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Australian Transfer-Pricing in the Aftermath of Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia [2019]

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AUSTRALIAN TRANSFER-PRICING IN THE AFTERMATH OF GLENCORE INVESTMENT PTY LTD V COMMISSIONER OF TAXATION OF THE COMMONWEALTH OF AUSTRALIA [2019]

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Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia (2019) 272 FCR 30 ('*Glencore*') has dominated the Australian transfer pricing landscape for the past two years, with international tax specialists awaiting the outcome with great anticipation. The decision in the Federal Court of Australia and its subsequent appeal to the Full Federal Court and the High Court are of great importance to Australian transfer pricing due to its direct implications on the Australian Commissioner of Taxation's powers of reconstruction. While dealing with older statutory legislation, the insights of the court and the methods utilised to come to a decision have the potential to provide a strong interpretative precedent in future transfer pricing disputes. It is the opinion of the author that the outcome in *Glencore* will affect the current transfer pricing regime despite the gradual strengthening of the Commissioner of Taxation's powers under the new legislation. This article revisits the decision in *Glencore* and aims to provide a frame of reference for the use of members of the tax community and other individuals interested in understanding the context of the appeal and the implications this will have for Australian transfer pricing.

I. INTRODUCTION: AUSTRALIAN TRANSFER PRICING - THE OLD REGIME

While this article will be primarily focused upon explaining the Commissioner of Taxation's powers of reconstruction, and the impact of the decision by Justice Davies in *Glencore*, a brief summary of Australian transfer pricing history will be explored. In particular, the 'old regime' under Division 13 and Subdivision 815-A will be summarised with respect to their approach to the Commissioner's powers of reconstruction and how this contrasts with the new regime under Subdivision 815-B. The case law of this era of Australian transfer pricing will be examined, with attention given to the evolution of the Court's position on transfer pricing disputes.

A. *International Treaties*

The Organization for Economic Co-Operation and Development (OECD) provides a standard practice guideline in the form of the Transfer Pricing Guidelines (TPG).[1] These are intended to influence and inform Australian transfer pricing specialists and legislators in forming the domestic framework for Australian transfer pricing.

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Note from the Author: I would like to extend my heartfelt appreciation for the diligent work of Helen Matthews, for her exceptional assistance in editing this article and providing significant improvements to the presentation and academic consistency of the final product.

1 OECD Publishing, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (1995) ('OECD Transfer Pricing Guidelines').

On a bilateral level, the Associated Enterprises and Business Profits Articles of Australia's double-tax agreements ('DTAs') cover the topic of profit-shifting arrangements and arm's-length principle.[2]

As with all international treaties, the DTA takes precedence where there is an inconsistency with existing domestic law, with the exception of matters pertaining to tax avoidance covered under Part IVA of the *Income Tax Assessment Act 1997* ('*ITAA97*').[3] The Australian Taxation Office ('ATO') has consistently maintained that the Associated Enterprises and Business Profits Articles provide the ATO with an independent power of assessment in transfer pricing matters, though this has been met with mixed response by the courts and the administrative appeals tribunal. This 'additional' power has been referred to as the 'sword, not a shield' notion, referencing Australia's rejection of the internationally held view of DTAs as being primarily used as shields to protect taxpayers from the inequities of double taxation.[4]

B. *Division 13, Roche and SNF*

Until 1999, sections 136AA through 136AF of Division 13 of the *Income Tax Assessment Act 1936* (Cth) had received limited attention in the courts. As a result, the ATO was uncertain as to the effectiveness of Division 13; something it was unable to rectify without further judicial interpretation. It would not be until *Re Roche Products Pty Ltd and Federal Commissioner of Taxation*2008 ATC 10-036('*Roche Products*') that the ATO would be involved in a major transfer pricing case concerning the arm's length principle and international related party dealings insofar as it relates to Division 13.

Despite the ATO's concerns regarding Division 13, the decision to overhaul Australia's transfer pricing regime stalled until the Federal Court of Australia ('FCA') found in favour of the taxpayer in the relatively low stakes case (approx. $2m) of *Commissioner of Taxation v SNF (Australia) Pty Ltd* (2011) 193 FCR 149('*SNF*'). Here, the court rejected the ATO's approach to transfer pricing methodology and the ATO seized this defeat as an opportunity to execute a rapid revision of the Australian transfer pricing regime. Within a year of the *SNF* decision, the Commonwealth Government was convinced to bolster Australia's transfer pricing regime and release Subdivision 815-A.

C. *Subdivision 815-A*

Enacted in 2012, Subdivision 815-A of the *ITAA97* covers related-party dealings between Australian resident taxpayers and foreign entities resident in Australian double tax treaty partner jurisdictions. Subdivision 815-A applied retrospectively to financial years beginning on/after 1 July 2004 and focused more heavily upon the Commissioner's powers to assess transfer pricing arrangements under the Associated Enterprises and Business Profits Articles of Australian DTAs. It is important to note that Subdivision 815-A was only ever intended to be an interim measure to be operated concurrently alongside Division 13 until the new transfer pricing regime could be introduced.[5]

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2 Explanatory Memorandum, Tax Laws Amendment (Cross-Border Transfer Pricing Bill) (no. 1) 2012 (Cth), 7 [1.13] ('Explanatory Memorandum, (Cross-Border Transfer Pricing Bill) (no. 1)').

3 *International Tax Agreements Act 1953* (Cth) s 4(2).

4 Explanatory Memorandum, (Cross-Border Transfer Pricing Bill) (no. 1) (n 2), 10 [1.28]–[1.29].

5 Jones Day Publishing, *Recent Developments in Transfer Pricing and the Taxation of Multinational Companies in Australia* (November 2017), 2.

Under Subdivision 815-A, the Commissioner can assess a taxpayer when they receive a 'transfer pricing benefit' when dealing with an international related party from a treaty partner nation. This 'transfer pricing benefit' is defined by Australia's Associated Enterprises and Business Profits Articles and targets transactions resulting in lower Australian profits than would otherwise have been earned had the transaction been made between independent entities.[6] In the relevant Articles, an entity is considered to have gained a transfer pricing benefit for the purposes of Subdivision 815-A if the commercial conditions between two connected entities differ from the arm's length conditions and, more importantly, had the arm's length conditions operated instead, one of the following would apply:

- the amount of the entity's taxable income for an income year would be greater,
- the amount of the entity's loss of a particular sort for an income year would be less,
- the amount of the entity's tax offsets for an income year would be less,
- an amount of withholding tax payable in respect of interest or royalties would be greater.[7]

It is important to note that Subdivision 815-A states that the OECD Transfer Pricing Guidelines, as well as the OECD Model Tax Convention, are both viable assistive documents for interpreting the new transfer pricing legislation with regards to reassessment of a transfer pricing benefit.[8] A notable criticism is the one-way nature of Subdivision 815-A, which applies only where the Australian tax base is negatively affected from the perspective of revenue as a result of a transfer pricing benefit.[9] This can be seen from the criteria listed above. While this is understandable from a revenue collection perspective, it is notable that there is no flexibility available to the ATO in cases where the taxpayer's dealings result in overpayment and may contribute to the already not-inconsiderable amount of unresolved double taxation related treaty disputes.

The new regime reinforces the ATO's attempts to utilise Australia's double taxation treaties as a 'sword' capable of inflicting significant taxation-based liabilities and penalties upon taxpayers. The ATO maintains that there are no principles intended to reserve DTAs for exclusive use as 'shields' for the taxpayer.[10] While technically correct from a legal perspective, it is the writer's opinion that this represents a cause of concern from a policy standpoint, as it effectively results in Australian DTAs being utilised as a sword wielded against our treaty partner taxpayers, placing them at a *disadvantage* to non-treaty partner taxpayers who notably don't fall under the auspices of this legislation.

This is notable as the legislation states that the transfer pricing rules are equivalent to, but independent of, the transfer pricing rules in Australia's double taxation agreements.[11] It is the writer's observation that a rule that is intended to be 'independent' of Australia's DTAs might be intended to operate regardless of whether a transfer pricing benefit arises for a treaty partner taxpayer or a non-treaty party taxpayer.

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6 *Income Tax Assessment Act 1997* (Cth) s 815-15(1) ('*ITAA97*').

7 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, 43 [3.11], 47 [3.37]–[3.38], 49 [3.47]–[3.48].

8 *ITAA97* (n 6) s 815-20(2).

9 Explanatory Memorandum, (Cross-Border Transfer Pricing Bill) (no. 1) (n 2), 8 [1.20].

10 Ibid 19 [1.64].

11 *ITAA97* (n 6) 815-1.

D. *Chevron*

The first major case of litigation under the 'newer' regime was *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4)* [2015] FCA 1092 (23 October 2015*)* ('*Chevron (No 4)*'). In *Chevron (No 4)*, the core of the transfer pricing assessment involved the assertion (by the Commissioner) that the related parties, Chevron and Chevron Texaco Funding Corporation, were not dealing at arm's length. The Commissioner made a successful argument that the conditions of the loan would have differed significantly had the taxpayer been acting at arm's length. This was based upon the assumption that an independent party would have offered a security or guarantee on the loan in order to gain a more favourable interest rate. This absence of arm's-length indicators proved to be fatal to the taxpayer's case. While *Chevron (No 4)* provided numerous arguments explaining their position, some commercial and others creative (such as the so-called 'orphan' argument), including the evidence of transfer pricing experts, the Court gave no weight to these opinions and found in favour of the Commissioner when the Full Federal Court unanimously dismissed Chevron's appeal in *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation* (2017) 251 FCR 40 (*Chevron)*. Ultimately, Chevron was ordered to pay the Commissioner's costs, with $300 million in amended assessments and penalties of 25% imposed on the basis that Chevron had entered into a 'scheme' under Section 284-160(2) of Schedule 1 of the *Taxation Administration Act 1953*(Cth).

II. AUSTRALIAN TRANSFER PRICING – THE NEW REGIME AND GLENCORE

A. *Glencore*

In *Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* (2019) 272 FCR 30('*Glencore*'), the case revolved around the pricing of copper concentrate mined in Queensland by Cobar Management Pty Ltd (a subsidiary) and sold to Glencore International AG (the parent). This concentrate was sold unrefined to the parent company in Switzerland and on sold to smelters internationally. The rate at which the copper concentrate was sold by the Australian taxpayer was at a 23% of the copper reference price.

The Commissioner's position was that the Australian taxpayer was underpaid some $240 million over 3 years and claimed taxes, interest and penalties in excess of $90 million. The Commissioner's position was supported by their traditional interpretation of the Commissioner's powers to reconstruct transactions that are deemed not to be at arm's length. The reconstructed transaction would adjust the 23% price sharing to a 50% benchmark/50% spot price for treatment and copper refining charges ('TCRCs'), which was the historic price used by the taxpayer.[12]

In brief, the Commissioner led numerous arguments for the reconstruction of the transaction that gave rise to the transfer pricing dispute on the basis that the Australian taxpayer would not have entered into the initial agreement under arm's-length conditions.[13] These arguments included the following key principles:

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12 *Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* (2019) 272 FCR 30('*Glencore*'), 36[4].

13 Ryan Finley, 'Glencore wins $63 million Australian Transfer Pricing Case', *Tax Notes International* (online, September 9, 2019) 2<https://www.taxnotes.com/tax-notes-international/transfer-pricing/glencore-wins-63-million-australian-transfer-pricing-case/2019/09/09/29wzb>.

1. Use of hindsight to determine that a different pricing ought to have been used.
2. Whether the decision to negotiate the 23% Price Sharing contract was commercially motivated.
3. Whether comparable pricing agreements need to be direct/identical.

These key principles will be examined below.

B. *Use of Hindsight*

Justice Davies was quick to dismiss the Commissioner's argument that the Australian taxpayer would have made a greater profit had the ATO's proposed copper pricing benchmarks been used instead of the 23% price sharing offtake agreement.[14] The Commissioner attempted to use this hindsight to suggest that it was unreasonable that the taxpayer would have agreed to sell its copper concentrate to Glencore International at the 23% rate stipulated by the price sharing contract. Her Honour, however, referred to the Canadian case of *Cameco Corporation v R*(2018) TCC 195 to rule out any further use of hindsight in the transfer pricing analysis of the original transaction.[15]

C. *Commercial Motivations*

Justice Davies noted that Division 13 and Subdivision 815-A do not give the Commissioner the power to undertake an investigation into the commercial prudence of a non-arm's length contract or transaction entered into.[16] Rather, the relevant division and subdivision provide for a comparative analysis of the consideration given under the actual agreement with a comparable 'real world' arm's length consideration.[17] Her Honour noted that the OECD Guidelines had nothing to contribute regarding the assumptions of the Commissioner in this matter, stating that the arm's length principle does not introduce nor involve any investigation or consideration of purpose or motive.[18]

D. *Use of Expert Evidence*

A significant departure from previous cases (*Roche, SNF* and *Chevron (No 4)*) is the weight given to expert evidence. In prior cases, most notably *Chevron (No 4),* the court outright rejected evidence provided by some of the world's most knowledgeable transfer pricing experts, as encapsulated by the following quote from Justice Robertson:

> Also, in relation to the s 136AD issue, I give no weight to the opinions of transfer pricing economists where those opinions appear not to be founded in the statutory language which the Court must apply.[19]

In contrast, while the decision in *Glencore* did not turn upon the weight of expert evidence, there was nonetheless a notable reference to evidence provided by (copper mining) industry experts

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14 *Glencore* (n 12)116 [333].
15 Ibid 115–116 [331], citing *Cameco Corporation v R* (2018) TCC 195, [811] ('*Cameco*').
16 Ibid 117 [338].
17 Ibid [339].
18 Ibid [340], citing OECD Transfer Pricing Guidelines (n 1) Ch 1 [1.37].
19 *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4)* [2015] FCA 1092 (23 October 2015) [500].

throughout the decision. Of particular note was the evidence provided by Mr. Wilson, expert witness for the taxpayer. Mr. Wilson had few immediate connections to the issue of copper concentrate pricing and the mining risks that necessitate a shared pricing agreement, having neither worked for *Glencore,* in a mine, nor a smelter, nor directly participated in copper trading. However, Mr Wilson has written parts of the Brook Hunt Report from 1988 to the present day; this report being the primary resource and reference guide for the copper market internationally. The acceptance and subsequent preference of Mr Wilson's evidence signals a widening of the Court's views towards industry leaders and outside experts, especially when compared to the earlier approach taken by the Court in earlier cases.

E. *Direct Comparable*

The Commissioner argued that none of the contracts provided by the taxpayer to support their price sharing agreement rate of 23% were directly comparable and, therefore, they were inadequate for use as a comparable uncontrolled price (CUP). The proposed ATO approach required an identical relevant comparable.[20] This logic ignores the outcome of *SNF* where the Full Court held that such a requirement would set the taxpayer's burden of proof at an 'unattainable height'.[21] Reinforcing the decision of the Federal Court in *SNF*, Justice Davies rejected the Commissioner's arguments as impractical and unrealistic from a commercial and compliance standpoint.[22]

F. *23% Price Sharing Agreement*

Her Honour went on to note that the 23% price sharing rate of the taxpayer was within the arm's length range, referencing the 2006 Brook Hunt Report which ranged between 21-26%, the taxpayer's comparable contracts which ranged between 20-27.5%, the London Metal Exchange copper price at 22% and, most notably, Mr Ingelbinck's (the primary expert witness for the *Commissioner*) statement that the agreement seemed to be 'reasonably consistent' with the Brook Hunt Report.[23] In light of the evidence and in the absence of the arguments that have been rejected or rendered unusable, Justice Davies concluded that the taxpayer's price sharing percentage rate fell within the 'normal range' at 23%.

G. *Reconstruction and the OECD*

The Commissioner's primary argument heavily leaned upon the decision of Chief Justice Allsop in *Chevron*, referencing in particular his description of Article 9 (the Associated Enterprises article) of the Convention between Australia and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (the Swiss Agreement) as having 'broad and flexible' conditions and that the causal test in s 815-15(1)(c) is a 'flexible comparative analysis', to justify their flexible reconstruction of the initial agreement in order to support their position in *Glencore.*[24]

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20 Peter Collins, 'Glencore v FCT: Transfer pricing decision' (2019) 54(6) *Taxation in Australia*332, 333.

21 *Glencore* (n 12) 118 [344], citing *Commissioner of Taxation v SNF (Australia) Pty Ltd* (2011) 193 FCR 149at [102].

22 Ibid [345].

23 Ibid 119 [347]–350].

24 Ibid 46 [39]–[40], citing *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation (2017) 251FCR 40*, [82] ('*Chevron*').

Justice Davies ultimately rejected this logic, noting that a transfer pricing analysis should be based on the form of the actual transaction entered into, rather than 'impermissibly' restructuring the actual contract into a contract of a different character.[25] Her Honour went on to point out that Chief Justice Allsop directly referenced the 1995 OECD Transfer Pricing Guidelines that 'restructuring the controlled transaction under review is generally inappropriate' and that analysis 'ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them'.[26]

In what was likely the most significant blow against the ATO's general position on transfer pricing reconstruction, Justice Davies heavily considered the OECD Transfer Pricing Guidelines when interpreting the execution of Subdivision 815-A. As per s 815-20(1)(b), Subdivision 815-A comes into effect when an entity receives a transfer pricing benefit 'consistently with the documents covered by this section'.[27] As per s 815-20(2), the documents covered by Subdivision 815-A 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.[28]

Unlike previous transfer pricing cases, *Glencore* saw a deep analysis of the applicability of s815-A with regard to its consistency with the OECD Guidelines. In particular, Justice Davies found that the Commissioner's argument in *Glencore* was inconsistent with paras 1.37 and 1.38 of the Guidelines, which warns against the disregarding of an actual transaction, save in the case of two exceptional circumstances.[29]

These 'exceptional circumstances' are described in detail in the aforementioned paragraphs. In brief, they refer to circumstances where:

1. The transaction *in its totality* differs from those that might be adopted by rational, commerce driven independent parties in *comparable* circumstances, or

2. The actual transaction does not possess commercial rationality that would have been agreed upon by unrelated parties under comparable circumstances.

The OECD Guidelines go on to *strongly* advise against the non-recognition of a transaction with commercial rationality as the 'restructuring of legitimate business transactions would be a wholly arbitrary exercise' which runs the risk of being compounded by double taxation where the other tax administration does not agree with the reconstruction.[30] Justice Davies struck upon these two exceptions with notable vigour, stating that the 1995 Guidelines make it clear that restructuring for the purposes of comparative analysis is limited to these two exceptional cases, and that the

25 Ibid 110–111 [314].
26 Ibid, citing *Chevron* (n 24) [89].
27 *ITAA97* (n 6) s 815-20(1).
28 Ibid s 815-20(2).
29 OECD Transfer Pricing Guidelines (n 1) Ch 1 [1.37].
30 IbidCh1 [1.36]–[1.38].

facts of *Glencore* did not fall within either of the two exceptions referred to in the Guidelines.[31] Furthermore, Her Honour observed that the wording of the Guidelines do not imply that the two exceptions are intended to act as alternatives to the general rule, firmly establishing reconstruction as a last resort measure.[32]

H. *The Two Step Test for Determining the Arm's-Length Process*

Justice Davies found fault with the Commissioner's arguments regarding the taxpayer's onus of proof, pointing out that his attempt to predicate an agreement on benchmark terms incorrectly omitted two statutory questions directed by the legislative provisions.

The first question addresses the matter of determining the following:

1. Whether there has been a non-arm's length international dealing between enterprises (Division 13), or
2. Whether the operative conditions between the entities differ from those which might be expected to operate between independent entities (Subdivision 815-A).[33]

This first question acts as a prerequisite for allowing an adjustment of the actual consideration received or paid by an entity to meet the arm's length equivalent.

The second question addresses the matter of determining the following:

1. Whether the consideration received for a related-party dealing was lesser or greater than the arm's length equivalent (Division 13), and
2. Whether there is a *causal* relationship between non-arm's length conditions and profits not accruing to the taxpayer (Subdivision 815-A).[34]

This question's purpose is to determine an arm's length *amount* for the actual transaction.

Justice Davies references Chief Justice Allsop in *Chevron* in her conclusion that the hypothesised dealing, when correctly applied, ought to be a comparable agreement to the actual transaction, but where the consideration is *not* distorted by the parties' lack of independence and lack of arm's-length dealing.[35] Her Honour drew parallels between *Cameco*, especially to Justice Owens' observation that the traditional transfer pricing rules' task is to ascertain the price that would have been paid in the *same circumstances* if the parties had been dealing at arm's length, adding that traditional transfer pricing rules must not be used to recast the arrangements actually made.[36]

I. *The International Arm's-Length Standard*

Glencore highlighted the importance of international standards with regard to establishing the arm's-length principle. Justice Davies made extensive reference to the OECD's adoption of the arm's-length principle and of Australia's subsequent deference to that international standard as evidenced in the domestic legislation's references to OECD documents (as can be seen in s815-1

31 *Glencore* (n 12) 112 [319].
32 Ibid, citing OECD Transfer Pricing Guidelines (n 1) Ch 1 [1.41].
33 Ibid 113 [324].
34 Ibid.
35 Ibid, citing *Chevron* (n 24) [4] (Allsop CJ), [129] (Pagone J).
36 Ibid 114 [325], citing *Cameco* (n 15) [751].

ITAA97). Her Honour attaches special importance to the overarching 'policy objective' of upholding these international standards and ensuring fairness and equity among different taxing countries.[37] This is significant as it takes a holistic approach to Australian international taxation legislative interpretation, as evidenced by the following statement by Justice Davies:

> [any] construction and application of [Division 13 and Subdivision 815-A] that distorts the application of the arm's length principle…by applying some different measure for determining an arm's length price than one based on the arm's length equivalent of the transaction actually entered into, would not give effect to the policy objective.[38]

As was the standard for this case, Her Honour went on to provide a cautionary note that it does not necessarily follow that Division 13 and Subdivision 815-A will apply to all non-arm's length cross-border dealings, as such dealings may nonetheless have an arm's length consideration.[39] With reference to Justice Middleton in *SNF (Australia) Pty Ltd v Commissioner of Taxation* [2010] FCA 635(*SNF 2010).* Justice Davies warned that the absence of real bargaining does not necessarily follow that the consideration agreed upon was not an arm's length consideration.[40] Armed with this interpretation, Her Honour proceeded to reject the Commissioner's hypothetical transaction built upon different commercial considerations and a different commercial structure to that which was actually entered into.[41] This 'rewriting' of the actual arrangement involved an engagement in an 'extensive exercise in commercial judgement which does not coincide with, or give effect to, the objective of the arm's length principle'.[42]

This conclusion is highly important because it reinforces the OECD standards as representing an Australian policy objective. In the writer's opinion, this potentially has the effect of equating all Australian legislation which draws authority from the OECD standards as having an implicit 'intention' to be applied according to the relevant OECD Guidelines. Interpreted further, this imbues our existing OECD dependent legislation with a new 'spirit of the law' that has the potential to guide future interpretation in a manner that significantly curtails the Commissioner's ability to deviate from the intended OECD supported application of key international taxation principles.

J. *Immediate Implications*

It should go without saying that *Glencore* will have a decisive effect on ongoing transfer pricing cases that fall under Subsection 815-A. Almost all the Commissioner's arguments were soundly rejected, with the reasoning and statutory interpretation of several submissions challenged and many assumptions outright dismissed as irrelevant or incorrect. If the Commissioner's position in *Glencore* in any way reflects the Commissioner's position in other outstanding transfer pricing disputes, then the outcome of *Glencore* is likely to unleash a complete upheaval of the status quo with regards to reconstruction related tax cases.

Additionally, while *Glencore* operated under the old transfer pricing regime, this case nevertheless established key principles that will continue to have a significant impact on judicial interpretation of the current transfer pricing rules under Subdivision 815-B of the *ITAA97*. Regardless of how

37 Ibid 52 [48].
38 Ibid.
39 Ibid [49].
40 Ibid [49], citing SNF (Australia) Pty Ltd v Commissioner of Taxation [2010] FCA 635 at [39].
41 Ibid 113 [322].
42 Ibid.

Subdivision 815-B is affected by the principles established in *Glencore*, the increased acceptance of expert evidence and taking into consideration external OECD Guidelines represents a key shift in the Court's approach to international taxation law cases to come.

III. THE RECONSTRUCTIVE PROVISION – SUBDIVISION 815-B

As of 29 June 2013, Division 13 *and* Subdivision 815-A have been supplanted by Subdivision 815-B, 815-C and 815-D of the *ITAA97*.[43] Of particular relevance to the outcome of *Glencore* is the introduction of the 'reconstruction provision' under s 815-130. Unlike its predecessor, s 815-130 attempts to empower the Commissioner to reconstruct transfer pricing arrangements from a domestic legislation power base rather than exclusively from the OECD as did Subdivision 815-A. Subdivision 815-B revolves around the concept of the 'transfer pricing benefit', automatically enforcing arm's-length conditions where an entity receives such a benefit under certain conditions.[44] These provisions offer significantly more grounds for reconstruction than the prior legislation allowed.

However, the author notes that the outcome of *Glencore* was not defined by the inadequacies of Subdivision 815-A, but rather by the inconsistencies of the Commissioner's *interpretation* of Subdivision 815-A (in the view of the court) with the OECD Transfer Pricing Guidelines.

Further supporting this notion: despite these inconsistencies, the ATO has maintained that reconstruction under section 815-130 operates in concord with the OECD Guidelines.[45] This is especially significant as the more recent 2017 OECD Transfer Pricing Guidelines have reaffirmed that 'in other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them'.[46] These exceptional cases are, by and large, the same as they were in 1995 and are detailed in Chapter 1.122-125 of the updated Guidelines.

The author notes that Subdivision 815-B has no such reference to 'exceptional cases', while the Guidelines strong urging on tax administrations to give special care and careful weight when considering a restructure appears to have been quietly ignored. Of particular note, the wording of sections 815-115(1)(b) and 815-130(2) appear to be self-executing and thus, entirely devoid of nuance altogether.[47] Section 815-115 automatically substitutes arm's-length conditions when such conditions are 'taken not to operate' between an entity and another entity receiving a transfer pricing benefit. Section 815-130, similarly, disregards the form of the actual commercial or financial relations to the extent that they are inconsistent with the subject of arm's length commercial relations.

This wording, in the opinion of the author, is concerningly self-empowering and offers little room for discretion or exception, despite the OECD Guidelines' evident reservations regarding the unrestrained use of reconstructive provisions. Even more curious, when weighed against the ATO's contention that section 815-130 operates in accordance with the OECD Guidelines, is the ATO's open acknowledgement that section 815-130 neither 'requires nor contemplates the

43 *Income Tax (Transitional Provisions) Act 1997* (Cth)s 815-15.

44 *ITAA97* (n 6) s 815-115.

45 ATO, *Income tax: transfer pricing - the application of section 815-130 of the Income Tax Assessment Act 1997* (TR2014/6,12 November 2014), 5 [15] ('TR 2014/6').

46 OECD Publishing, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2017), Ch 1 [1.121].

47 *ITAA97* (n 6) s 815-130(2).

existence of any other 'exceptional circumstances' other than those strictly defined within its subsections.[48] This may prove to be a contentious topic in future transfer pricing disputes as Subdivision 815-B maintains no active reference to the OECD Guidelines warnings against 'arbitrary' reconstruction, nor does it imply that reconstruction is to be used only as a last resort.

IV. CONCLUSIONS

With Subdivision 815-B as yet untested in litigation and with *Glencore* on appeal to the Federal Court, the nature of reconstruction in Australian transfer pricing is still very much undecided. Despite the significant (and self-executing) powers granted to the Commissioner by the new transfer pricing regime, the outcome of *Glencore* has provided valuable ammunition for taxpayers seeking clarification on the application of arm's-length principle, OECD standards, transfer pricing methodology and reconstruction.

It is the interpretation of the author that Justice Davies' conclusions about the nature of the reconstruction power lend support to the possibility that Australian Courts may prove unwilling to throw their weight behind the unrestrained application of Subdivision 815-B. Her consistent reference to the OECD Guidelines and International Standards indicates a forceful push back to certain attempts by the Commissioner to 'distort' the actual intended application of OECD approved measures. Her Honour's remarks regarding the OECD's warnings against using reconstruction except under the most exceptional of circumstances, as well as Her Honour's notes about the distortion of OECD standards, may prove particularly useful for future taxpayers facing off against the new reconstructive provisions.

The focus of the decision upon international transfer pricing standards suggests that, while section 815-130 greatly reinforces the Commissioner's powers to reconstruct, the significant dissonance between the new legislation and the OECD Transfer Pricing Guidelines may ultimately lead to similar outcomes to that in *Glencore*. While it is true that *Glencore* decided a matter of old law under Subdivision 815-A, it is nonetheless important to note that just as *SNF 2011* still featured heavily in Justice Davies' considerations when deciding upon the matter in *Glencore*, it is highly likely that *Glencore* will weigh heavily upon Subdivision 815-B cases in the future. While the Commissioner may dispute the exceptional circumstances argument with regard to reconstruction on the grounds of the powers granted by Subdivision 815-B, the unprecedented weight given to expert witness evidence, referring to the OECD Transfer Pricing Guidelines and the application of the hindsight principle used in *Cameco* are all significant rulings on their own and each have the potential to dramatically affect the outcomes of future transfer pricing disputes.

If the Federal Court's decision is upheld on appeal, then this will represent a clear step away from the Australian court's prior, almost traditional, resistance to outside expertise and opinions on international taxation matters. If foreign expertise, international standards and multilateral measures such as the OECD Guidelines finally assert themself in Australian courts, then *Glencore* will have opened the door to a more holistic, forward-thinking approach to Australian transfer pricing.

In addition, its implications on the Commissioner's powers of reconstruction, the holistic approach of the court in *Glencore* may well have an effect on other recent Australian legislation such as the Multinational Anti-Avoidance Law (MAAL), introduced in 2015 in the Tax Laws

[48] TR 2014/6 (n 45) 31 [121].

Amendment (Combating Multinational Tax Avoidance) Bill 2015, and the Diverted Profits Tax (DPT), introduced with the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017.

Both laws are intended to reinforce the Australian government's already considerable powers in combating tax avoidance. While this in and of itself is within Australia's prerogative as a sovereign nation, it does represent a notable departure from the OECD's collaborative approach to dealing with international tax avoidance.[49] It is the author's observation that enabling the ATO to unilaterally decide which portion of the international taxation pie slice they are entitled to claim can set a dangerous precedent for other treaty partners to do the same, increasing the scope for international tax disputes. A ruling from the court that reinforces this unilateral approach can only serve to undermine the efforts of the OECD in bringing international revenue authorities in line with a transparent and equally applicable standard of conduct. Such a standard of conduct is fundamental for preventing the limitless introduction of tit-for-tat approaches to international taxation and critical for preventing the onset of a taxation arms race as revenue authorities race to draw lines around taxpayers without regard for international agreements.

In conclusion, *Glencore* gives taxpayers a glimpse of an Australian transfer pricing landscape with an unprecedented willingness to consider industry experts, tax treaty integrity, policy concerns and international standards. While the ruling is based on old legislation, the basis of the reasoning and the source of the court's interpretation is based on current international standards. If the Full Federal Court upholds the decision in *Glencore* on appeal, then that same holistic approach to international taxation law may well become the standard for international tax disputes going forward and will have far reaching consequences for the interpretation of powers under both current and future tax legislation.

V. POSTSCRIPT: THE DECISION OF THE FEDERAL COURT

In the time between writing and publishing this article, the Full Federal Court of Australia heard the appeal by the Commissioner of Taxation in *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187 (*Glencore 2020)*. In the interests of completion, the author will summarise the key positions contained within the 3-0 ruling of the Full Federal Court in their decision to dismiss the Commissioner's appeal on all but one point.

The decision was handed down by Justices Middleton and Steward in joint judgment and Justice Thawley on 6 November 2020 and reinforced many of the key principles mentioned above in the decision of Justice Davies, while offering clarity and insight into the broader applications of Australian transfer pricing provisions.

A. *OECD Guidelines and Reconstruction*

The joint-judgement of Justices Middleton and Steward was firm in its conclusion that the OECD Transfer Pricing Guidelines are only applicable insofar as it reinforced the need for a revenue authority to apply 'arm's-length principle' to the transaction actually undertaken by the associated enterprises as it has been structured by them. Justices Middleton and Steward pointed out that the Guidelines are merely a guide as to how a revenue authority ought to apply 'arm's-

[49] Anthony Faisandier, 'The Maal and DPT: Two roads diverged from the OECD - did they make any difference?' (2017)*Australian Tax Forum* 32(4) 793,794.

length principle'. Building off this position, the learned judges ruled that the issue of reconstruction was not actually in question and Their Honours found that Division 13 and Subdivision 815-A had been correctly applied to the transaction actually undertaken.

Rather, the issue in question was whether the pricing formula originally established in the contract did not differ from that which would be used between unrelated parties dealing independently of one another in the contemporary copper concentrate market. Justices Middleton and Steward determined that the argument of whether the Commissioner was correct to exercise the power of reconstruction was irrelevant and that the Commissioner was entirely entitled to contend that the pricing formula utilised was not 'arm's-length'.[50] In their view, the language of Subdivision 815-A offered distinction between terms which define price and terms which do not, and Their Honours concluded that the Commissioner may substitute the former, but not the latter.[51] In his independent ruling, Justice Thawley concluded with the view that reconstruction was not limited by the circumstances set out in the OECD Transfer Pricing Guidelines. Justice Thawley also differed from Justices Middleton and Steward on the topic of substitution, being of the opinion that terms which define price and terms which do not may both be substituted under Subdivision 815-A. Instead, their Honours found that the case turned on the question of whether the conditions between the relevant parties were sufficiently similar to those which might have been expected to operate between independent parties.[52]

B. *23% Price Sharing*

The court supported Justice Davies' judgement that the 23% price sharing rate was 'within arm's-length'. It is important to note that the court acknowledged the validity of the Commissioner's argument and the strength of their expert witness's opinion. However, Justices Middleton and Steward went on to clarify that, due to the complexity of the industry, contemporaneous forecasting and managing risk, the Commissioner's position was insufficient to negate the argument that the taxpayer's rate was *also* an arm's-length outcome.[53] This ruling by the court is interesting and indicates that commercial prudence will be heavily considered in future transfer pricing cases as a matter of course. If *Glencore 2020*serves to provide a benchmark of how the court will approach pricing disputes, then the notion that taxpayers need only defend the validity and commercial prudence of the agreement actually made, rather than dispute the position put forward by the revenue authority, is a significant takeaway for transfer pricing disputes waiting to be heard.

C. *Freight Allowance*

The appeal was allowed in part, on one count, due to the taxpayer's failure to adequately explain the calculations used to justify the freight allowance for 2009, which was fixed at the rate for shipping to India. This proved to be an inarguable position for the taxpayer, as the rate for India was considerably higher than the freight costs for China, Japan or Korea, all of which saw much greater traffic than India had between 2007 and 2009. Justices Middleton and Steward observed that the taxpayer had failed to lead expert evidence explaining how independent parties might have reached that price. Nor did the taxpayer attempt to lead evidence that at the start of each

50 *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187, at [191].
51 Ibid [156].
52 Ibid [298].
53 Ibid [213].

year, the parties did not have the knowledge of where the copper concentrate might be shipped, thus justifying using the expensive shipping rate for India as the baseline. Without offering comparable rates from independent parties or leading any evidence that India was expected to see higher traffic than it had in previous years, the court found that the taxpayer had failed to discharge the onus of proof on that issue.[54]

D. *Appeal to the High Court*

While the ATO did successfully win on the matter of freight, the finding of the Full Federal Court was such that the High Court could not find any question of principle sufficient to warrant a grant of special leave for appeal on other points.

Chief Justice Kiefel and Justice Gordon were quick to point out that the Commissioner of Taxation was merely continuing to press the matter on essentially the same grounds as was done in the Federal Court and the Full Federal Court. In Their Honour's opinions, the Full Federal Court had sufficiently approached the key principles in question and thus dismissed the application for special leave to appeal.

VI. CONCLUSION

In light of the judgement of the Full Federal Court overwhelmingly erring in favour of the ruling of Justice Davies, *Glencore* remains a critical case for the future of Australian transfer pricing. Despite the fact that the powers granted to the Commissioner of Taxation under Subdivision 815-B remain untested, the approach of the court appeared to indicate a newfound flexibility when determining arm's-length standards and a significant wariness of applying such contentious principles as reconstruction and logic in hindsight. Of equal importance was the Court's firm stance on the flexibility to be applied to arm's-length pricing. With the potential for several different 'arm's-length' prices being correct depending on the risks, priorities and real commercial concerns of the involved parties, the court was quick to point out that the taxpayer needed only to show that their pricing position was within the range of a commercially acceptable arm's-length agreement and there was no need for them to prove that their pricing was 'more' or 'less' arm's-length than the position put forward by the Commissioner. Of particular note is the following excerpt from the ruling of Justices Middleton and Steward:

> The Court must take care not to make the task of compliance with Australia's transfer pricing laws an impossible burden when a revenue authority may, years after the controlled transaction was struck, find someone, somewhere, to disagree with a taxpayer's attempt to pay or receive arm's length consideration.[55]

The implications of this statement are twofold: not only is the Court unwilling to open the Australian transfer pricing landscape to unlimited reinterpretation and the application of hindsight, but also that the Court is inclined towards granting taxpayers the benefit of only having to prove that their transfer pricing position is arm's-length, without the arduous task of mounting a successful argument as to why their position is *more* arm's-length than that put forward by the Commissioner's.

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54 Ibid [235].

55 Ibid [203].