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Australia: Commissioner's appeal dismissed in landmark decision

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The judgment in *Commissioner of Taxation v SNF (Australia) Pty Ltd* [2011] FCAFC 74 was the first decision of the Full Federal Court of Australia on a substantive transfer pricing issue. The Court concluded that the taxpayer, SNF Australia, had provided sufficient evidence to demonstrate that the Commissioner's assessments were excessive.

The decision has substantial ramifications for the Commissioner and taxpayers relying on the transactional net margin method (TNMM). Taxpayers need to check carefully whether there are comparable transactions, between unrelated parties, that establish an "arm's length" price. Where these transactions exist, they should be used rather than relying on the statistically-driven TNMM.

I. SNF Australia's circumstances

SNF Australia is the Australian distributor of chemicals used to cleanse water, primarily in industrial settings such as pulp and paper milling, mining and sewerage treatment. SNF France, the parent company, supplied products to SNF Australia as its local distributor, to on-sell to the Australian market. Products were also received by SNF Australia from sister companies in China and the United States.

SNF Australia returned losses for a number of years. The Commissioner raised assessments against SNF Australia, essentially on the basis that he considered the company had incurred losses due to it paying too much for its products from related companies.

SNF Australia led evidence demonstrating that the prices paid to SNF France were *lower* than those for products sold by SNF France to unrelated parties. On this basis, there would be no grounds for the Commissioner to raise assessments.

SNF Australia also explained its losses as attributable to unreasonably low levels of sales, competition in the Australian market, excessive stock losses and poor management but not by transfer pricing.

II. The decision at First Instance

The Federal Court concluded that the transactions put forward by SNF Australia as evidence of a comparable uncontrolled price were adequately comparable.

Middleton J accepted that SNF Australia paid the suppliers less for the same or similar products than comparable third party purchasers. His Honour also found that the SNF Australia's consistent losses were caused by other factors and not the pricing of the goods.

III. The Full Federal Court decision

The Full Court, in a joint judgment by Ryan, Jessup and Perram JJ, held that while there were some errors in the judgment at first instance, the conclusion and reasoning were correct.

The issue of whether SNF Australia's proposed comparable transactions were truly comparable was central to the dispute. The Commissioner's expert, Dr Becker, conceded early in proceedings that the TNMM should not be preferred to determine the arms length price where there were comparable uncontrolled prices (CUPs). On this basis, the Commissioner's appeal relied heavily on persuading the Court that the comparable transactions selected by SNF Australia were not truly comparable.

As with all tax appeals, the Full Court noted that the taxpayer has the onus of proving that the Commissioner's assessments were excessive.

However, the Full Court concluded that SNF Australia was not required to quantify and lead evidence to

establish the correct arms length price, only that the Commissioner's assessments were excessive. This departs from the previous decision in *WR Carpenter Holdings Pty Ltd v Commissionerof Taxation* [2007] FCAFC 103, where the Court interpreted the domestic law as seeming to require "the applicant to prove the actual amount of the arm's length consideration". The Full Court decision in SNF Australia makes it clear that proving that this is not required.

The Commissioner sought to reject SNF Australia's comparables on the basis that the circumstances were not identical and therefore not truly comparable. This would have opened the way for the Commissioner to fall back on the TNMM as the appropriate method for determining an arm's length price.

The Full Court rejected the Commissioner's submission, concluding that "this is not, to put the matter bluntly, what section 136AD(3) says". Their Honours highlighted that the Commissioner's argument would mean that "…a taxpayer, who bears the onus in tax appeals, can never succeed in such a case for the bar will be set at an unattainable height". This may be a happy result for the Commissioner but not a fair one.

SNF Australia had provided three sets of transactions which it contended were "truly comparable". The first set consisted of five foreign companies, the second, a group of Australian and New Zealand companies and the third, a large group of 21 companies. The Full Court examined each set separately, and determined that the first set and a (slightly adjusted) version of the third set were appropriate.

The second set was excluded because SNF Australia failed to lead evidence that the comparable companies were distributors, and therefore functionally comparable to SNF Australia.

It is important that taxpayers take the time to check that the proposed comparables are at the same point in the supply chain and keep documentary evidence to that effect. A transaction between a manufacturer and a distributor is unlikely to be comparable to a transaction between a manufacturer and an end user.

IV. Comment

The Full Court decision has cast light on what constitutes comparable transactions for determining an arm's length price. It is clear that a CUP cannot be ignored. It is also clear that a potential CUP cannot be ruled out as not "truly comparable" because the circumstances are not identical.

The practical difficulty for taxpayers is that the Commissioner has an unlimited time period to raise assessments on transfer pricing issues. Taxpayers that have relied on TNMM in the past should consider reviewing their historical position, as well as their current position, in light of the SNF Australia decision.

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