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The Meaning of 'Associate': An Analysis of the Outcomes of Commissioner of Taxation v BHP Billiton (2019)

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THE MEANING OF 'ASSOCIATE': AN ANALYSIS OF THE OUTCOMES OF *COMMISSIONER OF TAXATION V BHP BILLITON* (2019)

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This article will discuss the judgment of the recent Australian tax case of Commissioner of Taxation v BHP Billiton Limited ('BHP'). Specifically, it will discuss how the case affects the meaning of the word 'associate' and the phrase 'sufficiently influenced.' It will do this by recapping the original Administrative Appeals Tribunal ('AAT') case of MWYS v Commissioner of Taxation which formed the basis of the appeal in BHP. It will then discuss the majority and dissenting judgements in the BHP case and how they both interpreted the meaning of 'associate' and 'sufficiently influenced,' before reconciling the ideas from both judgments, and the original AAT judgement. This paper will then aim to highlight the precedential value of BHP and how BHP may affect other areas of Australian Taxation Law, namely the Controlled Foreign Corporation rules, Thin Capitalisation Rules, and the R&D grant rules.

The Full Court of the Federal Court of Australia (FCAFC) recently released its judgment from *Commissioner of Taxation v BHP Billiton Limited* ('*BHP*').[2] *BHP* involved the application of Australia's Controlled Foreign Corporation (CFC) rules from Part X *Income Tax Assessment Act 1936* (Cth) ('*ITAA36*'). The case was an appeal from *MWYS v Commissioner of Taxation (Taxation)*[3] and considered whether the parties were 'associates' of one another. Prima facie, a determination of association would seem to be a straightforward and unimpactful event. The commonly understood everyday meaning of a seemingly simple word would lend credence to this idea. However, the term 'associate' is present throughout Australian legislation and therefore the definition that the Court would ultimately derive could have a potentially large effect across the legal and business community in Australia. This article starts with the background facts and scenario that led to the *MWYS* decision before exploring how the definition of 'associate' and 'sufficient influence' was explored in both *MWYS* and in *BHP*. This article It will then look at the outcomes and precedential value that arose from *BHP* before looking at how the case would affect other issues in Australian Taxation Law.

I BACKGROUND

BHP Billiton Ltd ('AusLtd') is an Australian resident company. AusLtd is one half of a dual-listed company arrangement (DLC), along with BHP Billiton Plc ('UKPlc'), a United Kingdom resident company. A dual-listed company arrangement is a corporate structure that is analogous to a

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[2] [2019] FCAFC 4 (*'BHP'*).

[3] [2017] AATA 3037 (*'MWYS'*).

partnership but between two companies. In this arrangement, both companies work towards a common economic goal and business practice. The companies typically bind themselves through a series of contractual agreements that lets them operate as one unit while also retaining certain aspects of independence. In the BHP DLC, both parts of the DLC had the same individuals on their board of directors, had a unified senior executive management team, and required directors to have regard for the interests of shareholders of both sides of the DLC as if they were a 'single economic entity'.[4] The DLC contractual agreement also determined the equalisation ratio of the DLC. The equalisation ratio is the ratio at which each entity has its share of ownership, dividend, voting rights, and profit.[5] In the BHP Billiton DLC, the ratio sat at 58:42 for AusLtd and UKPlc respectively.

AusLtd and UKPlc both have direct and indirect interests in several other subsidiaries and companies, including BHP Billiton Marketing AG ('BMAG').6 Based on the previously described DLC structure, AusLtd has a 58% indirect interest in BMAG7 and UKPlc has a 42% indirect interest in BMAG.8 BMAG is a Swiss resident company which operates as a marketing hub out of Singapore through a Singapore based branch.9 BMAG purchases commodities from Australian subsidiaries of AusLtd, and also from Australian subsidiaries of UKPlc.10 BMAG then further resells these commodities at a profit, thus resulting in income earned.11 BMAG's income resulting from the commodity sale is what the commissioner targeted in the amended assessment and is the subject of this case.

AusLtd's tax filings for the 2006-2010 income years contained income from BMAG. Specifically, AusLtd claimed 58% of BMAG's commodity sales that came from commodities purchased from AusLtd's Australian subsidiaries (hereafter referred to as AusLtd derived profit).[12] AusLtd did so because, under the Australian CFC rules, it self-assessed that this income would be considered tainted sales income and would be attributable to AusLtd.

In his amended assessment for AusLtd, the Commissioner also included 58% of BMAG's sales that were from commodities purchased from UKPlc's Australian subsidiaries (UKPlc derived profit).[13] The Commissioner took the position that under the CFC legislation, the UKPlc derived profit was also attributable to AusLtd,. The Commissioner and decided that the income derived from the UKPlc subsidiary derived income was attributable to AusLtd because it was also tainted sales income under *ITAA36*.

A Tainted Sales Income

Tainted sales income is described in s 447 *ITAA36*. It is sales income of a CFC that arises from the sale of goods sold to an associate, who is an Australian resident,[14] or purchased from an

[4] *MWYS* (n 2) 17.
[5] *MWYS* (n 2) 14.
[6] Ibid.
[7] Ibid.
[8] Ibid.
[9] Ibid 15.
[10] Ibid 16.
[11] Ibid.
[12] Ibid.
[13] Ibid.
[14] *Income tax Assessment Act 1936* (Cth) s 447 ('*ITAA36*').

associate, who is an Australian resident, before being sold to another party.[15] When income is determined to be tainted sales income, it is attributable to a resident taxpayer under the CFC rules. The key concept in determining whether income is tainted sales income of a resident taxpayer is the term "associate". If the entities are associates of each other, the income will be attributed to the Australian resident taxpayer. The argument outlined by AusLtd was that the UKPlc derived profit was not from any entity that was associated with them and therefore not attributable to them. The Commissioner argued otherwise.

B Associate

For the UKPlc derived profit to be considered tainted income, the UKPlc subsidiaries would have to be considered associates of BMAG. The term 'associate' is defined in s 318 of the *Income Tax Assessment Act 1936* (*ITAA36)*. This section describes the relationships and scenarios that give rise to an association between entities. These vary but for the purposes of this case, if an entity sufficiently influences another[16], they are considered associates.

C Sufficiently Influenced

The outcome of *BHP* was dependent on how the Court interpreted and applied 'sufficiently influenced'. The issue with 'sufficiently influenced' is not just how the individual words are defined, but how they work practically. What is influence and how much of it is needed to be 'sufficient?' This was the task of Allsop CJ and JJ Thawley and Davies in hearing the appeal from the Administrative Appeals Tribunal ('AAT').

In both *MWYS* and *BHP*, the AAT and the Full Court began by looking at how the legislation defined 'sufficiently influenced'. The phrase 'sufficiently influenced' is defined in s 318 (6)(b) *ITAA36* as:

> "a company is sufficiently influenced by an entity or entities if the company, or its directors, are accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of the entity or entities (whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts)."

Both the AAT and the Full Court looked at the construction of s 318 (6)(b) to determine a test for sufficient control, and how the elements of the test would be defined, interpreted, and applied.

II FIRST INSTANCE - MWYS V COMMISSIONER OF TAXATION

In MWYS, Logan J compared the construction of s 318(6)(b) *ITAA36* with the definition of 'director' in s 9 *Corporations Act 2001* (Cth). Both definitions were deemed to be worded closely similar enough that shadow director cases could be used to provide a functional definition of 'sufficiently influenced'. Logan J focused on the phrases 'accustomed to act' and 'in accordance with the person's instructions or wishes' in this discussion. To this end, Logan J focused on the consideration of whether there was 'abrogation of effective control' by AusLtd or UKPlc to each other as an important part of their criteria.[17] Importantly, Logan J stated that 'sufficiently

[15] *ITAA36* (n 14) s 447(1).
[16] *ITAA36* (n 14) 318(2)(d)(i) & 318(2)(e)(i).
[17] *MWYS* (n 2) .

influenced' would require the 'imposition of wishes'[18] of one party on another or the 'subservience'[19] of one party to another. Effectively, the AAT ruling deemed the definition to be read as one and set the bar for 'sufficiently influenced' fairly high.

Justice Logan's interpretation of s 318(6)(b) suggests that it does not apply when the parties are operating on an 'equal' relationship. For a party to be able to 'sufficiently influence' another, the relationship between them must be of unequal power, such as a parent-subsidiary relationship. Furthermore, they determined that if one entity is 'sufficiently influenced' by a second party, a third party cannot logically also 'sufficiently influence' the original entity.[20] This interpretation would logically present a possible legal defence in similar cases, or other situations where the terms 'associate' or 'sufficiently influenced' is used. The Commissioner disagreed and appealed to the Federal Court of Australia Full Court.

III BHP BILLITON LTD V COMMISSIONER OF TAXATION

The majority opinion of Thawley J and Allsop CJ in *BHP* construed the definition of 'sufficiently influenced' differently than was seen in *MWYS*. Thawley J stated that s 318 (6)(b) should be read as three separate independent tests, and not one comprehensive test.[21] This means that when determining whether an entity 'sufficiently influences' another, the Courts should see if the influenced entity

(1) Is accustomed to act in accordance with the directions, instructions or wishes of the other entity, or;

(2) Under an obligation to act in accordance with the directions, instructions or wishes of the other entity, or;

(3) Might reasonably be expected to act in accordance with the directions, instructions or wishes of the other entity.

Each of these would be an independent test with separate considerations. Only one of them would have to be satisfied to confirm 'sufficient control'. Interpreting the test this way would make it a more flexible test with a lower threshold to overcome.

At this point, s 318(6)(b) was determined to be three tests with three distinct elements to consider. Thawley J then determined how the core element of each test should be determined. Each test has a unique core element and they are the application of the phrases: 'accustomed to act', 'under an obligation to act', 'and 'might reasonably be expected to act'. Justice Thawley stated that 'accustomed to act' would depend upon a determination of past facts,[22] 'under an obligation' would depend on the existence of an obligation at the point of time that the determination of sufficient

[18] Ibid 32.
[19] Ibid 31.
[20] Ibid 55.
[21] *BHP* (n 1) 85.
[22] *BHP* (n 2) 85.

influence is being made,[23] and 'might be reasonably be expected to act' would require a prediction of future events and the likelihood of their actual objective occurrence.[24]

Justice Thawley then continued with his deconstruction and analysis of s 318(6)(b). He stated that the construction of s 318(6)(b) does not call for a strict legal obligation to 'act in accordance' for an entity to be deemed to be acting in accordance. The presence of past behaviours would seem to be enough to make a case of 'acting in accordance'. The determination of this would then seem to be a question of fact and degree, as opposed to a question of strict legal liability to act in a certain way. 'Sufficiently influenced' is a term which naturally lends itself to an intensity of causative actions or behaviours. Naturally, this creates a spectrum on which the intensity and influence can fall. In other words,there is a spectrum of influence and a certain point along that spectrum which is considered 'sufficient' enough to be deemed to influence the other party. On one end of the spectrum, a minor influence would not be considered to be enough, and on the other hand, an immense impact on the other party's behaviours would be required to fulfil the test. The debate in this case, was where along the spectrum is enough to be deemed a sufficient amount of influence.

Justice Thawley's judgment does not explicitly lay down a firm range. He stated that it must be more than a 'mere coincidence' and that there must be a clear causative value[25] in how the influencing party acts or behaves. The Court determined that 'sufficient influence' sits at a level of being less than strict legal control and that the AAT's criteria of 'imposition of wishes' or 'subservience' was going too far.[26] These ideas begin to offer minor clarity and an overall explicit minimum threshold was not determined.

The threshold of 'sufficiently influenced' would seem to be dependent on the context of the legislation being considered. The Full Court was displeased with Logan J's stricter analogy between s 318 (6)(b) *ITAA36* and the definition of 'director' from s 9 *Corporations Act 2001* (Cth). Instead, the majority opinion focused on how the definition of 'sufficiently influenced' was more dependent on the purpose of its surrounding legislation. The aim of the target of the legislation and the surrounding legislative context needs to be considered when making determinations of a definition.[27] As an example, the legislation does not list the number of and types of acts that are required for the purposes of s 318(6)(b), and therefore the Court determined that there is no restriction on either of these.[28]

A DLC Structure

Of particular note to this case was the DLC arrangement between AusLtd and UKPlc. The Full Court focused on the details of the arrangement in more detail and therefore came to different conclusions than the AAT in *MWYS*. The Full Court particularly focused on the operation of the Special Voting Shares ('SVS') between AusLtd and UKPlc. Each 'head' of the DLC arrangement had an SVS that could affect the other 'head'. In certain situations, one 'head' could vote down a proposal only to see it passed by the other 'head' after the use of their SVS.[29] The majority opinion in *BHP* agreed that this constituted 'sufficient influence' between AusLtd and UKPlc which meant

[23] Ibid.
[24] Ibid.
[25] Ibid 87.
[26] Ibid 106.
[27] *BHP* (n 1) 93-94.
[28] Ibid 88.
[29] Ibid 218.

that they were associates of one another.[30] The details of the DLC arrangement are important to consider as they showed the exact relationship and strength of ties between AusLtd and UKPlc. The consideration of the DLC structure would suggest that the applicability of the majority opinion to other scenarios may be limited to a similar fact pattern, and/or would require a detailed analysis of the business relationship between entities.

B Dissenting Judgement

The dissenting judgment in *BHP* was delivered by Justice Davies. Justice Davies disagreed with her colleagues and instead favoured the approach of Logan J in *MWYS*. Justice Davies stated that s 318 (6)(b) should not be read as three independent tests, but as one whole test whose elements would all have to be fulfilled.[31] She agreed with the approach of Logan J in looking at 'sufficiently influenced' through the lens of shadow director cases.[32] Furthermore, Davies J stated that the SVS, and their operation, do not constitute 'sufficient influence' but instead are just examples of 'acting jointly with a mutuality of interest'.[33] This would seem to be counterintuitive, however, as a 'mutuality of interest' would suggest a certain level of influence by two parties on each other. Davies J would then seem to also subscribe to the notion that influence, association, and control can only occur between parties at a non-equal relationship. Interestingly, the one area to which the entirety of the Court agreed to was the idea that ss 318(2)(i)(A) and 318(2)(i)(B) cannot operate together, meaning that the possible defence of already being another entity's associate would not work.

C Reconciling These Ideas

Between *MWYS* and *BHP*, four members of the FCAFC ruled on the issue of association and 'sufficient control'. The main differences in their approaches centred on how s 318(6)(b) should be read, and the lens through which elements of 'sufficient control' should be viewed. This amounts to a difference of whether the test in s 318(6)(b) is one whole test or three separate tests, and whether the application of those tests should be done via comparison to s 9 *Corporations Act 2001* (Cth) or not. Allsop CJ attempted to reconcile these ideas in the following way:

> "The associate provisions in s 318 take their place in a Part that is directed to the question of what amounts are to be included in a taxpayer's assessable income. The associate provisions take their place in this scheme by identifying relationships of sufficient proximity of association to subject an entity to tax by that association. Thus, the object of the Part (unlike the object of the shadow director provisions) is not one which, in its essence, requires limitation to a unidirectional element of influence, dominance, or control by one over the other."[34]

Chief Justice Allsop viewed the underlying purpose of the associate provisions and how they are structurally intended to operate to achieve those goals. His judgment would seem to favour Thawley J's approach and consider 'associate' and 'sufficiently influenced' as unrelated to the strict measures from the shadow director provisions.

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[30] Ibid 153-155.
[31] Ibid 38.
[32] Ibid 27, 29.
[33] Ibid 41.
[34] *BHP* (n 1) 10.

International tax law is no stranger to exercises in statutory interpretation. The balance between a strict and flexible interpretation is an increasingly common feature of international tax law cases. Previously, Allsop CJ has stated:

> "The Court must not, 'put to one side or ... diminish the necessity to begin and end with the words of the statute [nor] seek to find a purpose of the Division outside its words...', Courts must avoid 'narrow textualism' and 'the words used by Parliament ... should ... be given meaning and operation ... with the necessary flexibility of analysis... The provisions should not be interpreted pedantically."[35]

Does this lead to a conclusion that the test for 'sufficient influence' across Australian law should be the exact same as in the *BHP* judgment or should the *BHP* test be taken but modified by the surrounding statutory provisions of the specific case? It appears that when a case or statute refers to 'associate' or 'sufficiently influenced' the *BHP* tests can be used but should be modified in their extent by any related surrounding statutory provisions.

IV OUTCOMES OF BHP BILLITON LTD V COMMISSIONER OF TAXATION

BHP focused on what 'sufficient influence' consisted of and how it should be determined. Unless this judgment is struck down in an appeal, the majority opinion would seem to be where 'sufficient influence' and therefore the meaning of 'associate' lies. The fundamental aspects of the Full Court's judgment can be distilled into several points. Firstly, 'sufficient influence' is not as high a threshold as actual control. The level of behaviours from directors does not need to amount to dominance, subservience or the repudiation of their duties. As long as one of the three tests can be confirmed, the entity in question will be deemed to be 'sufficiently influenced' and therefore also be deemed an 'associate.'

Secondly, an entity can be influenced by more than one party simultaneously. The construction of ss 318 (2)(i)(A) and 318 (2)(i)(B) are not exclusive of one another like AusLtd and the AAT contended. If an entity is clearly influenced by or associated with another entity in a scenario, this does not mean that further entities cannot influence it enough in the same circumstance for the purposes of s 318(6)(b). Also, as opposed to Logan J's determination of influence, the Full Court's findings state that 'equal' parties can influence one another. The effect of this finding would be concerning to larger entities that work closely together, DLC arrangements and hybrid structures.

Thirdly, the adoption of one entity's widely known or promoted standards is a strong indication that the adopting entity is 'acting in accordance' with the wishes, directions or instructions of another. An example of this in *BHP* was the adoption of common marketing materials between AusLtd, UKPlc, and BMAG.[36] This indication would immensely grow the scope of 'acting in accordance' and is likely more applicable to other cases and legislation than some of the other principles from *BHP*. While the other principles are closely tied to the factual scenario and the DLC arrangement between AusLtd and UKPlc, this approach to 'acting in accordance' is not and therefore can be more easily relied upon in other judgments.

[35] *Chevron Holdings Australia Pty Ltd v Commissioner of Taxation* (2017) 345 ALR 570, 3.
[36] *BHP* (n 1) 171.

V THE PRECEDENTIAL VALUE OF BHP BILLITON LTD V COMMISSIONER OF TAXATION

The precedential value of *BHP* is debatable. On the one hand, the principles derived from this case would seem to be relevant only in a similar factual scenario. On the other hand, the approach to 'associate' and 'sufficiently influenced' is clearly applicable in other scenarios. It appears that the actual nature of the principles from this case lie somewhere in between these two ideas. The approach from this case, as to whether an entity is 'sufficiently influenced', can be used in other scenarios. However, the contextual and purposive features of the surrounding legislation would still need to be considered. In essence, the approach to 'sufficiently influenced' in *BHP* would remain, but its threshold would need to be tweaked by the surrounding legislation. It is important to get the right balance when determining 'sufficient influence' and that balance would need to shift depending on the circumstances. While s 318 *ITAA36* is referred to explicitly in other legislation[37] the level of association between entities in different contextual circumstances may need to differ. The word 'associate' is present across Australian tax legislation, with the CFC legislation, thin capitalisation rules, and the research and development incentives being just a few examples of where it appears.

VI AUSTRALIA'S CFC LAWS

Controlled Foreign Corporations CFC rules are one of the many mechanisms which countries can use to combat increasingly complex international tax planning methods. The taxation of foreign sourced income usually occurs after the income is accrued by a resident taxpayer in their resident nation.[38] Due to this feature, some types of income, such as income from dividends, can avoid taxation by deferring its accrual. The income will then be kept in a foreign jurisdiction, away from the resident tax authority. CFC laws target tax planning methods where passive income is kept overseas by deferring it in the overseas jurisdiction. Therefore, CFC laws work as an anti-tax deferral regime. Broadly, these laws achieve their goals by attributing foreign company income to domestic taxpayer shareholders.[39] As discussed above, the Australian CFC legislation comes from Part X of the ITAA36. While the legislation is complex, determining whether it applies to an entity can be broadly summed up in a few overarching steps for the purpose of this paper. These steps are broad representative summaries, and in practice can involve many sub-questions and sections of legislation for each step. In determining whether CFC rules apply, the legislation effectively wants the following questions answered:[40]

(4) Is a foreign company a CFC? If yes then;

(5) Is an Australian resident an attributable taxpayer? If yes, then;

(6) Does the CFC have attributable income?

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[37] For example, s 995-1 *Income Tax Assessment Act 1997* (Cth) operates by referencing s 318 *ITAA36* as its source of the definition of 'associate' throughout the Act.

[38] Roy Rohatgi, *Basic International Taxation - Volume 2: Practice* (BNA International, 2nd ed, 2007) 184.

[39] Ibid.

[40] Woellner et al, *Australian Taxation Law* (Oxford University Press, 29th ed, 2019) 1356.

If all of these questions are answered in order in the affirmative, then the CFC rules apply. If not, then they are not applicable to the entity in question. Again, this is a very simplified explanation of the CFC rules, but it provides a starting point to understand the issues from *BHP*. The outcomes from *BHP* would speak towards the first question and through to the limits of tracing. Whether or not a foreign company is a CFC is determined by whether it is controlled by Australian resident taxpayers or associates.[41] The broadening of 'sufficiently controlled' means that entities that would not previously be considered as 'associates' might now be. The approach to determining 'sufficient control' would likely remain the same, if not very similar to what was seen in *BHP*. Effectively, the judgment from *BHP* would allow the Australian CFC rules to capture more entities and more income. Furthermore, the extension of 'associate' would extend the reach of tracing in CFC cases. Tracing can only be done through entities that are deemed CFCs[42] so a broader definition of 'control' and 'associate' would mean the Commissioner can trace farther and through more entities. While the Australian tax authorities may find this favourable, other nations are likely to disagree.

The purpose of CFC rules is to prevent the erosion of a country's tax base through income deferral.[43] These anti-deferral rules target deferred income where other methods, such as transfer pricing, cannot.[44] In this way, the rules are used by countries as a shield of last defence against the erosion of their tax base. The principles from *BHP* could potentially expand the operation and reach of the Australian CFC rules to the point where they can be used as a tax grab mechanism as opposed to a defensive anti-deferral backstop. Arguably, the difference between these does not matter to the Australian tax authorities, but corporations would stress that the rules be used in a balanced way. The use and power of CFC rules should be balanced between the desire to protect erosion of the Australian tax base, and aggressively chasing income that would now fall under the rules due to an expanded definition of 'associate'. Applying the precedent from *BHP* liberally would give the Australian CFC rules more reach but would require them to be used by the ATO in a way that is not overreaching or over-aggressive. The resulting policy implications may be considered in an appeal of *BHP* and could result in the modification or repeal of the ruling in *BHP*.

This is not to say that strong CFC rules are necessarily detrimental. In fact, CFC rules have proven to be very effective in curbing profit shifting behaviour around the world.[45] The design of CFC rules enables tax authorities to approach a group of entities broadly and structurally whereas thin capitalisation rules, for example, focus more on specific behavioural parameters. Generally, CFC rules tend to affect the behaviour of multinational groups through their choice of profit shifting behaviours, their choice of subsidiary locations, and their investment strategy.[46] The implementation of strong CFC rules, along with an attractive business environment in a nation, should work as a 'carrot and stick' system. Strong CFC rules, that only target income separated from its value creator, deter avoidance through income deferral and a favourable business environment encourages business involvement within a nation.

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[41] *ITAA36* (n 14) s 340.

[42] Lynne Oats, Angharad Miller and Emer Mulligan, *Principles of International Taxation* (Bloomsbury Professional, 6th ed, 2017 556.

[43] Ibid.

[44] Oats, Miller and Mulligan (n 37) 549-550.

[45] Axel Prettl, 'Profit Shifting & Controlled Foreign Corporation Rules the Thin Bridge between Corporate Tax Systems' [2018] *SSRN Electronic Journal*, 3.

[46] Ibid.

VII OTHER AFFECTED TAX PROVISIONS

The potential impact of the *BHP* judgment could be felt throughout the tax legislation. The word 'associate' appears throughout different Australian tax legislation. This section will look at how selected provisions of Australian tax law could be affected by an expanded definition of 'associate'. Specifically, this section will address the research and development grant, the thin capitalisation provisions, stapled structures and the determination of equity interests, and Division 7A.

A Research and Development Grant

The *BHP* judgment may also negatively impact taxpayers who want to claim Research and Development tax incentives (R&D incentives). Broadly, the R&D incentives are tax offsets of 43.5% (refundable) or 38.5% (non-refundable) towards eligible research and development incentives.[47] The difference between the offset amounts is related to an entity's aggregated turnover. Aggregated turnover is the combined turnover of a company, its affiliates, and any connected entities.[48] If an entity has an aggregated turnover of AUD$20 Million or less, they are eligible for the higher offset.[49] The concept of 'affiliated entities' could be affected by the *BHP* judgment. 'Affiliated entities' are ones that are expected to act 'in accordance with your directions or wishes'.[50] This concept was discussed in *BHP* and the use of a common marketing scheme was determined to be enough to fulfil the requisite criteria.[51] Applying *BHP*, the threshold to be an 'affiliated entity' in respect of the R&D incentive provisions would be quite low. For smaller R&D companies, or for more capital-intensive R&D activities, every dollar saved makes a large difference. Sharing common materials with other loosely related entities would be a cost saver that may now see them be grouped together and put over the AUD$20 Million R&D offset level. The difference between the 43.5% and 38.5% offsets are not just the size of the offset, but also how it effectively it works. The higher percentage comes in the form of a refundable offset whereas the lower percentage is non-refundable. A refundable offset is effectively treated as cash for the receiving entity whereas the non-refundable offset works practically as an accounting benefit. Strictly applying the *BHP* test in this way would discourage R&D companies from investing and carrying out beneficial R&D in Australia. This is contrary to the goal of R&D incentives and would require an alternative or modified *BHP* approach.

B Thin Capitalisation

The judgment in *BHP* would potentially impact the Australian thin capitalisation ('ThinCap') rules. The ThinCap rules are designed to limit debt deductions by inbound or outbound investors.[52] The Australian ThinCap rules are located in Division 820 of the *Income Tax Assessment Act 1997* (Cth) ('*ITAA97*'). Broadly, the *BHP* judgment would work in a similar way to the CFC rules and capture a wider range of entities as 'associates'. This is important for the ThinCap rules, as exceptions to the rules apply to entities that, with associates, have debt deductions higher than AUD$2 Million

[47] *Income tax Assessment Act 1997* (Cth) s 355-100 ('*ITAA97*').
[48] Ibid s 328-115 (2).
[49] Ibid s 355-100 (1).
[50] Ibid s 328-130(1).
[51] Ibid s 355-100 (1).
[52] *ITAA97* (n 47) ss 820-65, 820-80.

AUD.[53] If the Australian tax authorities are able to include more entities as 'associates' and therefore more debt deductions, they will be able to apply the ThinCap rules to more taxpayers. Again, the amended rules would give the tax authorities a larger reach. This may encourage multinational entities to invest through equity as opposed to debt, or it may shift investment away from Australia. Having certainty in the application of the rules would encourage the former, as would having additional incentives to generally encourage investment. The implication of the *BHP* test on the ThinCap rules are worth considering because of the similar purposes of the CFC and ThinCap legislation.

C Stapled Structures & Equity Interests

The meaning of 'associate' is also important when considering stapled structures. A stapled structure, also referred to as a stapled security, is a financial instrument comprised of two or more securities that are bound together contractually into one unit so that they can only be dealt with together.[54] An example of the type of financial instruments joined together would be a share in a company and a unit in a trust that is related to the company. While the ATO has previously attempted to address their position on the parts of stapled structures being associates of one another in TR 2012/D5W (Income tax: debt and equity interests: when is a public unit trust in a stapled group a connected entity of a company for the purposes of s 974-80(1)(b) of ITAA 1997) (withdrawn)[55], the *BHP* judgment would seem to indicate that both parts of a stapled structure could be deemed to operate similarly as the two heads of a DLC structure and are, in fact, associates of one another.

Once particularly important consideration regarding stapled structures being associates of one another is whether section 974-80 *ITAA97* applies to them and therefore, if the interest in the structure is an equity or debt interest. This is an important consideration because equity and debt interests can be treated differently in various parts of the Australian tax legislation. For example, returns on debt interests can be deductible, but returns on equity interests are not deductible. The determination of whether an interest is a debt or equity interest also has implications for rules and calculations under the ThinCap regime, and could affect how corporations decide to structure themselves, and invest in Australia. Furthermore, returns on equity interest can be franked whereas returns on debt interest are not frankable. Section 974-80 *ITAA97* is triggered when an interest in one company is held by a 'connected entity'.[56] Entities are connected with each other if they are 'associates' of one another.[57] Therefore, the implications of BHP could have a significant impact on the operation of section 974-80 and the consequences that flow from something being deemed an equity interest.

D Division 7A

Division 7A of the *ITAA36* is another anti-avoidance provision that could be affected by the ruling in *BHP*. Broadly, Division 7A exists to stop tax avoidance by treating certain amounts of money from companies to their shareholders as dividends paid by a private company.[58] The amounts in

[53] Ibid s 820-35.
[54] *Taxation Administration Act 1953* (Cth) Sch 1 s 12-435 (4).
[55] See TR 2012/D5W.
[56] *ITAA97* (n 47) s 974-80 (1)(b).
[57] Ibid s 995-1 (definition of 'connected entity').
[58] *ITAA36* (n 14) s 109C.

question consist of amounts paid[59] and/or lent[60] by a company to a shareholder or their associate(s), and/or amounts of debts owed by a company to a shareholder or the shareholder's associate(s) that are being forgiven.[61] These dividends are then included in the assessable income of the recipient of that amount. Once again, an expanded definition of 'associate' would operate by increasing the reach of Division 7A.

The basic operation and carve-outs in Division 7A would still exist as they do now, however the expanded reach of the division would capture entities that it would not before. For example, a wife who operates her own business may now be an associate of a distant business that her husband owns shares in through a trust. Whereas a stricter control test would likely not capture both these entities, an argument could be made that the husband would be expected to act in accordance with his wife's wishes and their combined best interests and therefore dealings between the husband and the distant corporation could possibly have an impact on the wife and her business. Whereas Division 7A is likely meant to capture a relationship more in line to the one present between corporations and shadow directors, the result of *BHP* could mean that it now has a much further reach with a much greater impact on the Australian tax base than the ThinCap or CFC provisions While the international tax issues are where the potential impact of *BHP* will likely be most obviously seen, impacts to sections of the tax code such as Division 7A could have the greatest impact on the Australian tax base.

VIII CONCLUSION

MWYS and *BHP* are solid examples of how the interpretation of a small phrase can turn into an adventure in statutory interpretation and the exploration of the finer details of the technical aspects of tax legislation. The judgment in *BHP* provided for a flexible and open interpretation of 'associate' and 'sufficiently influenced' that ultimately results in a test with a lower threshold. The applicability of this new test to other parts of the Australian tax legislative regime is debatable, but the potential effects, particularly to business structuring, and inward investment into Australia, could be wide-ranging. Hopefully, the decision from the current appeal to the High Court will provide clarity on the phrase 'sufficiently influenced' and the determination of who is an 'associate'.

[59] Ibid ss 109C (1)(b).
[60] Ibid ss 109D, 109E.
[61] Ibid s 109F.