of why the guidance does not apply is included by the taxpayer.

Finally, the *manner* in which the taxpayer responds to ATO requests is also taken into account in arriving at the CAR outcomes. Here, the ATO considers the provision of timely and complete responses to their requests may indicate the presence of stronger tax governance frameworks and a willingness to engage with them in order to obtain better review outcomes. Where timeliness, completeness and overall willingness to engage does occur, the ATO notes that they will seek to tailor their engagement with the taxpayer through shorter reviews, shorter combined tax assurance reports, and reduced compliance interventions – though these benefits are neither concretely documented nor enshrined in law.

Review outcomes and post-review documentation

Following a CAR, the ATO will share their findings with the taxpayer. The findings will include discussing the areas where the ATO are content that the right amount of income tax has been paid during the years under review, the identification of any tax risks, the ATO's assessment of the taxpayer's GST risk and whether the taxpayer is to be referred for a Top 1,000 GST assurance review. The findings include specific risk ratings for both the income tax and GST components of the review.

For the income tax component, the ATO may recommend specific actions the taxpayer should take to address identified tax risks, and the ATO may follow up on these recommendations in a subsequent compliance activity – for example, a Next Actions Review (being a follow-on program for those taxpayers with items of low or medium assurance) or the subsequent CAR.

For the GST component, the ATO may recommend specific actions to address identified GST risks and again, may follow up on those recommendations at a future point. Where specific GST concerns are identified, the taxpayer may be further referred for a Top 1000 GST assurance review.

Forewarned is forearmed

Tax authorities generally have two levers at their disposal to increase tax compliance and/or reduce any behaviors that they deem to represent unacceptably aggressive tax planning: they can either increase enforcement levels and/or encourage taxpayers to change their behaviors by offering some form of reward to those who do.

While few tax authorities (if any) are actively reducing their enforcement activity, many are now pairing enforcement with programs similar to Australia's Combined Assurance Program that pair deep technical analysis of tax and financial outcomes with a comprehensive review of tax governance and tax risk management activities.

By measuring the behaviors of taxpayers, tax authorities can effectively reward those who are compliant, transparent and acting in a more collaborative way, while simultaneously targeting enforcement efforts more closely on those who don't – or "resourcing to risk" as it can be described.

It is clear from program guidance that the ATO expects all taxpayers to have a good understanding of their expectations in regard to tax assurance - including those set out in publications such as the recently published *GST Governance, Data Testing and Transaction Testing Guide,* and the earlier *Tax Risk Management and Governance Review Guide*. It is our experience that taxpayers selected for a CAR will be in a more advantageous position if they can demonstrate such guidance has been referred to and utilized by the company during any design, review, testing or enhancement of their overall tax governance approach – particularly given governance outcomes can influence overall review outcomes.

Assurance programs present an important new phase in the taxpayer-tax authority relationship, and all business tax leaders should be aware of them, factoring them into both day-to-day operations as well as longer term compliance and planning strategies.

The views reflected in this article are the views of the author and do not necessarily reflect the views of the global EY organization or its member firms