SW Accountants & Advisors

Take the lead

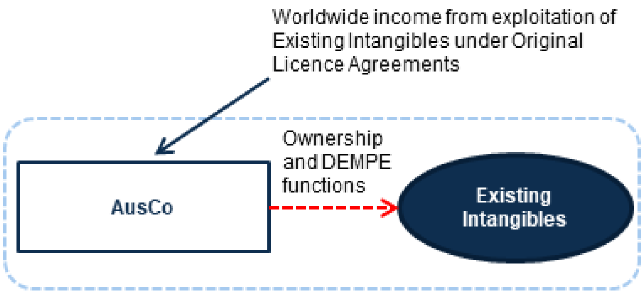
ATO issues final risk guideline on Intangibles migration arrangements

12/02/2024

Appendix 1 of the Guideline includes 15 examples of Intangibles migration arrangements to illustrate how the RAFs should be applied by taxpayers. To facilitate readers' understanding, three examples that focus on centralisation of intangibles assets in various risk categories are presented below.[3]

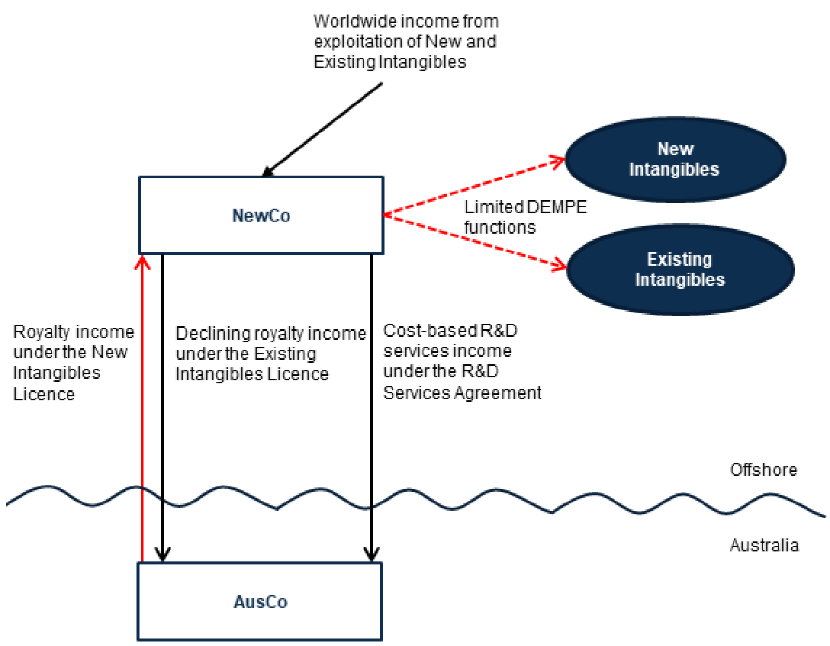
Example 1

Original arrangement



- AusCo is part of a global group that manufactures, markets and sells goods and provides services associated with those sales.
- AusCo and its IRPs exploited valuable intangible assets in undertaking their operations. The intangible assets include patents, know-how, trademarks, copyright and other intangible assets or rights.
- AusCo owned, managed and controlled DEMPE activities associated with the Existing Intangibles and assumed associated risks.
- AusCo derived royalties from its IRPs for the exploitation of the Existing Intangibles globally under licence agreements between AusCo and its IRPs (Original Licence Agreements).

Decision to centralise intangible assets



[3]Other examples in the Guideline touch on bifurcation of intangibles, non-recognition of Australian intangibles and DEMPE activities, migration of pre-commercialised intangibles, cost contribution arrangement, contract R&D arrangements etc.

AusCo and the global group decided that the Existing Intangibles and New Intangibles should be centralised in a new entity (NewCo) in a foreign jurisdiction. NewCo was expected to qualify for a tax concession for income derived from intangible assets. The New Intangibles would initially be adapted from the Existing Intangibles.

AusCo entered into a licence agreement (Existing Intangibles Licence) with NewCo to transfer the rights to the Existing Intangibles to NewCo. NewCo would pay royalties to AusCo for the right to exploit and sub-licence the Existing Intangibles to other IRPs, including AusCo.

The Original Licence Agreements between AusCo and its IRPs were terminated. AusCo and its IRPs subsequently executed a master Licence Agreement with NewCo (New Intangibles Licence), under which NewCo received worldwide royalty income from the rights to exploit the Existing Intangibles and any New Intangibles developed.

NewCo and AusCo also entered into a contract R&D Services Agreement under which AusCo would provide R&D services to NewCo in relation to the New Intangibles in return for a cost-based fee. Any New Intangibles that were developed as a result of the R&D undertaken by AusCo would be owned by NewCo.

New arrangement following centralisation

Year 1

- AusCo's functional profile did not substantially change.
- Existing Intangibles - while the development ceased, AusCo continued to perform and control the management and exploitation of the Existing Intangibles.
- New Intangibles - AusCo continued to employ the same specialised staff and use its expertise and assets to manage, perform and control DEMPE activities.
- NewCo managed and performed limited DEMPE activities, assumed limited risks and received royalty income in connection with the Existing Intangibles and the New Intangibles

Year 2

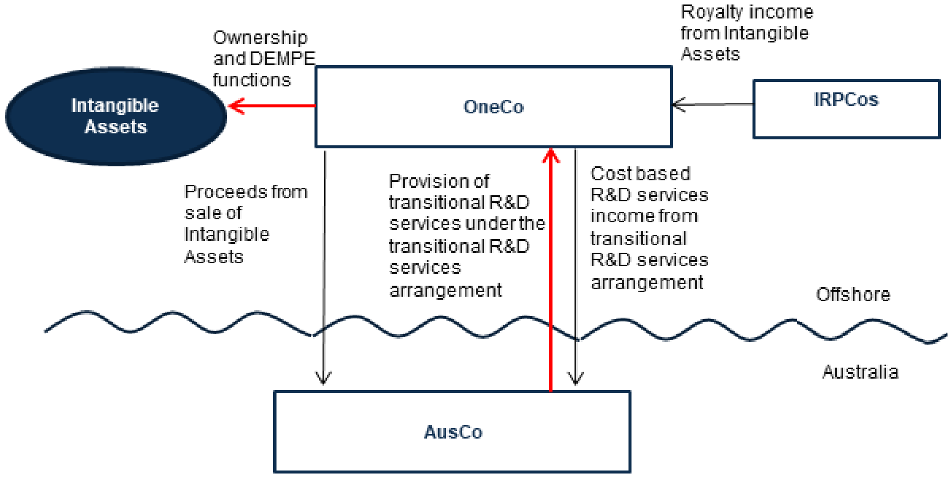
- AusCo continued to undertake the majority of the DEMPE activities while receiving cost-based remuneration under the R&D Services Agreement and declining royalties under the Existing Intangibles Licence.
- NewCo hired some additional staff and acquired additional assets to assist it in the management of DEMPE activities (not sufficient to wholly manage, perform or control the DEMPE activities and assume the associated risks). NewCo received royalty income derived from the Existing Intangibles and the New Intangibles

Example 10

Original arrangement

Similar to Example 1.

Decision to centralise intangible assets



AusCo and the global group determined that the Intangible Assets should be centralised in an entity (OneCo) in a foreign jurisdiction, which is the global group's largest market in terms of third party product sales.

Rather than licensing as in Example 1, AusCo entered into a Sale Agreement with OneCo to transfer the Intangible Assets to OneCo. Meanwhile, the Original Licence Agreements between AusCo and its IRPs were novated to OneCo with OneCo as the licensor. As a result, OneCo received worldwide income from the exploitation of the Intangible Assets.

AusCo discontinued with manufacturing and R&D functions and continued with distribution functions only.

AusCo entered into a transitional R&D Services Agreement with OneCo, under which AusCo would provide R&D services to OneCo in relation to the Intangible Assets in return for a cost-based fee (to assist OneCo as it built up the necessary capability and expertise to undertake these functions). Any New Intangibles that were developed as a result of the R&D undertaken by AusCo would be owned by OneCo.

New arrangement following centralisation

Year 1

AusCo performed R&D activities under the direction and oversight of OneCo, which employed sufficiently skilled staff to manage DEMPE activities.

Year 2

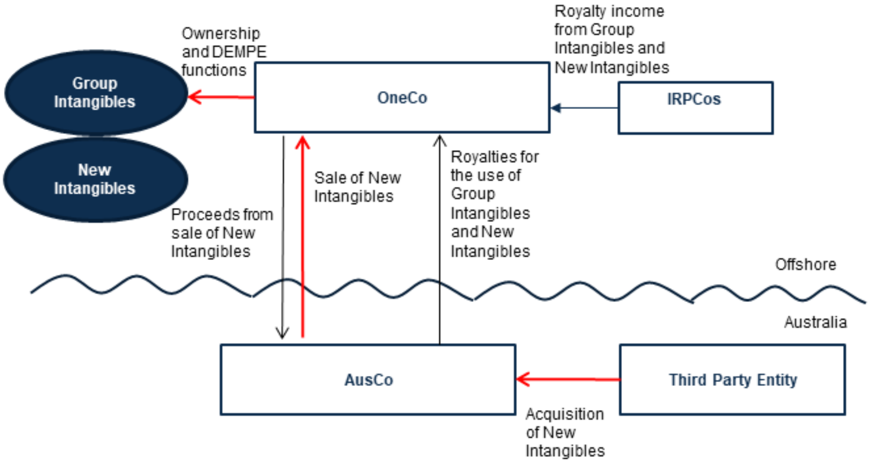
OneCo had employed additional staff and acquired additional assets to assist in the management of DEMPE activities for the Intangible Assets (sufficient to allow OneCo to wholly manage, perform and control the DEMPE activities connected with the Intangible Assets and assume all associated risks). The R&D Services Agreement between AusCo and OneCo was terminated.

Evidence

A number of commercial and legal factors were considered in making the decision to centralise. AusCo maintained documentation to substantiate the commercial rationale underpinning its decision to centralise and support the arm's length nature of the pricing and terms of all arrangements in connection with the restructure, including, but not limited to, the Sale Agreement and the novation of the Original Licence Agreements.

Example 12

Original arrangement



Unlike Example 1 and 10, the Group Intangibles were originally centralised in a foreign related party, OneCo. OneCo had always owned, managed and controlled all DEMPE activities associated with the Group Intangibles. OneCo had material operations, including many specialised staff with the expertise and skill to manage, perform and control DEMPE activities.

AusCo did not perform DEMP activities with respect to any of the Group Intangibles, including R&D activities. AusCo paid a royalty to OneCo under a Royalty Agreement for the right to licence and exploit the Group Intangibles in its ordinary business operations.

Acquisition and transfer

AusCo acquired business assets from a third party Australian entity, including intangible assets (New Intangibles) considered to complement the global group's existing Group Intangibles.

Shortly after AusCo acquired the New Intangibles, it transferred the New Intangibles to OneCo.

OneCo had the appropriate expertise, staff and infrastructure to continue to own, manage and perform DEMPE functions with respect to the New Intangibles while AusCo did not. Following the transfer, AusCo did not perform any control functions relating to the DEMP activities.

AusCo exploited the New Intangibles in its ordinary business operations. AusCo and OneCo amended their existing Royalty Agreement to include the New Intangibles to the Group Intangibles licensed by AusCo under the Royalty Agreement. AusCo maintained evidence that substantiated the arm's length nature of the royalty paid under this agreement.

Risk assessment result

According to RAF Table 1 of the Guideline, the risk assessment on each of the three examples is as follows:

Risk assessment factor	Application of criteria		
	Example 1	**Example 10**	**Example 12**
Restructure or change	AusCo had licensed Intangibles to NewCo. Ausco continued to perform and control DEMPE activities for NewCo with respect to Existing Intangibles, as well as intangibles that were connected to the Existing Intangibles (New Intangibles).	AusCo sold the Intangibles Assest to OneCo and also novated Original Licence Agreements with IRPs to OneCo. Afterwards, AusCo entered into a transitional R&D service agreement with OneCo and continued to distribute products associated with the Intangible Assets.	Shortly after AusCo acquired the New Intangibles, it transferred the New Intangibles to OneCo. AusCo exploited the New Intangibles in its ordinary business operations following the transfer.
	5	**5**	**5**
Circumstances of the IRP	NewCo is a newly established entity with few employees. AusCo continued to perform and control DEMPE activities for NewCo with respect to Existing Intangibles as well as New Intangibles.	In Year 1, OneCo had qualified staff to manage DEMPE activities, but AusCo had a continued involvement in intangible assets it had previously developed. OneCo is located in a jurisdiction which has the largest market in terms of customer revenue from the products.	OneCo had always owned, managed and controlled all DEMPE activities associated with the Group Intangibles. OneCo had material operations, including many specialised staff with the expertise and skill to manage, perform and control DEMPE activities AusCo was not involved in the DEMPE activities of Group Intangibles post-transfer.
	15	**5 (10-5)**	**0**
Tax outcomes	NewCo was expected to qualify for concessional taxation on the income from the New Intangibles.		None of the risky tax attributes or outcomes apply.
	10	**0**	**0**
Tax outcomes	Had the New Arrangement not occurred, AusCo would have continued to own and derive income from the exploitation of the Existing Intangibles and the New Intangibles. Also AusCo would not have been required to pay royalties to NewCo for the use of the New Intangibles that AusCo developed.	As a result of the sale, OneCo, instead of AusCo, received worldwide income from the exploitation of the Intangible Assets.	Had AusCo not transferred the New Intangibles to OneCo, AusCo could have been entitled to the income from the exploitation of New Intangibles.
	10	**10**	**10**
Total Score and risk zone	**40** **red zone (higher risk)**	**20** **blue zone** **(lower to medium risk)**	**15** **green zone (lower risk)**

On the basis that the centralisation occurred in the current year, RAF Table 2 will be relevant in subsequent years after centralisation.