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2 October 2026

Dear Sir/Madam,

PCG 2026/D4 Royalty characterisation of payments relating to intermediation or distribution arrangements – ATO compliance approach

CPA Australia is Australia's leading professional accounting body and one of the largest in the world. We represent the diverse interests of more than 176,000 members in over 100 countries and regions. We make this submission in response to the ATO's Draft **PCG 2026/D4 Royalty characterisation of payments relating to intermediation or distribution arrangements – ATO compliance approach** (draft PCG) on behalf of our members and in the broader public interest.

Executive summary

CPA Australia supports practical guidance that gives taxpayers confidence about how the Australian Taxation Office (ATO) will allocate compliance resources. However, the draft PCG should be revised before finalisation because several features may classify ordinary commercial arrangements as higher risk, impose information requirements that taxpayers cannot reasonably satisfy, and encourage outcomes that are not closely aligned with the underlying legal question.

The central concern is that the risk framework may operate as a de facto substantive rule. A compliance rating should not pressure a taxpayer to recognise a royalty, increase Australian profitability or obtain commercially unavailable offshore information merely to avoid an intermediate or high-risk rating. The final guideline should instead distinguish clearly between legal characterisation, transfer pricing outcomes and compliance risk, and should provide workable pathways for taxpayers to substantiate positions across contemporary software, cloud and subscription models.

Key comments and recommendations

We make the following key comments and recommendations:

- clarify prominently that risk ratings do not determine the legal character of a payment or create a presumption that a royalty exists;
- broaden the green zone to accommodate ordinary Software as a Service (SaaS), cloud, digital delivery and reseller arrangements where the Australian intermediary does not obtain or exercise economically significant intellectual property rights;
- provide practical apportionment principles and worked examples for mixed payments, using terminology consistent with TR 2026/2;
- reconsider the 75 per cent residual amount, 50 per cent undissected payment and 10 per cent operating margin thresholds, supported by evidence and sector testing;
- simplify the residual amount calculation and permit reasonable alternative evidence, materiality thresholds and documented reasonable efforts where offshore cost data is unavailable;

- use the draft PCG's risk-zone terminology consistently and provide additional zone-specific examples covering common modern business models;
- clarify the scope of Schedule 1, the treatment of restructures, documentation and self-assessment expectations, and the consequences of not calculating a risk rating;
- apply the final compliance approach prospectively and provide a transitional period of at least 12 months from finalisation;
- explain how the draft PCG interacts with tax treaties, transfer pricing, anti-avoidance rules, existing ATO engagements and dispute resolution mechanisms; and
- undertake further consultation, publish supporting evidence and review the framework after an initial period of operation.

Please refer to Appendix A for our detailed discussion. If you have any queries, contact me at jenny.wong@cpaaustralia.com.au or Bill Leung, Tax Technical Advisor, at bill.leung@cpaaustralia.com.au.

Yours sincerely,

Jenny Wong

Jenny Wong
Tax Policy Lead

Appendix A

Detailed discussion

Introduction

CPA Australia welcomes the opportunity to comment on Draft Practical Compliance Guideline PCG 2026/D4 (draft PCG), released with Taxation Ruling TR 2026/2, which was published on 4 September 2026. The draft PCG explains the ATO's proposed compliance approach to the legal view expressed in TR 2026/2. Schedule 1 presently addresses software intermediation arrangements and may be supplemented by further schedules. Our comments below therefore focus principally on the operation of Schedule 1 while identifying issues relevant to the broader framework.

1. The risk framework may be mistaken for a substantive legal test

The draft PCG correctly states that its risk zones concern the allocation of compliance resources and do not determine whether a payment is legally a royalty. In practice, however, the design of the zones may cause taxpayers, auditors and other stakeholders to treat the ratings as proxies for the correct legal outcome. This risk is particularly acute where a lower-risk rating depends on recognising a minimum royalty or satisfying a profit-based exception.

Recommendation 1: The final PCG should state prominently, and repeat within each relevant risk zone, that a rating does not determine the application of subsection 6(1) or section 128B of the *Income Tax Assessment Act 1936*, the applicable treaty, or the arm's length outcome under Division 815 of the *Income Tax Assessment Act 1997*. A taxpayer should not be regarded as presenting higher risk merely because it maintains a reasonably arguable legal position that no royalty exists.

2. The green zone is too narrow for modern software distribution

The simple distribution category appears directed principally to the resale of existing software copies where no copyright right is granted or exercised. Modern supply chains commonly involve subscription access, cloud hosting, licence keys, authentication processes, customer portals and automated delivery. These features do not necessarily establish that the Australian intermediary has obtained an economically significant right to exploit copyright. Nevertheless, the current criteria may place these routine arrangements outside the green zone and into a higher-risk category. The final PCG should use its risk-zone labels consistently and explain clearly the boundary between each consecutive category.

Recommendation 2: Expand the green zone to include arrangements where the Australian entity performs routine marketing, contracting, billing, customer support or access-administration functions but does not control source code, reproduce or adapt software on its own account, or otherwise exploit copyright for independent commercial value. The final PCG should focus on the substance and significance of the rights held, rather than treating common delivery mechanisms as determinative.

3. Apportionment is recognised in principle but insufficiently supported in practice

TR 2026/2 recognises that the statutory expression "to the extent" may require a mixed payment to be apportioned between royalty and non-royalty components. The practical utility of that principle is limited if taxpayers are not given examples showing how to identify and value separable components. The absence of a detailed worked apportionment scenario increases uncertainty and may lead taxpayers to assume that the entire payment will be treated as a royalty whenever rights are bundled.

Recommendation 3: Include worked examples covering bundled software access, support, implementation, hosting, marketing and distribution services. The examples should explain acceptable apportionment methods, evidentiary expectations and the circumstances in which valuation, cost-based allocation or comparable uncontrolled pricing may be appropriate. The ATO should also confirm that a reasonable, contemporaneously documented method will not be displaced solely because another defensible method could produce a different result.

4. The quantitative thresholds require stronger justification

The proposed thresholds may generate risk outcomes that reflect business model, cost structure or group profitability rather than royalty risk. A requirement for a recognised royalty to equal at least 75 per cent of the residual amount or 50 per cent of an undissected payment may be disproportionate for routine distributors. Similarly, an operating margin exceeding 10 per cent may be unsuitable for high-volume, low-margin businesses. The alternative comparison with the global group margin may also be distorted by different functions, markets, accounting policies and business cycles.

Recommendation 4: Publish the policy rationale and empirical basis for each threshold and test them against representative business models before finalisation. The final PCG should provide industry-sensitive ranges or a rebuttable pathway based on reliable transfer pricing evidence, rather than a single bright-line test. Thresholds should be reviewed after an initial period of operation and adjusted if they produce anomalous outcomes.

5. The residual amount calculation is difficult to apply and may overstate risk

The calculation requires Australian taxpayers to obtain and allocate offshore supplier costs relating to Australian sales. That information may not be maintained at the required level, may be subject to confidentiality restrictions and may be outside the Australian entity's control. Excluding categories such as related-party royalties, intangible amortisation and share-based remuneration may also produce a residual amount that does not reflect the supplier's economic cost base or the value of non-royalty activities.

Recommendation 5: Allow taxpayers to use information reasonably available to them, including audited segment data, existing master file and local file information, management accounts, allocation keys and independent benchmarking. The final PCG should include a materiality threshold, a simplified method for smaller or less complex arrangements, and a safe harbour where the taxpayer has made and documented reasonable efforts but cannot obtain data controlled by an offshore counterparty.

6. The examples do not provide sufficient coverage or balance

The worked examples are helpful, but they do not adequately explain the boundary between the risk zones. The final PCG should use the same zone labels throughout and include a comprehensive example for each zone so taxpayers can understand when a position outside the green zone will nevertheless attract an intermediate, rather than high, level of compliance attention. The examples also do not sufficiently cover marketplace platforms, managed service providers, cloud aggregators, multi-tier distribution, bundled support, embedded software and arrangements involving non-standard treaty definitions.

Recommendation 6: Add examples that isolate the factors changing the risk outcome and include at least one example for each zone. Each example should state which facts are decisive, which are merely indicative, and how the outcome would change if a particular fact were removed or altered.

7. Scope, restructures and administrative expectations require clarification

Schedule 1 presently addresses software intermediation arrangements, while the broader framework contemplates that further schedules may be added. Taxpayers need to know which arrangements fall within the current schedule and how the ATO will approach arrangements spanning software, services and other intellectual property. The draft PCG also addresses restructures, but further guidance is needed on when a change to contracts, functions or pricing will be viewed as ordinary commercial conduct rather than an attempt to obtain a lower-risk rating.

Recommendation 7: Clarify the boundaries of Schedule 1 and the intended process for adding future schedules. Provide restructure examples that distinguish commercial changes from arrangements warranting further review. The final PCG should also specify the documentation expected for each risk zone, whether taxpayers are expected to calculate or disclose a rating, the consequences of not doing so, and how prior rulings, settlements and assurance outcomes will be treated.

8. Retrospective administration and the absence of transition create unfair compliance risk

The draft PCG is proposed to apply to arrangements entered into before and after finalisation. Businesses may therefore be expected to reconstruct historical contractual, operational and offshore cost information against a framework that did not exist when the relevant transactions occurred. This is particularly difficult given that TR 93/12 was withdrawn with effect from 1 July 2021, the ATO subsequently issued draft rulings TR 2021/D4 and TR 2024/D1, and TR 2026/2 finalised the ATO's current view on 4 September 2026. Businesses need sufficient time to review contracts, systems and withholding positions against the final guidance.

Recommendation 8: Apply the final compliance approach prospectively and provide a transitional period of at least 12 months from finalisation for taxpayers to review arrangements and implement systems. For earlier periods, the ATO should adopt an education-first approach and generally refrain from allocating compliance resources where a taxpayer relied on the law and guidance reasonably available at the time, preserved available records and has taken reasonable steps to address its position prospectively.

9. Treaty and broader regime interactions require clearer guidance

The draft PCG may apply alongside treaty-specific royalty definitions, transfer pricing rules, the general anti-avoidance rule, the multinational anti-avoidance law, the diverted profits tax and dispute resolution processes. Taxpayers need to understand whether, and how, a PCG rating changes when the applicable treaty uses a non-standard definition or when the same facts are subject to an advance pricing arrangement, mutual agreement procedure or ATO assurance review. Without clearer coordination, taxpayers may face duplicated analysis and unresolved double taxation.

Recommendation 9: Include a decision framework explaining the order in which domestic law, the applicable treaty, the PCG, transfer pricing and integrity rules should be considered. The final PCG should also explain how existing ATO assurance, rulings, settlements, advance pricing arrangements and treaty dispute resolution processes affect the risk rating and the allocation of compliance resources.

Implementation and consultation

Before finalising the PCG, the ATO should test the revised criteria with taxpayers and advisers across a representative range of software and digital business models. This should include unrelated-party and related-party distributors, small and medium-sized businesses, SaaS providers, cloud marketplaces, managed service providers and businesses supplying tangible products with embedded software. The ATO should publish de-identified examples, quantitative modelling and the evidence supporting the thresholds to demonstrate that the proposed settings produce proportionate outcomes. It should also commit to a post-implementation review after an initial period of operation, informed by taxpayer experience and compliance data.

Conclusion

CPA Australia supports the ATO's objective of providing transparent, risk-based guidance for cross-border software and intellectual property arrangements. The draft PCG is an important opportunity to improve certainty, but the framework should be practical, proportionate and clearly separated from the legal characterisation of payments.

We encourage the ATO to revise the risk zones, quantitative tests, evidentiary requirements, examples, scope, treatment of restructures, broader regime interactions and transitional arrangements in line with the recommendations above, supported by further consultation and post-implementation review.

Summary: recommended amendments before finalisation

Priority	Recommended amendment	Intended outcome
1	**Recommendation 1:** State prominently that a risk rating does not determine legal characterisation or presume that a royalty exists.	Maintain a clear separation between the law and the allocation of compliance resources.
2	**Recommendation 2:** Broaden the green zone for routine contemporary software, SaaS, cloud and reseller models.	Ensure risk ratings reflect commercially ordinary arrangements without economically significant intellectual property rights.
3	**Recommendations 3 and 6:** Add practical apportionment guidance, use consistent risk-zone terminology and provide zone-specific worked examples covering common modern business models.	Enable consistent treatment of mixed payments and clearer differentiation between risk zones.
4	**Recommendation 4:** Recalibrate and justify the quantitative thresholds using representative evidence and sector testing.	Reduce distortions arising from differing business models, cost structures and profitability.
5	**Recommendation 5:** Simplify the residual amount calculation and accept reasonable alternative evidence, materiality thresholds and documented reasonable efforts.	Make compliance feasible where relevant offshore data is unavailable or outside the Australian taxpayer's control.
6	**Recommendation 7:** Clarify the scope of Schedule 1 and the treatment of restructures.	Provide certainty for mixed arrangements and distinguish commercial changes from higher-risk conduct.
7	**Recommendation 7:** Specify documentation, self-assessment and disclosure expectations, and the consequences of not calculating a rating.	Support proportionate administration and predictable taxpayer obligations.

Priority	Recommended amendment	Intended outcome
8	**Recommendation 8:** Apply the final approach prospectively and provide at least 12 months from finalisation for transition.	Allow orderly implementation and avoid unfair retrospective compliance outcomes.
9	**Recommendation 9:** Clarify treaty, transfer pricing, integrity rules, existing ATO engagement and dispute-resolution interactions.	Reduce duplicated analysis, uncertainty and double taxation risk.
10	**Implementation and consultation:** Undertake further consultation, publish supporting evidence and conduct a post-implementation review.	Confirm that the framework remains proportionate and operates as intended.