Australia

Federal Court Disagrees with SingTel Australia that Interest Paid to British Virgin Islands Company Was Arm’s Length

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In *Singapore Telecom Australia Investments Pty Ltd v. Commissioner of Taxation*, Moshinsky J has agreed with the Commissioner that SingTel Australia paid excessive interest on an AUD 5.2 billion loan from its British Virgin Islands holding company. Moshinsky J therefore upheld amended assessments disallowing interest deductions of AUD 894 million. However, the simplicity of the result belies the complexity of the Australian transfer pricing provisions and his Honour’s lengthy and careful reasoning. The authors examine the decision in detail and conclude that, despite the Commissioner's success, the transfer pricing landscape in Australia remains uncertain and unpredictable – especially given the taxpayer’s recent (2021) win in *Commissioner of Taxation v. Glencore Investment Pty Ltd*. All transfer pricing matters clearly need to be considered separately on a case-by-case basis.

1. Introduction

The parties involved in the case described below are: Singapore Telecom Australia Investments Pty Ltd (STAI), incorporated in Australia; Singtel Australia Investment Ltd (SAI), incorporated in the British Virgin Islands (BVI) but resident in Singapore; Singtel Optus Pty Ltd (formerly known as “Cable & Wireless Optus Ltd”) (SOPL), incorporated in Australia; Singapore Telecommunications Ltd, Singapore incorporated and owner of 47.59% of SAI direct and 52.41% through Mobile, a wholly owned Singapore subsidiary; and Singapore Telecom Mobile Pte Ltd (Mobile), incorporated in Singapore.

In *Singapore Telecom Australia Investments Pty Ltd v. Commissioner of Taxation*,[1]1 Moshinsky J of the Federal Court of Australia has held that the interest paid by an Australian company – to its BVI holding company – exceeded the interest that would have been paid if the two companies had been unrelated and were dealing with each other at arm’s length.

Justice Moshinsky therefore upheld the Commissioner’s amended assessments disallowing tax deductions for approximately AUD 894 million of interest paid by the Australian subsidiary to its immediate BVI parent company. Those amended assessments had been issued under Division 13 of Part III of the Income Tax Assessment Act 1936 (ITAA 1936) (Division 13) and Subdivision 815-A of the Income Tax Assessment Act 1997 (ITAA 1997) (Subdivision 815-A).

While the Commissioner was successful in *SingTel* and *Chevron Australia Holdings Pty Ltd v. Commissioner of Taxation* in 2017,[2] those decisions stand in contrast to the Commissioner’s loss in 2020 in *Commissioner of Taxation v. Glencore Investment Pty Ltd*.[3]

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1. AU: FCA, 17 Dec. 2021, *Singapore Telecom Australia Investments Pty Ltd v. Commissioner of Taxation* [2021] FCA 1597 (*SingTel*).
2. AU: FCAFC: 21 Apr. 2017, *Chevron Australia Holdings Pty Ltd v. Commissioner of Taxation* [2017] FCAFC 62 (*Chevron*). ***See*** M.St.J.R. Butler, J.J. Pengelly & L.Y. Wang, *Full Federal Court Upholds Assessments Against Chevron Australia in Milestone Transfer Pricing Decision in Chevron Australia Case*, 24 Intl. Transfer Pricing J. 4, p. 243 (2017), Journals Article & Opinion Pieces IBFD.
3. AU: FCAFC: 6 Nov. 2020, *Commissioner of Taxation v. Glencore Investment Pty Ltd* [2020] FCAFC 187 (Special Leave to Appeal to High Court refused 21 May 2021: [2021] HCATrans 98) (*Glencore*). ***See*** M.St.J.R. Butler, L.Y. Wang & C.H. Vu, *Full Federal Court Dismisses Commissioner of Taxation’s Appeal in Commissioner of Taxation v. Glencore and Finds Prices for Copper Concentrate Were Arm’s Length*, 28 Intl. Transfer Pricing J. 4, p. 1 (2021), Journal Articles & Opinion Pieces IBFD.

The decisions in *SingTel*, *Glencore* and *Chevron* demonstrate the significant difficulties and uncertainties associated with litigating transfer pricing cases that face both taxpayers and the Commissioner alike.

This article starts by summarizing the background to the appeal by the taxpayer (STAI) to the Federal Court (section 2.), then reviews the provisions in Division 13 and Subdivision 815-A and the four main Australian transfer pricing decisions since 2008 (section 3.).

The article next examines the detailed evidence in *SingTel*, including the terms of the Loan Note Issuance Agreement between STAI and SAI (LNIA) (section 4.), and the taxpayer and the Commissioner's respective submissions (section 5.).

The article then analyses the judgment of Moshinsky J (section 6.) before commenting on the issues associated with cross-border related-party financing arrangements and the implications of *SingTel* for future transfer pricing litigation and the setting of transfer prices (section 7.). The article concludes by looking at the Notice of Appeal lodged by STAI (section 8.).

2. Background Facts

The *SingTel* case involved a simple question: did STAI pay excessive interest on an AUD 5.2 billion loan from SAI, its immediate parent company, which was incorporated in the BVI but resident in Singapore?

By reference to the specific statutory requirements in Subdivision 815-A, Moshinsky J was required to decide whether:[4]

- conditions operated between STAI and SAI, in their commercial and financial dealings, which differed from those which might be expected to operate between independent enterprises dealing wholly independently with one another (the Conditions Issue); and
- but for the fact SAI participated directly in the management, control and capital of STAI, an amount of profits *might* have been expected to accrue to STAI and, by reason of that participation, the amount of profits had *not* so accrued (the Profits Issue).[5]

2.1. Acquisition by SingTel of SOPL

As a result of a takeover that took place in October 2001, SingTel – through SAI – acquired 52% of the issued shares in Cable & Wireless Optus Ltd (CWO) from a subsidiary of Cable & Wireless Plc.[6] SAI acquired the balance of the CWO shares from a number of public shareholders.[7] CWO then changed its name to SOPL.[8]

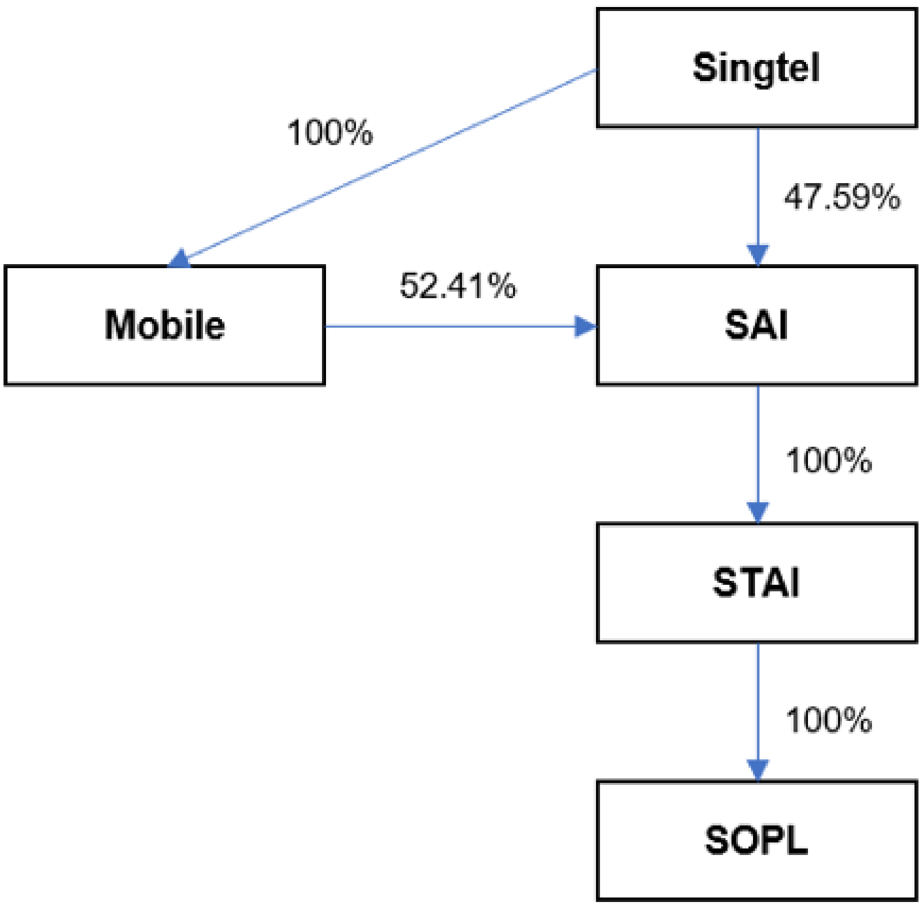
In June 2002, SAI sold 100% of the issued capital of SOPL to STAI for AUD 14.2 billion,[9] with the purchase price payable by STAI to SAI being satisfied by STAI issuing:[10]

- AUD 9 billion worth of ordinary shares to SAI; and
- AUD 5.2 billion worth of loan notes under the LNIA to SAI.

Those transactions resulted in STAI becoming the subsidiary of SAI, with SingTel remaining as the ultimate parent company (*see* Figure 1).[11]

4. *SingTel*, at para. 298.
5. Although the Commissioner made determinations under both Division 13 and Subdivision 815-A, Moshinsky J noted that the focus of both parties' submissions was on Subdivision 815-A, and his Honour's reasons therefore concentrated on the application of that Subdivision (with only brief reference to the operation of Division 13). Id., at paras. 14 and 349.
6. The Australian tax implications of the disposal of the 52% shareholding were considered in AU: FCAFC, 1 May 2017, *Cable & Wireless Australia & Pacific Holding BV (in liquidatie) v. Commissioner of Taxation* [2017] FCAFC 71, where the Full Federal Court unanimously held that an amount of AUD 3,918,797,343.42 debited to a buy-back reserve account in the ledger of Cable & Wireless Optus Ltd (subsequently renamed Singtel Optus Australia Pty Ltd) did not record a transaction reducing a share capital account. The Full Court distinguished the decision in AU: HCA, 5 Dec. 2012, *Commissioner of Taxation v. Consolidated Media Holdings Ltd* [2012] HCA 55, where the High Court held that a "share buy-back reserve" account was a share capital account because it only represented a return of equity. The return of funds to CWO's shareholders was accordingly treated as a dividend and subject to withholding tax of AUD 452,452,013.
7. *SingTel,* at paras. 33-40.
8. Id., at para. 50.
9. Id., at para. 56.
10. Id., at para. 56.
11. Id., at paras. 58 and 60.

Figure 1 – Relevant entities in Singtel group after October 2001 takeover



2.2. Rate of interest payable under LNIA

Under the LNIA, the rate of interest payable on the loan notes was initially (June 2002) the one-year Bank Bill Swap Rate (BBSW) plus 1% per annum.[12]

As a result of amendments to the LNIA in March 2003 (Second Amendment), the interest rate payable on the loan notes was increased to BBSW plus 4.552%.[13]

In March 2009, the interest rate on the loan notes was further amended (Third Amendment) by replacing BBSW with 6.835%, so the rate became 13.2575% per annum, i.e. [(6.835% plus 1%) x $^{10}/_{9}$] plus 4.552%].[14]

2.3. Amended assessments

In October 2016 – some 14 years after the relevant transactions – the Commissioner made determinations under Division 13 and Subdivision 815-A with respect to the income years ended 31 March 2010 through 2013. The determinations under

12. Id., at para. 5.
13. Id., at para. 7.
14. Id., at para. 8.

Division 13 and Subdivision 815-A were in alternative to each other, as those two sets of provisions had concurrent operation during the relevant period.[15]

The Commissioner then issued amended notices of assessment for the years ended 31 March 2011, 2012 and 2013 (note that the determination for the year ended 31 March 2010 reduced STAI's carry-forward losses, with the adjustment being reflected in the amended assessment for the year ended 31 March 2011).[16] After the Commissioner disallowed STAI's objection against the amended assessments, STAI appealed to the Federal Court.

3. Relevant Statute and Case Law

3.1. Division 13 and Subdivision 815-A

Moshinsky J was required to examine two sets of provisions:

- Australia's previous transfer pricing rules, which were enacted in 1982 and contained in Division 13; and
- the rules in Subdivision 815-A, which were introduced in 2004 (but replaced in 2013 by Subdivisions 815-B to 815-D).

The two sets of rules (in Division 13 and Subdivision 815-A) had concurrent operation in the 2010 through 2013 income years.

Under Division 13, the Commissioner can deem "arm's length consideration" to have been received for a supply of property or services, where the consideration that was in fact received was *less* than arm's length consideration.

Under Subdivision 815-A, where profits do not accrue to an Australian taxpayer, owing to **non-arm's length conditions* operating between associated entities, but which might have been expected to accrue, the Commissioner may negate the **transfer pricing benefit*.

The relevant provisions are set out in Appendix 1 to this article.

3.2. Case law

There have been four significant Australian court decisions since 2008 that have considered Division 13 and Subdivision 815-A, namely, *Re Roche Products Pty Ltd v. Commissioner of Taxation* (*Roche*),[17] *Commissioner of Taxation v. SNF (Australia) Pty Ltd* (*SNF*),[18] *Chevron* and *Glencore.*

The decisions in *Roche* and *SNF* highlighted a number of the shortcomings of the previous transfer pricing rules in Division 13, which led to the insertion of the new provisions in Division 815.

Moshinsky J referred in *SingTel* to the decisions in *Glencore*, *Chevron* and *SNF* on a number of occasions and those decisions (and *Roche*) are summarized in Appendix 2.

4. Evidence

STAI called one lay witness, Mr Paul O'Sullivan (Chairman and a director of SOPL),[19] and two expert witnesses:[20]

- Dr William Chambers (in relation to credit rating); and
- Mr Charles Chigas (primarily in relation to debt capital markets (DCM) matters but also in relation to credit rating).

The Commissioner called the following expert witnesses:[21]

- Mr Robert Weiss (in relation to credit rating); and
- Mr Gregory Johnson (in relation to DCM matters).

Moshinsky J set out, at length and in detail, the evidence given by the parties. Given the importance of the facts in this matter – indeed, in all transfer pricing matters – the facts are summarized below in Table 1 and the expert evidence given by the parties is summarized in Table 2.

15. Id., at para. 9.
16. Id., at para. 11.
17. AU: AAT, 22 July 2008, *Re Roche Products Pty Ltd v. Commissioner of Taxation* [2008] AATA 639 (*Roche*), Case Law IBFD.
18. AU: FCAFC, 1 June 2011, *Commissioner of Taxation v. SNF (Australia) Pty Ltd* [2011] FCAFC 74 (*SNF*), Case Law IBFD.
19. *SingTel*, at paras. 22 and 168.
20. Id., at paras. 23 and 190.
21. Id., at paras. 25, 190 and 229.

Table 1 – Facts considered by Moshinsky J

SingTel, SAI and STAI
- SingTel is a publicly listed company resident in Singapore.[1] - SAI was incorporated in the BVI on 1 May 2001 and is a subsidiary of SingTel.[2] - STAI is also a subsidiary of SingTel and was incorporated in Australia on 3 May 2001. [3]
Background of 2001 takeover

- In March 2001, SingTel submitted an offer to acquire 52% to 100% of CWO and was selected as the preferred bidder. [4]
- On 18 May 2001, SingTel, through SAI, made a takeover offer for CWO. [5]
- On 20 August 2001, SAI and STAI entered into an option agreement (Option Agreement), where:[6]
    - STAI was granted a call option to purchase CWO shares from SAI; and
    - SAI was granted a put option to sell the CWO shares to STAI.
- Before completion of the acquisition of CWO, SingTel required additional funding (approximately AUD 5.6 billion) to meet certain commitments.[7]
- CWO changed its name to SOPL, following SAI's acquisition on 23 October 2001. [8]

STAI restructure and LNIA
- On 28 June 2002, SAI exercised the put option under the Option Agreement and STAI acquired all the issued shares in SOPL for AUD 14.2 billion.[9] - After SingTel transferred its shareholding in STAI to SAI for AUD 2.00, STAI became a wholly owned subsidiary of SAI.[10] - On 28 June 2002, SAI and STAI entered into the LNIA, which stated that STAI proposed raising funds to finance the acquisition of shares in SOPL by issuing unsecured, registered and transferable loan notes for SAI's benefit.[11]
Additional factual findings
- SOPL remained independent of SingTel in its day-to-day operations in Australia as it relied on systems, software and networks managed in Australia.[12] There was no realistic suggestion that SAI would not extend ongoing funding to STAI for the remainder of the LNIA.[13]

1. AU: FCA, 17 Dec. 2021, *Singapore Telecom Australia Investments Pty Ltd v. Commissioner of Taxation* [2021] FCA 1597 (SingTel).
2. Id., at paras. 1 and 3.
3. Id., at paras. 30-32.
4. Id., at para. 34.
5. Id., at para. 37.
6. Id., at para. 38.
7. Id., at para. 45.
8. Id., at para. 50.
9. Id., at para. 56.
10. Id., at paras. 57-58.
11. Id., at para. 61.
12. Id., at para. 181.
13. Id., at para. 189.

Table 2 – Expert evidence called by STAI and Commissioner

"No Amendment Model"
- Mr Johnson (on behalf of the Commissioner) prepared a "No Amendment Model" that calculated the interest that would have been payable for each year of life of the LNIA, on the assumption the LNIA was not amended (and thus the interest rate of BBSW plus 1% remained the same for the life of the LNIA).[1] - Moshinsky J did not take issue with these calculations. [2]
Credit rating evidence

- Expert evidence was provided by way of a Joint Credit Rating Report prepared by Mr Weiss (on behalf of the Commissioner) and Dr Chambers and Mr Chigas (on behalf of STAI). [3]
- The Joint Credit Rating Report indicated that the credit rating of a subsidiary must first be assessed as to its own, *stand-alone*, creditworthiness without parental support.[4]
- The credit rating of a "less creditworthy" subsidiary is frequently raised above the stand-alone rating to reflect the nature and extent of the parental support. [5]
- In issuing a credit rating which determines the creditworthiness of a company, a rating agency will consider both business risk and financial risk, and will assess the combination of the company's stand-alone credit and any implicit parental support.[6]
- Implicit parental support depends on the support given to the subsidiary during times of financial distress.[7]
- The rating agencies (Moody's and S&P Global Ratings) provide guidance that, when issuing a credit rating, a "bottom-up" approach should be used. That is, the creditworthiness of the subsidiary should be considered first, which may be raised later based on evidence of implicit support provided by the parent company.[8]
- Although there is no definition of a "top-down" approach, Mr Weiss (called by the Commissioner) considered the only difference between both approaches to be a difference in terminology.[9]
- All three experts agreed STAI had "relatively weak credit metrics – high debt leverage and low interest coverage ratios", as STAI: [10]
  - carried a significant debt burden (AUD 5.2 billion of debt under the LNIA) with a substantial interest expense (which reduced profitability); and
  - required substantial ongoing capital expenditure to maintain the company's competitive position (which reduced cash flow).
- Dr Chambers (called by STAI) – the expert whose evidence Moshinsky J preferred[11] – generally rated STAI's "*stand-alone*" credit rating (using S&P and Moody's respective scales) as:[12]
  - in 2002 and 2003: BB- to B+ (speculative, possibly vulnerable to experiencing major ongoing uncertainties); and B1 to B2 (speculative, subject to high risk);
  - in 2008 and 2009: BB to BB- (speculative, less vulnerable in the near term to experiencing major ongoing uncertainties); and Ba3 to B1 (speculative, subject to substantial credit risk).
- With implicit parental support, STAI's credit rating was:[13]
  - in 2002 and 2003: BBB- to BB (less vulnerable in the near term, to having adequate capacity to meet financial commitments, but more subject to adverse economic conditions); and Ba1 to Ba3 (speculative, subject to substantial credit risk);
  - in 2008 and 2009: BBB to BB+ (investment grade with adequate capacity to meet financial commitments, less vulnerable in the near term but may be subject to or experience ongoing uncertainties to adverse business, financial and economic conditions); and Baa3 to Ba2 (medium grade, subject to moderate to substantial credit risk).
- Moshinsky J expressed a preference for Dr Chambers' view because Dr Chambers adopted a cautious approach, which better reflected the credit agencies' criteria in assessing STAI's overall credit rating (i.e. STAI's stand-alone rating plus implicit parental support provided by SingTel to STAI).[14]

DCM evidence

- Mr Chigas (called by STAI) and Mr Johnson (called by the Commissioner) gave evidence on two points: [15]
  - identifying any conditions in the LNIA between SAI and STAI which differed from conditions expected to operate between independent enterprises dealing at arm's length, in substantially similar circumstances; and
  - if there were any such conditions, whether there were any, and if so what amount of, profits which, but for those conditions, might have been expected to accrue to STAI by reason of those conditions.

Mr Chigas' views

- Mr Chigas' views on whether the various financing terms of the LNIA between SAI and STAI were as would be expected, or differed from what could be expected, in a DCM bond issue, were as follows:

Expected	- deal size; maturity; interest payment/capitalization; optional redemption; amortization; security; covenants; redemption notice; known withholding tax.[16]	
Differed	- issuer structure	Under the LNIA, all expenses and taxes of SOPL (the operating company) were paid before cash flow was available for distributing to STAI (the holding company). Such "structural subordination" is frequently mitigated by the operating subsidiary guaranteeing the debt of the holding company, so Mr Chigas would have expected the LNIA to have been guaranteed by SOPL if it had been a DCM bond issue.[17]
	- interest rate	The interest rate structure under the LNIA was consistent with arm's length third-party transactions. However, the actual percentage of interest charged on the LNIA differed from the rate Mr Chigas would have expected. [18]
	- future withholding tax	This provision differed as LNIAs tended to include provisions addressing potential future changes in tax policies. The LNIA did not have such a provision, which exposed STAI to an unlimited liability for future, unknown costs.[19]
	- power to issue Variation Notice	Although the ability for SAI to issue Variation Notices was unique, it did not adversely affect STAI's profits.[20]

- Ultimately, Mr Chigas accepted that the difference between the actual interest incurred under the LNIA (AUD 4.9 million), and the interest under the "market" scenario (AUD 7.7 million), was approximately AUD 2.8 billion. [21]

Mr Johnson's views

- Although several of Mr Johnson's views were consistent with those of Mr Chigas, Mr Johnson considered that the provisions listed below would "not have been acceptable to an independent borrower or lender", namely: [22]
  - the uncertainty created by the Variation Notices in both the original and amended LNIAs;
  - the put/call provision in the original LNIA;
  - the potential structural problems of deferring cash interest under the Benchmark provisions in the amended LNIA;
  - the calculations of the Premium and Break Costs under the amended LNIA;
  - the "non-money" provisions (i.e. general terms and conditions not directly related to interest rate, fees or repayment terms) of the original LNIA in aggregate, and individually;
  - the LNIA structure and pricing, given the access to USD bonds and AUD bank markets on 31 March 2003.
- Mr Johnson believed STAI could have borrowed at a *lower* rate from third-party domestic Australian banks. [23]
- In Mr Johnson's opinion, the LNIA resulted in excess interest rate expense over the course of the ten-year borrowing.[24]
- If STAI had not borrowed under the provisions of the LNIA and, instead, had borrowed from the bank and the DCM, an estimated AUD 1.23 billion in profits should have accrued to STAI.[25]

1. AU: FCA, 17 Dec. 2021, *Singapore Telecom Australia Investments Pty Ltd v. Commissioner of Taxation* [2021] FCA 1597 (*SingTel*).
2. Id., at para. 166.
3. Id., at paras. 191-195.
4. Id., at paras. 198, 210 and 211.
5. Id., at paras. 201, 210.
6. Id., at para. 206.
7. Id., at para. 209.
8. Id., at paras. 208, 209 and 221.
9. Id., at paras. 220(a) and 226.
10. Id., at para. 217.
11. Id., at para. 223.
12. Id., at para. 202.
13. Id., at paras. 47, 202 and 324.
14. Id., at paras. 223-228.
15. Id., at paras. 232.
16. Id., at para. 238.
17. Id., at para. 239.
18. Id., at para. 240.
19. Id., at para. 241.
20. Id., at para. 242.
21. Id., at para. 267.
22. Id., at paras. 271 and 277.
23. Id., at para. 272.
24. Id., at para. 288.
25. Id., at para. 289.

5. STAI's and Commissioner's Submissions

5.1. STAI's contentions

STAI submitted:[22]

- It was "common ground" that a company in STAI's position in June 2002 could have borrowed AUD 5.2 billion without a guarantee.
- The terms and economic effect of the LNIA were substantially similar to terms that would be expected in a transaction between independent parties, where the borrower sought to defer interest payments to suit its expected cash flow.

22. Id., at para. 158.

- The actual cost of borrowing to STAI under the LNIA was not greater (in fact, it was significantly less) than the cost a party in STAI's position might be expected to have paid to an independent party, acting wholly independently, to achieve the same cash flow advantages which STAI actually achieved.

In fact, the credit spread of the LNIA (144 basis points plus withholding tax gross-up) was lower than the credit spread that might reasonably be expected to have been agreed in an arm's length DCM transaction between independent parties.[23]

5.2. Commissioner's contentions

The Commissioner contended that an agreement between two parties in the same circumstances had to: (i) be "commercially rational"; and (ii) be one into which two independent parties, acting wholly independently with each other, would enter.[24]

The Commissioner submitted:[25]

- It was implausible that SingTel would have permitted STAI to borrow AUD 5.2 billion on the terms of the LNIA, including as amended, from an unrelated creditor.
- STAI had other, significantly more attractive, "*options realistically available*" to it,[26] including, if Singtel's implicit credit support did not increase STAI's credit rating to the A level (which the Commissioner disputed), the provision of a parent guarantee by SingTel.
- The terms of the LNIA – in its initial form and as amended – included conditions in the commercial and financial relations of SAI and STAI that departed fundamentally from arm's length conditions. No instrument with those terms existed in the market.
- The Second and Third Amendments inflated the interest rate well over that which would be payable at arm's length, having regard to the credit quality of STAI's assets and that of the SingTel group.
- The effect of the 2003 amendment was to make the notes interest free for the period in which STAI did not have positive taxable income. During that period, there was no accrual of interest, so SAI did not have to deduct Australian interest withholding tax during that period.
- The "benchmarks" in the LNIA appear to have been "*reverse-engineered*" to be met, not at the time STAI became profitable, but at the time it exhausted its carried-forward tax losses. Introducing the "premium" meant that, if and when STAI was profitable *and* had used up its tax losses, interest deductions, at a high interest rate, would be used to reduce STAI's Australian tax.

6. Decision of Moshinsky J

After a comprehensive review of the evidence, and the taxpayer and the Commissioner's respective submissions, and having regard to focus of both parties' submissions on Subdivision 815-A (rather than Division 13), Moshinsky J concluded as follows:[27]

- *Conditions issue*: conditions were operating between STAI and SAI, in their commercial and financial relations, that differed from those which might be expected to operate between independent enterprises dealing wholly independently with one another (i.e. those conditions were not "arm's length"); and
- *Profits issue*: a reliable hypothesis was that independent parties, in the positions of SAI and STAI (and SingTel), might have been expected to have agreed in June 2002 that:
  - the interest rate applicable to the loan notes would be the one-year BBSW plus 1%, with a withholding tax gross-up; that is, the same rate as was actually agreed in the original LNIA;
  - interest under the loan notes could be deferred and capitalized;
  - there would be a parent guarantee from a company like SingTel of the obligations of the company in the position of STAI;

23. Id., at para. 158(c).
24. Id., at para. 162(a), (b).
25. Id., at para. 162(c)-(g).
26. Id., at para. 162(c); *see* *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2010), Primary Sources IBFD, paras. 1.34-1.35; and 1995 Guidelines, paras. 1.15–1.16.
27. Id., at paras. 18, 349.

- having agreed to those components in June 2002, independent parties in the positions of SAI and STAI would *not* have agreed to make the 2003 and 2009 amendments;
- as the same interest rate as agreed by the parties in the original LNIA might be expected to have applied through the whole life of the transaction (and as set out in the No Amendment Model),[28] for each of the years ended 31 March 2010, 2011, 2012 and 2013, but for the above conditions, an amount of profits might have been expected to accrue to STAI, and by reason of those conditions, had not so accrued.

It followed from Moshinsky J's conclusions that STAI had *not* demonstrated the Commissioner's amended assessments were excessive[29] – and his Honour therefore upheld those assessments, disallowing deductions for AUD 894,774,368 of interest over the four-year reassessment period.[30]

It is understood SAI should be entitled to a refund of Australian interest withholding tax of approximately AUD 89 million, i.e. 10% of the AUD 894 million of interest disallowed.[31]

7. Observations

7.1. Cross-border financing arrangements have long been a focus area for ATO

The Commissioner has for many years focused on cross-border related-party financing transactions and their implications under Australia's transfer pricing laws.

Some 30 years ago, in 1992, the Commissioner issued Taxation Ruling TR 92/11,[32] setting out his views on the application of the provisions of Division 13 to loan arrangements and credit balances.

Twenty-five years later, in 2017, the landmark decision in *Chevron* considered the transfer pricing implications of the financing by the Chevron Group of the substantial capital requirements of its offshore drilling operations in Australia's North West Shelf.[33] *Chevron* involved amended assessments for the 2004 through 2008 income years and the Commissioner successfully argued that the interest charged by the Chevron Group to its Australian subsidiary was *not* an arm's length rate: *see* the summary of *Chevron* in Appendix 2.

Also in 2017, the Commissioner issued *Practical Compliance Guideline* PCG 2017/4,[34] which provides the Commissioner's views on the audit risk associated with cross-border financing structures. PCG 2017/4 contains a *"related party financing arrangement risk framework*" made up of six risk zones: White, Green, Blue, Yellow, Amber or Red, depending on an arrangement's risk level.

The proceedings in *SingTel* demonstrate that cross-border financing continues to be an area of long-term concern to the ATO – noting that the arrangements in *SingTel* date back to transactions and arrangements made in 2001 and 2002, over 20 years ago.

7.2. Determining whether conditions are arm's length with a financing arrangement

So how do you determine whether conditions operating between related entities – specifically as regards a financing arrangement – differ or do not differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another? Two options are described in sections 7.2.1. and 7.2.2.

7.2.1. "Depersonalization" of parties in *Chevron* and *Glencore*

The challenge facing taxpayers is to demonstrate to the Commissioner or the Court that the terms and outcomes of their dealings with *related* enterprises are the same as if they were dealing with *independent* enterprises and were dealing *wholly independently*.

For that purpose, what exactly is an "*independent enterprise*" and what characteristics – or, in the words of Middleton and Steward JJ in *Glencore*, what "personality" – should that independent third party be treated as having for the purpose of applying Division 13 and Subdivision 815-A?

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28. Id., at para. 345.
29. Id., at paras. 19 and 355.
30. Id., at para. 11.
31. A. Yeh, *Singtel Loses Landmark Australian Tax Case*, available at https://www.bloomberg.com/news/articles/2021-12-18/singtel-loses-landmark-australian-tax-case (accessed 18 July 2022).
32. "Income tax: application of the Division 13 transfer pricing provisions to loan arrangements and credit balances".
33. N. Chenoweth, *After Chevron, Tax Office poses $420b question*, Australian Fin. Review (16 May 2017).
34. "ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions".

In *Glencore*, Middleton and Steward JJ noted that Allsop CJ in *Chevron* had:[35]

> […] recognised the great variety of arm's length transactions that independent parties may negotiate. Each contract will be different but each will still be the product of an arm's length dealing. As a result, Division 13 should not be applied pedantically or inflexibly.

In their Honours' view, in determining whether a contract was the product of an arm's length dealing, the test did not require an "utter disembodiment" of the actual parties from the hypothetical transaction, nor did it require that "the hypothetical taxpayer stands entirely in the shoes of the taxpayer". Their Honours instead quoted with approval the test used by Allsop CJ in *Chevron* that:[36]

> The degree and extent of the depersonalisation will be dictated *by what is appropriate to the task of determining an arm's length consideration* – that is one that satisfactorily replaces what the taxpayer gave by what it should be taken to have given had it been independent of its counterparty.

In *Chevron*, the Full Federal Court disagreed with the taxpayer's submission that "the task at hand was … to price the interest rate that would be paid by a stand-alone borrower from an independent lender for a loan structured in the identical terms to the credit facility".[37]

Allsop CJ posed the question as follows:[38]

> What is the consideration that CAHPL or a borrower in its position might reasonably be expected to have given to an independent lender if it had sought to borrow AUD 2.5 billion for five years? The answer to this question is to be found in the evidence. Here the borrower in the independence hypothesis is a company in the position of CAHPL. It is part of a group the policy of the parent of which was to borrow externally at the lowest rate possible. Further, it was usual commercial policy of the parent of the group for a parent company guarantee to be provided by it (the parent) for external borrowings by subsidiaries. *In those circumstances, the consideration that might reasonably be expected to be given by a company in the position of the taxpayer CAHPL would be an interest rate hypothesised on the giving of a guarantee of CAHPL's obligations to the lender by a parent such as Chevron*. [Emphasis added.]

In a similar vein, Pagone J was of the view that CAHPL was not to be treated "as if it were an orphan" and not a member of the Chevron Group.[39]

In pricing the loan, the borrower (CAHPL) therefore was *not* treated as an independent, stand-alone, corporation. Instead, it was appropriate to take into account the fact that CAHPL was part of the Chevron Group and its borrowing would be supported by a guarantee from the parent company.

In *Glencore*, Middleton and Steward JJ outlined seven factors to be considered in determining the "appropriate" degree of "depersonalization":[40]

(1) The starting position is that only those attributes or features which can affect the consideration receivable should "clothe the hypothetical seller".[41]

(2) Only the *objective* attributes or features should be included.[42]

  (2.1) In *Glencore*, the objective attributes or features included the:

    (a) means, levels and costs of production of the mine;

    (b) size and location of the mine;

    (c) objective circumstances of the copper concentrate market as at the relevant time period; and

    (d) business structure of the parties – here, being a wholly owned subsidiary of a multinational nature resources group.

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35. *Glencore*, at para. 169.
36. Id., at para. 172.
37. *Chevron*, at para. 53.
38. Id., at para. 62.
39. Id., at para. 130.
40. *Glencore*, at paras. 176-187.
41. Id., at para. 177.
42. Id., at paras. 178-179.

(3) Exclude any considerations that are the product of the taxpayer's non-arm's length relationship with its direct parent and the broader group.[43]

(4) As the issue of risk-taking is dependent on the method or formula for determining the consideration payable for the sale, the taxpayer is entitled to choose the formula so long as it: (i) is commercially rational; and (ii) is what an independent party dealing at arm's length might reasonably be expected to have done.[44]

(5) There is a possibility of a range of arm's length outcomes.[45]

(6) The range of acceptable arm's length outcomes is limited by "what *might* reasonably be expected", not what *would* be expected.[46]

(7) In applying Division 13 or Subdivision 815-A, one should exercise a degree of flexibility and pragmatism. As construing a hypothetical scenario regarding independent parties, engaging in a transaction at arm's length, is a "difficult and complex issue", the Court should not interpret Division 13 or Subdivision 815-A narrowly. The Court should not look solely to expert reports – rather, when analysing the circumstances of the taxpayer, "common sense is required".[47]

7.2.2. Approach adopted by Moshinsky J in *SingTel*

Although Moshinsky J examined in some detail the characteristics of the "hypothetical" taxpayer in order to determine arm's length conditions in relation to the SingTel companies, his Honour did not expressly consider the extent to which the parties should be "*depersonalized*". Nevertheless, Moshinsky J considered that:[48]

> The overarching consideration is that the enterprises in the hypothetical should generally have the characteristics and attributes of the actual enterprises ….

Moshinsky J did not need to postulate his own hypothetical scenario but accepted both parties' submissions that the hypothesis was:[49]

> […] a transaction between a vendor and a purchaser of shares, where loan notes totalling AUD 5.2 billion are issued by the purchaser as partial consideration for the acquisition of the shares.

According to that hypothesis – and it is respectfully submitted, consistent with the approach adopted by the Full Court in *Chevron* and *Glencore* – Moshinsky J held that independent parties, in the positions of STAI and SAI, might have been expected to have agreed that:[50]

- in June 2002, the interest rate applicable to the loans would have been the one-year BBSW plus 1% (i.e. the interest rate in the original LNIA);
- interest under the loan notes could be deferred and capitalized; and
- there would be a parent guarantee from a company such as SingTel of the obligations of the company in the position of STAI.

On the basis of the evidence, Moshinsky J held that independent parties, in the positions of STAI and SAI, would *not* have agreed to make the changes in the Second Amendment (namely, financial benchmarks and the premium of 4.552%) or the Third Amendment (which changed the interest rate from the one-year BBSW plus 1% to a fixed amount of 6.835% plus a margin).[51]

His Honour instead concluded that the interest rate specified in the original LNIA would have been expected to operate – between hypothetical parties in the positions of STAI and SAI – for the whole of the life of the LNIA.[52]

The reasoning in *Chevron*, *Glencore* and *SingTel* is making it clear that it will *not* be sufficient to price a loan by reference to third-party loans that are perceived to be comparable borrowings. Taxpayers and advisers instead need to determine what a borrower, *in the taxpayer's position*, might reasonably have been expected to give as consideration for the loan.

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43. Id., at para. 180.
44. Id., at paras. 181 and 182.
45. Id., at para. 183.
46. Id., at paras. 184-185.
47. Id., at para. 186.
48. *SingTel*, at para. 320.
49. Id., at para. 321.
50. Id., at para. 322.
51. Id., at paras.8, 95 and 322.
52. Id., at paras. 300, 322 and 345.

7.3. Implications of *SingTel* for transfer pricing litigation and setting of transfer prices generally

The Commissioner's Decision Impact Statement regarding *Glencore* refers to the fact that: "the outcomes in [*Chevron* and *Glencore*] were reached after a consideration of all the evidence before the respective courts in each instance", then continues:[53]

> The Commissioner considers that it will always require a careful examination of the totality of evidence available to best establish the arm's length consideration or the arm's length conditions that might reasonably have been expected to operate in any given case.

As previously suggested,[54] the decisions in *Chevron* and *Glencore*, and now in *SingTel*, demonstrate that transfer pricing in Australia is not simply a matter of carrying out an economic analysis by reference to a set of comparables and then pointing to a supposed "arm's length" result.

Instead, defensible transfer pricing practice involves a careful consideration of the statutory, legal requirements and a determination of whether the "amount of profits" that accrued to, or would accrue to, an Australian taxpayer differs, or will differ, from the amount of profits that would have if "arm's length conditions" operate.

7.4. Scorecard

Looking at the litigation scorecard over the last 15 years:

- taxpayers have been successful in *Roche* (2008) (involving the pricing of the cross-border sale of pharmaceuticals), *SNF* (2011) (chemicals) and *Glencore* (2021) (copper mining);
- the Commissioner has been successful in *Chevron* (2017) and *SingTel* (2021) (both involving cross-border financing); and
- BHP Limited (the largest company in Australia) and the Commissioner reached mutually agreeable settlement for the payment of AUD 529 million in a dispute regarding BHP's "marketing hub" in Singapore.[55]

8. STAI's Appeal Notice

On 18 April 2022, STAI appealed to the Full Court of the Federal Court from Moshinsky J's decision.

The Originating Application for Appeal contends, among other things, that:

- for the purposes of Subdivision 815-A, the interest paid by STAI under the LNIA was the same or less than that which might have been expected to be paid by an independent third party in comparable circumstances, and there were no profits which might have been expected to accrue to STAI, if not for the operation of the LNIA terms between SAI and STAI;
- for the purposes of Division 13, the consideration given by STAI for the financial accommodation provided under the LNIA was not more than which might reasonably be expected to be given between independent third parties; and
- there was no probative evidence to support a conclusion that independent parties would have adopted the No Amendment Model (i.e. the parties would not have amended the original LNIA).

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53. *See* https://www.ato.gov.au/law/view/view.htm?docid=%22LIT%2FICD%2FNSD1636of2019%2F00001%22 (28 June 2022).
54. *See* M.St.J.R. Butler, L.Y. Wang & C.H. Vu, *Full Federal Court Dismisses Commissioner of Taxation's Appeal in Commissioner of Taxation v. Glencore and Finds Prices for Copper Concentrate Were Arm's Length*, 28 Intl. Transfer Pricing J. 4, p. 1 (2021).
55. BHP paid AUD 529 million in settlement of amended assessments for AUD 1.042 billion of tax, penalties and interest, covering the 2003 through 2018 income years, with BHP agreeing that all of its profits from the sale of Australian-owned commodities would thereafter be taxed in Australia; *see* https://www.ato.gov.au/media-centre/media-releases/marketing-hub-disputes/; and https://www.asx.com.au/asxpdf/20181119/pdf/440f9kqqdnxfyh.pdf (both accessed 28 June 2022).
It appears Rio Tinto may also have been involved in a dispute with the Australian and Singaporean tax authorities about the company's selling price for aluminium to its Singapore marketing hub. The ATO apparently issued Rio Tinto with an AUD 86.1 million assessment for this aspect; *see* https://www.afr.com/companies/mining/rio-tinto-hit-with-huge-bill-in-latest-tax-dispute-20210302-p5776t.
Rio Tinto also may have had a separate AUD 447 million dispute regarding the transfer pricing of iron ore: *see* https://www.afr.com/companies/mining/ato-escalates-aluminium-smelter-dispute-with-rio-tinto-20200408-p54i5i#:~:text=The%20ATO%20has%20told%20Rio,pricing%20of%20Australian%20iron%20ore (both accessed 28 June 2022)

9. The Future

Given the substantial amounts of interest claimed by STAI as allowable deductions (AUD 894 million) – and the significant amounts of tax and penalties payable if the interest paid by STAI was *not* an arm's length amount – the appeal to the Full Federal Court will be watched with great interest by taxpayers and the tax advisory community. So stay tuned!

10. Stop Press

In *Singapore Telecom Australia Investments Pty Ltd v. Commissioner of Taxation (No. 2)* (*SingTel No. 2*), Moshinsky J dealt with the form of final orders and costs.[56]

Since the Commissioner was substantially successful in the proceedings, there was no issue that he was entitled to an order for his costs. However, despite making an offer to compromise and a *Calderbank* offer on 14 July 2021 (offering to settle for AUD 133,804,990 being 50% of the additional income tax payable by reason of the amended assessments), Moshinsky J held that the Commissioner was only entitled to his costs on a party/party basis, and not on an indemnity basis.

Moshinsky J held:

> […] that it was not unreasonable for STAI to reject the offer to compromise and the *Calderbank* offer by reference to the circumstances as they existed at the time of the offers. Significantly, at that time, the Commissioner had not yet put forward his secondary case, based on the No Amendment Model, in respect of which he was successful in the Judgment.[57]

Appendix 1: Relevant Provisions in Division 13 and Subdivision 815-A

ITAA 1936, Division 13

Under Division 13, the Commissioner can deem "arm's length consideration" to have been received for a supply of property, where the consideration that was in fact received was less than arm's length consideration.

In more detail, section 136AD provides that:

> (1) Where:
>
> (a) a *taxpayer* has *supplied property under an international agreement;*
>
> (b) the Commissioner, having regard to any connection between any 2 or more of the parties to the agreement or to any other relevant circumstances, is satisfied that the *parties* […] *were not dealing at arm's length with each other in relation to the supply;*
>
> (c) consideration was received or receivable by the taxpayer in respect of the supply but *the amount of that consideration was less than the arm's length consideration* in respect of the supply; and
>
> (d) the Commissioner determines that this subsection should apply […];
>
> then […] *consideration equal to the arm's length consideration* in respect of the supply *shall be deemed to be the consideration received or receivable* […]
>
> (4) … where, for any reason […] it is *not possible or not practicable for the Commissioner to ascertain the arm's length consideration* in respect of the supply or acquisition of property, the *arm's length consideration* […] shall be deemed to be *such amount as the Commissioner determines*. [Emphasis added.]

For the 2007, 2008 and 2009 financial years, the Commissioner made determinations under both sections 136AD(1) and 136AD(4).

ITAA 1997, Division 815

Subdivision 815-A of the ITAA 1997 applies to income years commencing on or after 1 July 2004 until 29 June 2013 (being the start date for Subdivisions 815-B, 815-C and 815-D, which replaced Division 13).

56. AU: FCA, 22 Mar. 2022, *Singapore Telecom Australia Investments Pty Ltd v. Commissioner of Taxation (No. 2)* [2022] FCA 260 (*SingTel No. 2*).
57. *SingTel No. 2*, at para. 29.

Under Subdivision 815-A, where profits do not accrue to an Australian taxpayer, owing to "non-arm's length conditions" operating between associated entities, but which might have been expected to accrue, the Commissioner may negate the relevant "transfer pricing benefit".

In more detail, section 815-5 states that:

> The object of this Subdivision is to ensure the following amounts are appropriately brought to tax in Australia, consistent with the arm's length principle:
>
> (a) profits which would have accrued to an Australian entity if it had been dealing at *arm's length, but, by reason of non-arm's length conditions operating between the entity and its foreign associated entities, have not so accrued; […]

As explained above, section 815-10 allows the Commissioner to negate a **transfer pricing benefit*, with section 815-15 providing that:

> (1) An entity gets a transfer pricing benefit if:
>
> (a) the entity is an Australian resident; and
>
> (b) the requirements in the *associated enterprises article for the application of that article to the entity are met; and
>
> (c) an amount of profits which, but for the conditions mentioned in the article, might have been expected to accrue to the entity, has, by reason of those conditions, not so accrued; and
>
> (d) had that amount of profits so accrued to the entity:
>
> (i) the amount of the taxable income of the entity for an income year would be greater than its actual amount; […]
>
> The amount of the transfer pricing benefit is the difference between the amounts mentioned in subparagraph (d)(i) […].
>
> (5) An associated enterprises article is:
>
> (a) Article 9 of the United Kingdom convention (within the meaning of the International Tax Agreements Act 1953); or
>
> (b) a corresponding provision of another *international tax agreement.
>
> [Emphasis in original.]

In the present case, the applicable **international tax agreement* was the Australia/Switzerland double taxation agreement.

Section 815-20 continues:

> (1) For the purpose of determining the effect this Subdivision has in relation to an entity:
>
> (a) work out whether an entity gets a *transfer pricing benefit consistently with the documents covered by this section, to the extent the documents are relevant; and
>
> (b) interpret a provision of an *international tax agreement consistently with those documents, to the extent they are relevant.
>
> (2) The documents covered by this section are as follows:
>
> (a) the Model Tax Convention on Income and on Capital, and its Commentaries, as adopted by the Council of the Organisation for Economic Cooperation and Development and last amended on 22 July 2010;
>
> (b) the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as approved by that Council and last amended on 22 July 2010;
>
> (c) a document, or part of a document, prescribed by the regulations for the purposes of this paragraph. […]

Subdivision 815-A therefore incorporates, and is to be interpreted by reference to, the OECD Model Tax Convention and Commentaries, as well as the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.[58]

As a result of transitional provisions, the relevant documents for income years commencing before 1 July 2012 are the OECD Guidelines (1995) and the relevant OECD Model that was in place before each of the relevant years.[59]

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58. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), Primary Sources IBFD.
59. *Glencore*, at para. 22.

Section 815-40 prevents double taxation arising from the simultaneous operation of Division 13 and Subdivision 815-A. Section 815-40 provides:

(1) The amount of a *transfer pricing benefit that is negated under this Subdivision for an entity is not to be taken into account again under another provision of this Act to increase the entity's assessable income, reduce the entity's deductions or reduce a *net capital loss of the entity.

(2) Subsection (1) has effect despite former section 136AB of the *Income Tax Assessment Act 1936*.

Appendix 2: Summary of Decisions in *Roche*, *SNF*, *Chevron* and *Glencore*

Roche

The decision in *Roche*[60] was handed down by the Administrative Appeals Tribunal (AAT) in July 2008 and was the first transfer pricing dispute in Australia to proceed to formal judgment.

The case considered the transfer prices of pharmaceuticals acquired by Roche Products Pty Ltd (Roche), an Australian distributor and subsidiary of the Swiss company, F. Hoffman-La Roche Ltd. The Commissioner concluded that the prices paid by Roche in the 1993 through 2003 income years were excessive, and issued transfer pricing adjustments under Division 13, increasing the taxable income of Roche in those years by AUD 126 million.

AAT President Downes J accepted gross margin evidence to support the use by Roche of the resale minus method, in preference to the Commissioner's application of net profit methods that were not directly based on comparable transactions. His Honour therefore reduced the transfer pricing adjustment to AUD 45 million.

SNF

SNF [61]considered whether the Australian taxpayer had paid arm's length prices for chemical flocculants and coagulants purchased from its French parent company. The Commissioner audited SNF and issued transfer pricing adjustments under Division 13, which increased SNF's taxable income for the 1997 to 2003 income years to reflect arm's length consideration that should have been paid for the products purchased from the French parent.

The Full Court of the Federal Court upheld the decision of the primary judge, rejecting the Commissioner's use of the transactional net margin method. The Full Federal Court instead relied on a version of the comparable uncontrolled price method adopted by SNF and concluded that the prices paid by SNF were at arm's length. The Commissioner's appeal was therefore dismissed.

Chevron

The issue in *Chevron*[62] was whether the interest paid under a credit facility agreement between Chevron Australia and Chevron Finance was arm's length consideration. Chevron Finance was a wholly owned subsidiary of Chevron Australia, which was in turn a subsidiary of Chevron Corporation, a US company.

Under the credit facility agreement, Chevron Finance agreed to advance to Chevron Australia up to the AUD equivalent of USD 2.5 billion. Chevron Australia paid interest to Chevron Finance monthly, at a rate equal to 1-month-AUD-LIBOR-BBA (British Bankers' Association) + 4.14% per month, which during the relevant periods was approximately 9% per annum with no security.

Chevron Finance funded the advances by borrowing in the US commercial paper market, paying interest at a rate of approximately 1.2% per annum. Chevron Australia did not provide any guarantee or security over its assets to Chevron Finance, and Chevron Finance was entitled to terminate the facility at any time without cause.

The Full Federal Court disagreed with Chevron Australia's submission that it was sufficient to price a loan by reference to third-party loans that were perceived to be comparable borrowings. The Court held that the proper test instead required the determination of what a borrower, in the taxpayer's position, might reasonably have been expected to give as consideration for the loan.

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60. *See* M. Butler, *Swiss Pharma Company Subject to Transfer Pricing Adjustment*, 14 Asia-Pac. Tax Bull. 3, p. 198 (2008), Journal Articles & Opinion Pieces IBFD.
61. *See* M. Butler & J. Pengelly, *Commissioner Loses Transfer Pricing Appeal in SNF Case*, 18 Intl. Transfer Pricing J. 5, p. 363 (2011), Journal Articles & Opinion Pieces IBFD.
62. *See* M. Butler, J. Pengelly & R. Neilson, *Federal Court Hands Down Transfer Pricing Decision in Chevron Australia Case,* 23 Intl. Transfer Pricing J. 1, p. 18 (2016), Journal Articles & Opinion Pieces IBFD; and M. Butler, J. Pengelly & L. Wang, *Full Federal Court Upholds Assessments Against Chevron Australia in Milestone Transfer Pricing Case*, 24 Intl. Transfer Pricing J. 4, p. 243 (2017), Journal Articles & Opinion Pieces IBFD.

The Full Federal Court confirmed the decision at first instance (*per* Robertson J) that the interest paid by Chevron Australia to its US parent company exceeded the “arm’s length” amount for Australian transfer pricing purposes. The Full Federal Court therefore dismissed the appeal by Chevron Australia and upheld the Commissioner’s transfer pricing assessments, involving AUD 340 million of primary tax, penalties and interest.

Glencore

In *Glencore*,[63] the taxpayer was the head of a consolidated group of companies for Australian tax purposes (Glencore Group). One of the Glencore Group’s members (CMPL) operated a copper mine in New South Wales and sold 100% of the copper concentrate produced there to its Swiss parent company (GIAG).

The issue was whether the prices paid by GIAG to CMPL were less than might have been reasonably expected in an arm’s length dealing between independent parties. The Commissioner contended the prices over the relevant periods were approximately AUD 241 million *lower* than arm’s length prices, and amended CMPL’s tax assessments to increase the tax payable by AUD 72 million and imposed more than AUD 20 million in interest penalties.

Prior to the agreement for sale of copper concentrate in question, entered into in February 2007 (February 2007 Agreement), GIAG and CMPL had entered into a series of offtake agreements, which were fundamentally different to the February 2007 Agreement. In the copper industry, the February 2007 Agreement was known as a “price-sharing” agreement, whereas the previous offtake agreements were known as “market-related” agreements.

At first instance, following the principles in *Chevron*, Davies J held that the hypothetical transaction was not to be construed on the basis GIAG and CMPL were unrelated, but that CMPL was a member of the Glencore Group. In her Honour’s view, adopting the Commissioner’s approach (i.e. GIAG and CMPL were unrelated) would produce a “hypothetical transaction based upon different commercial considerations and a different commercial structure to that which was actually entered into”.

Davies J held that the prices paid by GIAG to CMPL were *within* an arm’s length range, and the price need not be *the* arm’s length price, but *an* arm’s length price. Her Honour therefore allowed the taxpayer’s objection. Davies J also referred to the importance of expert witnesses assisting the Court, rather than advocating their respective instructors’ positions.

The Full Federal Court dismissed the ATO’s appeal and held the prices in dispute for the sale of copper concentrate were arm’s length. In their joint judgment, Middleton and Steward JJ noted that Davies J had decided neither Division 13 nor Subdivision 815-A authorized the Commissioner or the Court to ascertain the consideration “that might reasonably be expected to have been paid”, or the profits “that might have accrued”, using a pricing formula that was *not* price sharing and *not* quotational period optionality with back pricing. Because: “[t]o do otherwise would have constituted an impermissible reconstruction of the agreement in fact entered into by CMPL and GIAG”.[64]

Their Honours stated, however, that they were:“[…] inclined to think the Commissioner did in fact apply Subdivision 815-A and Division 13 to the transaction *actually* undertaken by CMPL and GIAG. All he sought to change was the consideration payable for the copper concentrate in fact supplied”.[65]

Their Honours cautioned against the extent to which the evidence of expert witnesses should be relied on: “as there is only so much that such an expert can legitimately say about a deal with which she or he had nothing to do”.[66]

The High Court dismissed the Commissioner’s application for Special Leave to Appeal, with costs, emphasizing that:(i) the case was mainly fact and evidence based; and (ii) the Commissioner was unable to overturn facts accepted by both the Federal Court and the Full Federal Court on appeal.[67]

63. For a detailed discussion of the judgment of Davies J, *see* M. Butler, L. Wang & C. Vu, *Federal Court Agrees with Glencore That Prices for Copper Concentrate Were Arm’s Length*, Intl. Transfer Pricing 1, p. 47 (2020), Journal Articles & Opinion Pieces IBFD.
64. *Glencore*, at para. 151.
65. Id., at para. 154.
66. Id., at para. 100.
67. AU: HCA, 21 May 2021, *Commissioner of Taxation of the Commonwealth of Australia v. Glencore Investment Pty Ltd* [2021] HCATrans 98.