Chevron Australia Holdings Pty Ltd v Commissioner of Taxation

[2015] FCA 1092

FEDERAL COURT OF AUSTRALIA

ROBERTSON J

HEARING DATES: 29 SEPTEMBER, 3, 7–9, 13–17, 20–24, 27–30 OCTOBER, 21 NOVEMBER 2014, JUDGMENT DATE: 23 OCTOBER 2015

Double taxation conventions – Australia – Arm's length principle – Conditions of counterfactual – Whether independent parties dealing at arm's length refers to taxpayer and independent party or two abstract independent parties – Scope of 'consideration' – Whether standpoint of commercial lender or credit rating agency – Matters to be taken into account – Whether taxpayer had obtained transfer pricing scheme benefit – (Australia) Income Tax Assessment Act 1997, s 136AA(1).

Double taxation conventions – Australia – Interpretation – 'Corresponding provisions' – Whether articles in two conventions 'corresponding provisions' – Whether had to be similar in detail – Whether provisions similar in words rendered not corresponding by context – Australia-UK double taxation agreement, art 9 – Australia-US double taxation agreement, art 9 – (Australia) Tax Administration Act, s 815–15(5).

Double taxation conventions – Australia – Role and status – Whether articles of double taxation agreement could impose tax on taxpayers – Allocation of taxing powers.

Tax avoidance – Australia – Transfer pricing – Whether dominant purpose in entering into transaction to obtain transfer pricing scheme effect – Appropriate penalty – (Australia) Tax Administration Act, s 284–145(1).

The taxpayer, Chevron Australia Holdings Pty Ltd, was an Australian company but a wholly owned subsidiary of a US company. It entered into a credit facility agreement with another US-based subsidiary of the same parent company. This extended an unsecured loan denominated in Australian dollars in respect of which the taxpayer had to pay an interest rate defined by reference to Australian LIBOR. Evidence was given that at the time this meant an interest rate of approximately 8.5 per cent, while interest on a loan from the US at US dollar rates would be approximately

2 per cent. In 2012 the Income Tax Assessment Act was amended to apply new rules on transfer pricing to the tax years from 2004 onwards. The taxpayer was then assessed for several tax years since 2004 on the basis that the interest paid on the loan was greater than the arm's length interest rate and would be disallowed as a deduction. A number of issues arose in the interpretation of the domestic legislation and the Australia-US double taxation convention, in particular the construction and content of the hypothetical arm's length transaction with which the actual transaction was to be compared in deciding whether the taxpayer had obtained a transfer pricing benefit. The revenue argued that an arm's length loan would have been secured, resulting in a much lower interest rate. The revenue also argued that the Australia-US double taxation convention contained no 'associated enterprises' provision as defined by s 815–15(5) of the Income Tax Assessment Act 1997—a provision 'corresponding' to art 9 of the Australia-UK double taxation convention—on the ground that art 9 of the Australia-US double taxation convention had to be interpreted differently from that in the Australia-UK double taxation convention, owing to differences in context. The revenue further argued that one of the sources of its powers to make the assessments derived from art 9 of the Australia-US double taxation convention. The taxpayer argued, inter alia, that 'property' and/or 'services' as defined under s 136AA(1) of the Income Tax Assessment Act 1997 should be read down, only to include an agreement in relation to the lending of moneys.

Held (dismissing the challenges to the assessments):

(1) Article 9 of the Australia-US double taxation convention could not be relied upon to support the assessments independently of the transfer pricing provisions in domestic legislation. A double taxation convention neither gave the contracting state power to tax, nor obliged it to tax an amount over which it was allocated the right to tax. Rather, it avoided the potential for double taxation by restricting one contracting state's taxing power (see [57]–[60], [506], below).

Re Roche Products Pty Ltd (2008) 11 ITLR 92; *Undershaft (No 1) Ltd v Comr of Taxation* (2009) 11 ITLR 652 applied.

(2) 'Property' and 'services' should not be read down only to include an agreement in relation to the lending of moneys. What was required was to de-personalise the agreement to acquire so as to make it, hypothetically, between independent parties dealing at arm's length, but not so as to alter the property acquired. It was useful to adopt the tool of analysis that the hypothetical independent parties had the characteristics relevant to the pricing of the loan so as to enable the hypothesis to work. In this instance, the borrower would be an oil and gas exploration and production subsidiary (see [76]–[78], [80], below).

(3) The appropriate standpoint was that of a commercial lender, not a credit rating agency. One could not reach a non-arm's length interest rate on the basis that the actual interest rate was as high as it was because of the rating attributed to the borrower or borrowing, which rating relied on the absence of arm's length consideration given by the borrower. If the hypothetical borrower, not being the taxpayer, had at the time financial resources that the lender would regard as relevant in pricing the loan, that had to be taken into account. The industry in which the borrower participated was also a relevant factor if that would affect the price of the loan (see [501]–[503], [525], below).

(4) Article 9 of the Australia-US double taxation convention was a corresponding provision to art 9 of the Australia-UK double taxation convention. 'Corresponding provision' did not focus on the detail but referred to another provision the gist of which was the same. It was sufficient that both articles dealt with 'associated enterprises' and that the gist of each article was the same (see [565]–[567], below).

Greenock Harbour Trustees v Greenock Corporation (1905) 13 SLT 367; *Vela Fishing Ltd v Comr of Inland Revenue* [2003] STC 732 referred to.

New South Wales v Corbett (2007) 230 CLR 606 applied.

(5) The taxpayer had obtained a transfer pricing scheme benefit. Once the differential conditions had arisen the question which arose under s 815–15(1)(c) was whether an amount of profits which, but for the conditions, might have been expected to accrue to the taxpayer had by reason of those conditions, not accrued and whether under s 815–15(1)(d)(i) had the amount of such profits, accrued to the taxpayer, its taxable income for an income year would have been greater than the amount reported. On the evidence, it was reasonable to expect that, but for the scheme, the taxpayer would not have deducted the interest rate under the convention but would have borrowed at an arm's length interest rate and deducted that lower interest expense (see [585], [591], [626], below).

(6) It was reasonable to conclude that the taxpayer had entered into the agreement for the dominant purpose of obtaining a scheme benefit. The purpose of refinancing the taxpayer's debt could have been achieved by borrowing at an arm's length interest rate. It was not necessary to conclude that each of the parties had entered into the agreement for the dominant purpose of obtaining a scheme benefit; it was sufficient that that had been the subjective intention of the taxpayer (see [629], [630], below).

Comr of Taxation v Star City Pty Ltd (No 2) (2009) 180 FCR 448 applied.

EDITOR'S NOTE

This transfer pricing case is heading on appeal early next year. The case is extremely long, and only extracts are printed here. More than half the case consists of a record of the evidence presented before the Federal Court.

The case considered a number of issues relating to transfer pricing legislation in Australia, and also the determination of the transfer pricing adjustment on a loan between associated companies.

There is a very full commentary on this case by Professor Richard Vann which is printed below.

COMMENTARY

On 23 October 2015 the Federal Court delivered the long-awaited transfer pricing decision in the *Chevron Australia* case. The Australian Taxation Office ('ATO') won on the major issues (except the currency of the borrowing), though not on all of the many issues argued in the case. The case and the judgment of Robertson J (over 200 pages) are enormous and an appeal is scheduled to be heard in early 2017.

Facts

Chevron is a well-known oil and gas exploration and production ('E&P') multinational of which the parent company is listed and resident in the US. After the Chevron acquisition of the Texaco group in 2000 there was a restructuring of its Australian business unit to refinance existing debt and increase the debt level of the Australian operations to a 47 per cent debt to equity ratio.

As a result, in mid-2003, a Credit Facility Agreement was entered into between the parent of the Australian group Chevron Australia Holdings Pty Ltd ('CAHPL') (resident in Australia and also formed as part of the restructure) and its wholly owned subsidiary ChevronTexaco Funding Corporation ('CFC'), which was resident in the US and was formed to enable the raising of $US2.5bn in the US commercial paper market. The financing was done in a way which qualified for an interest withholding tax exemption in Australia (for which the ATO provided a private binding ruling). The funds were raised by CFC in USD and advanced for five years (subsequently extended by two years) to CAHPL in return for a promise to repay the equivalent amount of AUD with interest payable at Australian LIBOR plus 4.14 per cent.

No security was provided by CAHPL nor financial/operational covenants and the advance to CAHPL was not guaranteed by the US parent company, though the parent did guarantee the USD borrowing by CFC. CFC did not hedge the AUD/USD currency risk. CAHPL could at its option repay the loan at any time. The USD funds were raised by CFC at

approximately 2 per cent interest and on-lent to CAHPL in AUD at approximately 9 per cent interest.

The profit made by CFC was distributed as a dividend to CAHPL, tax-free under the Australian participation exemption for dividends, and CAHPL also made substantial dividend distributions to its US parent during the period of the loan. The judgment says that CFC was not taxable in the US on the interest received though the reason is not given. CAHPL claimed deductions for the interest paid to CFC over the term of the loan.

By assessments issued in 2010 and 2012, relying on two sets of transfer pricing rules in Australian domestic tax law (Division 13 of the 1936 income tax legislation for all years, on sub-division 815–A of the 1997 income tax legislation for some of the years) and on the associated enterprises article of the Australia-US 1982 tax treaty, the ATO denied a significant proportion of the interest deductions claimed (the exact amounts are not made clear in the judgment).

Evidence

The description of the evidence and the judge's findings on the evidence take up more than half of the judgment and a link is provided to the full text including the evidence in the extract below. Evidence about the transactions was given by a number of (former) employees of the Chevron group, though not the employee who made the decisions about the amount of the loan and had oversight of the project. The evidence included the advice received from investment banks on the amount that CAHPL could borrow and at what interest rate. Critically, it would appear that Robertson J accepted the evidence from one of the executives involved in the deal that:

- the higher the interest rate by CAHPL, the higher the cash benefit to CAHPL (because the corresponding dividend from CFC to CAHPL would be tax free to CAHPL);
- borrowing on the terms in fact adopted was not sustainable without the dividend flows from CFC;
- accordingly, the terms adopted would be unsustainable between independent parties as there would be no dividends between them; and
- the effect of CAHPL not granting security, not giving covenants and no parent guarantee for CAHPL's borrowing all combined to push up the interest rate.

There was a large amount of expert evidence on both sides including supplementary reports replying to claims made by experts on the other side. In total there were 19 expert witnesses (12 for the taxpayer, seven for the ATO) and 45 reports from the experts.

On the taxpayer's side the judge divided the evidence into a number of areas:

- two experienced commercial lenders and a former bank regulation official on how such lenders would price the loan;
- one expert on how credit rating of the loan/lender would have been done by a credit ratings agency;
- two experts on borrowing practices of oil and gas companies;
- on the issue of whether the terms of the loan could be re-characterised, for example, to be in USD rather than in AUD, an expert on transfer pricing, a former OECD official on the interpretation of the OECD Transfer Pricing Guidelines, an economist on whether there was a natural hedge for the exchange rate risk, and one accounting expert; and
- on the issue of whether the associated enterprises article of tax treaties conferred an independent assessing power, one expert on US tax law and a former US treaty negotiator who was involved in the 1982 treaty with Australia.

The ATO experts included an oil and gas industry expert, a banking industry expert, a transfer pricing economist, three ratings experts and an accounting expert. As a whole the judge did not derive a great deal of assistance from this wide range of experts, though he built up some important conclusions from a combination of some of their evidence.

Interpretation of legislation relied on for assessment

The relevant part of Division 13 which was originally enacted in 1982 had two critical elements: that 'a taxpayer has acquired property under an international agreement' and that 'the taxpayer gave or agreed to give consideration in respect of the acquisition and the amount of that consideration exceeded the arm's length consideration in respect of the acquisition.' Property was defined to include services which was in turn defined to include 'rights, benefits, privileges or facilities … under an agreement for or in relation to the lending of moneys.'

After noting that in the *SNF* case the court had rejected the ATO view that the legislative construct did not require that everything remain the same except that the relationship between the parties was removed and instead adopted a more hypothetical approach to the application of Division 13, Robertson J rejected the taxpayer's submission that 'property' and/or 'services' should be read down relevantly only to include an agreement in relation to the lending of moneys and held that the property acquired included the sums actually lent to it. He held that what is required by the Division 13 hypothesis is to depersonalise the agreement so as to make it hypothetically between independent parties dealing at arm's length but not so as to alter the property acquired. This view has

significance in relation to re-characterisation discussed below. The borrower does not, however, have to be viewed as entirely anonymous and takes on many of the actual characteristics of the borrower, in this case as an oil and gas E&P company, which has implications for the interest rate.

So far as the meaning of the term 'consideration' in the legislation is concerned, Robertson J quoted case law on different provisions focussing on stamp and gift duty to the effect that consideration does not have its contractual sense. In particular in the case of a loan and contrary to the taxpayer's submission, the consideration provided by the borrower is not limited to the interest rate paid. As CAHPL did not give the security and operational and financial covenants which the judge found that independent parties dealing at arm's length would have provided, the absence of which contributed to the higher interest rate actually paid, the arm's length consideration used by the ATO meant that its assessment was not excessive.

Robertson J notes that this approach does not amount to re-characterising the transaction, but determining what the arm's length consideration between independent parties would have been for the property in fact acquired. Later in the judgment he seems to come to a similar conclusion as a factual matter, but he expressly states that this is a separate and additional reason for finding that the taxpayer had not discharged the onus of proof. It is not exactly clear what the distinction is, although it may be that, in the former case, his Honour made specific factual findings in favour of the ATO and in the latter, his Honour determined that the taxpayer had failed to overcome its onus of proof.

Financing issues

Credit rating or commercial lender approach

One of the most important issues in the case is the approach to determining the interest rate. The ATO approach and expert evidence was to the effect that the way to go about this was to first determine the credit rating of CAHPL and the loan itself and then benchmark an arm's length interest rate or credit spread based on market rates for similarly rated comparable debt arrangements. Robertson J notes that the rating assigned to the borrower or loan needs to reflect the arm's length 'consideration' under Division 13 or arm's length 'conditions' under sub-division 815–A.

In the judge's opinion, the correct approach to determining the borrower's creditworthiness is from the perspective of a commercial lender and not by reference to how an external credit ratings agency would rate the borrower. As part of their internal credit risk analysis, there was evidence which the Court accepted that relevant lending institutions do not necessarily follow the same approach as credit ratings agencies and do not rely on credit agency ratings in deciding whether and at what price to lend.

One of the (but by no means the only) key differences in the approach to risk rating by banks and ratings agencies is the degree to which the rating reflects a company's stand-alone credit profile, versus the credit profile of the parent, and in particular the financial support that a bank would perceive the parent entity would provide to the subsidiary during periods of distress in the absence of an explicit guarantee. This so-called 'implicit support' issue is addressed below. The judge also found that caution was in fact exercised by ratings agencies issuing ratings moving from a non-investment grade rating (S&P BB+ and below) to an investment grade rating (S&P BBB- and above) because of the weight given to an investment grade rating by the marketplace.

From a practical point of view, the approach to determining the borrower's creditworthiness from the perspective of a commercial lender is an issue for the Court to decide on expert evidence; however, one wonders how taxpayers are expected to go about this in practice given that banks' internal credit risk rating processes are not transparent. Oddly, the judge appears to accept (or at least does not reject) the use of credit agency ratings for purposes of identifying comparable debt arrangements, notwithstanding the differences in approach to risk rating. It is also open to question whether adopting the practice of rating agencies might be acceptable in other circumstances, eg, situations where the closest comparables are not bank loans but Term Loan Bs or corporate bonds which are generally required to be rated by agencies.

Implicit support of subsidiaries by corporate groups

As noted above, the judgment addressed the issue of the influence of parental affiliation on the creditworthiness of the borrower and therefore the interest rate. The ATO has been a long-time proponent of the parental affiliation or implicit support concept, advocating that parental affiliation can have a material impact on and significantly improve the creditworthiness of the borrower. The ATO made a specific reference to the importance of parental affiliation in a 2010 ruling where it said that 'taking account of parental affiliation is consistent with the arm's length principle embodied in the transfer pricing provisions where, in determining the creditworthiness of a borrower, it is a feature of the market to take account of any affiliation the borrower has'.

In the *Chevron Australia* case, the questions as to the relevance and significance of parental affiliation were debated. CAHPL's counsel submitted that the parental affiliation concept had no application, as the statutory test was to determine the appropriateness of the pricing based on a hypothetical transaction between two separate and independent entities and that therefore the borrower could not have any parental affiliation. By contrast, the Commissioner's counsel argued that the affiliation between

the tested party and its group was fundamental to the interpretation and application of the arm's length principle.

Robertson J concluded that independent enterprises dealing wholly independently with one another may still be subsidiaries and may still have subsidiaries even if the enterprises are independent of each other. He therefore accepted that there was no legislative warrant for ignoring affiliation between a hypothesised party to a transaction and other members of that party's group of companies. Robertson J then acknowledged that while implicit support may be relevant when assessing a borrower's credit rating, its existence and value is a matter of fact. He accepted the taxpayer's argument that in the absence of a legally binding parental guarantee, implicit credit support had very little, if any, impact on pricing by a commercial lender in the real world. This view was consistent with the evidence of several expert witnesses for CAHPL and the conclusions in an article written by one of the Commissioner's expert witnesses.

Robertson J's finding on parental affiliation or implicit support was generally consistent with the findings in the *General Electric Capital* case in Canada where the concept of implicit support was also confirmed. However, in that case it was contemplated that the implicit support provided by the parent may have been of some value to General Electric Capital Canada (which was issuing commercial paper and unsecured debentures in the Canadian market): this seems to reinforce Robertson J's conclusion that the value of any implicit support is dependent on the facts. In practice it may turn out that the commercial lender approach applies to loans between related parties, and the credit rating and implicit support issues apply where one member of a group issues public bonds with the support of a parent guarantee.

Two future issues to be considered in this area are:

- accepting that the task is to remove the relationship between the parties, the issue of parental affiliation may be affected by whether the transaction is between two subsidiaries in a corporate group (in which case the parties' affiliation with their parent may, depending on the facts and evidence, be relevant), or between a subsidiary and the parent (in which case it would seem necessary to remove the connection between the subsidiary and parent); and
- whether the issue of parental affiliation can be extended outside a credit scenario, eg, where two subsidiaries dealing with each other receive functional support from their parent, it would seem relevant, on his Honour's reasoning, to take such support into account in considering the functions of each subsidiary.

Currency of the loan

An important and fundamental issue in this case, and one which was particularly hard fought, concerned the currency of the Credit Facility Agreement, under which funds were provided by CFC to CAHPL. Had CAHPL borrowed funds in AUD (as it contended), or in USD (as the ATO argued)? It is rare that such a basic factual issue could be in such serious dispute. Because prevailing base USD interest rates in 2003 were much lower than AUD interest rates, the answer to this question was of considerable importance.

The starting point from the ATO's perspective was that CFC had in fact transferred $US2.5bn, rather than its AUD equivalent. This, the ATO said, was the property acquired. In response, CAHPL led evidence from both its own staff, as well as experts, to the effect that the borrowing had been intended to be, and was in fact, AUD denominated, notwithstanding that CAHPL actually received funds in USD on drawdown. Amongst arguments advanced by CAHPL were concerns in 2003 about the tax implications of foreign exchange gains and losses upon realisation of a USD borrowing, as well as some fear that then fluid Australian tax reform proposals might alternatively lead to mandatory taxation of unrealised foreign exchange gains and losses, on a retranslation basis. The ATO essentially argued, via expert evidence, that it did not make sense for CAHPL to borrow in AUD, given its facts and circumstances, and in particular because its sales income would be USD denominated. The ATO also pointed to the fact that CFC had borrowed in USD, and passed on those funds to CAHPL.

Robertson J accepted the taxpayer's submission that borrowing in AUD would avoid or limit foreign currency gains and losses. Accordingly, Robertson J did not accept the ATO's arguments and expert opinions, and found that there 'can be no doubt as to the currency of the Credit Facility, which was in Australian dollars'.

It is clear that CFC borrowed funds in USD. As it on-lent the funds to CAHPL in AUD, CFC bore significant foreign exchange risk at an entity level. The judgment notes that consideration was given as to whether CFC should hedge its risk, but ultimately the decision was made not to hedge. Happily for CFC, it made a foreign exchange gain, rather than a loss, when CAHPL repaid the borrowing on maturity.

Re-characterisation

One element of the re-characterisation issue, in relation to currency, has been dealt with above. However, the parties were also in heated disagreement as to the ability of the Court to amend the terms of the loan for arm's length purposes.

Having determined that the property acquired was the rights or benefits

granted or conferred under that Credit Facility Agreement, including the sums lent, the judge found, as a matter of fact that if that property had been acquired under an agreement between independent parties dealing at arm's length with each other, the borrower would have given security and operational and financial covenants and the interest rate, as a consequence, would have been lower.

The taxpayer had contended that any such approach was re-characterisation or reconstruction. It pointed to a number of factors, such as the OECD Transfer Pricing Guidelines and the reconstruction power in the now current Australian transfer pricing law, sub-division 815–B in the 1997 income tax legislation, in support of its proposition that it was impermissible to rewrite the terms of the loan. Rather, in CAHPL's submission, it was necessary to keep the terms as they were and just determine the interest rate.

The judge rejected any suggestion that such re-writing of the terms of the Credit Facility Agreement amounted to impermissible re-characterisation. Rather, his Honour focussed on the words of the statute itself ('consideration' in Division 13, 'conditions' in sub-division 815–A) rather than transfer pricing lore. It was not possible to substitute the statutory language with admonitions against not 're-characterising' or not 'rewriting'.

This reasoning may give cause to consider the circumstances in which a Court (or the ATO) would need to rely on the re-characterisation power in sub-division 815–B or under the OECD Guidelines. No doubt there are cases where those provisions can apply beyond what his Honour did, but it seems likely that this re-characterisation argument will feature in the taxpayer's appeal. However, it is important to recall the finding that the terms of the loan were unsustainable between independent parties. Had that finding not been made, the result may have been very different.

Comparable uncontrolled transactions

The case also highlighted the very high (arguably, unrealistically high) standards of comparability expected by the courts at least as far as the benchmarking of interest rates is concerned in an application of the comparable uncontrolled transactions ('CUT') or comparable uncontrolled price ('CUP') method.

Robertson J rejected the four loan agreements put forward by the expert witness for the ATO, and also the five loan agreements put forward by the expert witness for CAHPL, for reasons such as:

- the amount of the loans was significantly different to that under review;
- there was security provided whereas there was none in the CAHPL loan;

- there were no financial covenants in the CAHPL loan;
- there was doubt as to whether the CAHPL loan should be benchmarked against senior debt or subordinated debt;
- the loans were of different tenors; and/or
- the borrower companies were either in different industries (not E&P, even if they were in the energy industry), or experiencing financial difficulties, or not operating in the Australian market, or were parents rather than subsidiaries.

This inability to identify comparable third party agreements reflects the fact that the agreement between CAHPL and CFC was drafted in a way that would simply not exist between an independent commercial lender and independent borrower—the lack of financial covenants or security was particularly at issue.

In this case it was always going to be a challenge to benchmark the interest rate using the traditional CUT/CUP approach, due largely to the way that the agreement between CAHPL and CFC was drafted. That was so even though two investment banks were consulted as to pricing by the taxpayer prior to entry into the loan. However, there are some key learnings to be taken from the conclusions reached by Robertson J in this case:

- any CUT/CUP search should be carried out using the financial data of the borrower that is or would have been available to an independent lender at the time of negotiation of the tested transaction;
- in order to identify CUTs/CUPs, the credit risk of the borrower should be assessed in the same/similar way as would be carried out by independent lenders at the time of the making of the loan (although as noted above, the practical aspects of this expectation have not been clarified by Robertson J);
- credit agency ratings should not always be relied upon for assessing the credit quality of the borrower, although the rating methodology used by the rating agencies may be similar to that which would be applied by an independent lender;
- whether or not implicit support of a parent exists is a matter of fact and so may be taken into consideration, but in practice such implicit support is likely to have little if any impact in the real world—whether there is any benefit would appear to be a question of fact;
- if no reasonable CUTs/CUPs are able to be identified from publicly available data, then consideration may be given to the use of alternative methods in the same way that would be done by independent commercial lenders; and
- loan agreements between related parties should be drafted with the terms that would appear at that time in the real world, as if

between an independent borrower and an independent lender (eg with clarity on subordination, appropriate financial covenants, security and so on). Without this, it would be very difficult in practice to benchmark the interest rate, given the high standards of comparability that would be expected.

Since no reasonably accurate CUTs/CUPs were able to be identified because of the way that the CAHPL/CFC loan was drafted, the conclusion reached by Robertson J was that the taxpayer had not 'shown that the consideration in the Credit Facility Agreement was the arm's length consideration or less than the arm's length consideration nor proved that the amended assessments were excessive'.

Given the very high standard of comparability that was expected in a CUT/CUP analysis by Robertson J, and the burden of proof placed on the shoulders of Chevron by Division 13 and/or sub-division 815–A, as well as his Honour's view that the Court was not confined to just adjusting the interest rate to an arm's length one but could look more broadly at arm's length terms, the decision against CAHPL followed.

Other issues

While pricing the debt was clearly the critical issue, the case involved a plethora of other issues. Some of these on constitutional, procedural and penalty issues are peculiar to Australia and are not pursued here nor reproduced in the extract from the judgment below.

Do tax treaties provide an independent transfer pricing adjustment power?

The ATO partly based its assessments directly on the associated enterprises article in the Australia-US 1982 tax treaty (art 9 in most treaties). The taxpayer contended that it was necessary to find domestic legislation supporting the adjustment to carry out the authority provided by the treaty. This issue was raised but not directly decided in previous transfer pricing cases in Australia (the *SNF* and *Roche* cases) which were both duly quoted by Robertson J. The judge for the first time in an Australian judicial decision clearly concluded against this ATO view. Three lines of thinking are apparent.

The first is that tax treaties assign taxing rights between states and leave the levy of tax to the domestic law of the state. Robertson J quoted various Australian cases for this view which tended against the ATO view and also ensured that no problems arise under s 55 of the Constitution which requires that laws imposing with taxation deal only with the imposition of tax. Secondly he quoted the stronger comment made in passing in the *Undershaft* case that tax treaties are exclusively relieving, which was regarded as 'squarely against' the ATO view. It is doubtful that this view is

correct in all cases in Australia, even though it applies in the US for constitutional and legislative reasons and is ensured by the terms of its treaties on the US side. The third line of thinking was based on the expert evidence that the US does not regard art 9 as imposing tax and that the same should apply symmetrically on the Australian side. The judge did not find it necessary to adopt this line of reasoning to support his conclusion.

Despite the judge's conclusions, this view did not end up assisting the taxpayer. In this case the issue was raised by the ATO to cover off the event that the assessments under Division 13 to the 1936 income tax law were held to be procedurally defective so that another ground was necessary to support them. Although not reproduced in the extract below the taxpayer was unsuccessful in its procedural challenges and so that ATO did not need to rely on this argument.

Interpretation of domestic legislation based on tax treaty language

The taxpayer mounted a comprehensive challenge to the application of sub-division 815–A of the 1997 income tax law which was enacted in 2012 and operates retroactively to 2004. This legislation was enacted for fear that the courts would reach the view (as occurred in this case) that the ATO argument for an independent power to adjust transfer prices under tax treaties would be rejected. The 2012 legislation effectively transposes the same language as in tax treaties directly into domestic tax law.

Aside from a few matters, the taxpayer's arguments were rejected by Robertson J. Because of the large number of the challenges, only some of them are noted here in bullet point form with the judge's response:

- Because the operation of the article in the Australia-US 1982 tax treaty entitled 'Associated Enterprises' was affected by the provisions of art 1(2) of the treaty preserving taxpayers' domestic law rights, it did not 'correspond' as required by sub-division 815–A to the equivalent article in the UK treaty. The judge rejected both the premise that art 1(2) had such a relevant effect and the conclusion that it therefore did not correspond as its 'gist' was the same.
- The taxpayer did not get a transfer benefit under sub-division 815–A because the profits were to be judged overall, including the dividends received by CAHPL from CFC which cancelled out the reduction of profits of CAHPL. The judge considered that the profits did not include the dividends.
- Division 820 of the 1997 income tax legislation on thin capitalisation was a code on interest deductions, and as the level of debt was within the permissible ratio, the ATO was unable to deny the deductions. This has been a long-contested area between the ATO and taxpayers but the judge held that those rules set limits on the amount of debt and did not deal with the interest rate charged on that debt.

a Relevance of judgment for transfer pricing in Australia and internationally

For income years from 2013 on, the relevant transfer pricing law in Australia is found in sub-division 815–B of the 1997 income tax law which replaces both Division 13 of the 1936 income tax law and *b* sub-division 815–A of the 1997 income tax law. In that sense the result and reasoning of Robertson J are only directly relevant for past income years in Australia. Nonetheless there are many messages in the judgment for the future of transfer pricing in Australia regardless of the final *c* outcome of any appeal process in the case which may take some years to resolve.

It seems likely that the ATO will assert that Robertson J's comments, as to the relevance of the lack of security and covenants should also be relevant going forward under sub-division 815–B, either with or without *d* resort to its express reconstruction power there. That is, if a related party loan does not provide security and covenants, and it might be expected that such terms would have existed, in comparable circumstances, in a loan between independent parties, the interest rate on the related party loan will need to be set on an assumption that such terms were in fact *e* included.

The various financing issues considered above can also generally be expected to be relevant in the context of sub-division 815–B.

Further, the case is important in relation to the use of experts in all *f* future transfer pricing cases and asking them the right questions. One of the main reasons that Robertson J found so little of the expert evidence to be useful was because the experts had not been asked the right questions in light of the tests in the relevant legislation. This point is easy to make with the benefit of hindsight, but it emphasises again just how much judges will *g* focus on the statutory language in preference to industry lore or the OECD guidelines.

While each country's transfer pricing law is different and the approach of tax administrations and courts also varies among countries, it is likely that the Chevron Australia case will have relevance to pricing intra-group *h* loans beyond Australia. It is surprising that such a basic issue as an interest rate on a loan can prove so troublesome. The judgment of Robertson J provides many insights into the issues involved and is likely to be closely studied when disputes about interest rates arise.

i Richard Vann[1]

1 George Condoleon, Graeme Cooper, Tony Frost and Hugh Paynter also contributed to writing this comment.

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Counsel

DH Bloom QC, SH Steward QC, P Kulevski, KS Deards, LA Hespe and *C Ensor* for the applicant.
JW De Wijn QC, GR Kennett SC, TM Thawley SC, CA Burnett and *TL Phillips* for the respondent.

Solicitors

King & Wood Mallesons for the applicant.
Maddocks Lawyers and *Minter Ellison Lawyers* for the respondent.

Judgment was reserved. a

23 October 2015. The following judgment was delivered.

ROBERTSON J. b

INTRODUCTION

[1] The applicant is Chevron Australia Holdings Pty Ltd ('CAHPL'). These proceedings concern the financial years 2004–2008, inclusive.

[2] Central to the proceedings is a Credit Facility Agreement dated 6 June 2003 between CAHPL and ChevronTexaco Funding Corporation ('CFC') under which CFC agreed to make advances from time to time to CAHPL 'in the aggregate the equivalent in Australian Dollars … of Two Billion Five Hundred Million United States Dollars'. Interest was payable monthly at a rate equal to '1-month AUD-LIBOR-BBA as determined with respect to each Interest Period +4.14% per annum' and the final maturity date was 30 June 2008 ('the Credit Facility Agreement'). The loan was repayable in full after five years but with provision for early repayment at CAHPL's option. CAHPL provided no guarantee to CFC and did not provide to CFC any security over its other assets. CFC was entitled to terminate the Credit Facility Agreement at any time without cause. CAHPL had the right to prepay any advance made to it. CAHPL and CFC are related, each having a common parent, Chevron Corporation ('CVX'), and CFC being a subsidiary of CAHPL. CAHPL and CFC were not dealing with each other at arm's length. c d e f

[3] The proceedings do not involve the general anti-avoidance provisions in Pt IVA of the Income Tax Assessment Act 1936 (Cth) ('ITAA 1936'). Neither do they involve any allegation that the Credit Facility Agreement was a sham. The proceedings do involve: under the ITAA 1936, the issue of arm's length consideration where a taxpayer, here CAHPL, has acquired property under an international agreement; under the Income Tax Assessment Act 1997 (Cth) ('ITAA 1997'), the cross-border transfer pricing rules; and the transfer pricing rules in Australia's double tax agreements, particularly the Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (6 August 1982, [1983] ATS 16 (entered into force 31 October 1983)) ('the United States convention'). g h

[4] A general procedural history is as follows. i

NSD 569–578 of 2012

[5] These ten tax appeals concern determinations dated 30 April 2010 under s 136AD(3) of the ITAA 1936 for each of the years ended

31 December 2003 to 2007 (2004–2008 tax years) inclusive. The determinations were made by Mr Gavin Roberts, an officer in the Large Business and International line of the Australian Taxation Office, acting in the name of Ms Cheryl-Lea Field, an Acting Deputy Commissioner of Taxation. On 20 May 2010, the Commissioner issued notices of amended assessment to CAHPL for each of the 2004 to 2008 tax years inclusive ('the 2010 amended assessments'). On 21 May 2010, the Commissioner issued notices of assessment of scheme shortfall penalty ('the 2010 penalty assessments'). CAHPL objected against the 2010 amended assessments and the 2010 penalty assessments which were deemed to be disallowed as the Commissioner did not make an objection decision within 60 days of receiving notices under s 14ZYA of the Taxation Administration Act 1953 (Cth). On 20 April 2012, CAHPL filed notices of appeal in this Court.

[6] The determinations dated 30 April 2010 took the following form, referring to CAHPL:

> **'Determinations made pursuant to sub-section 136AD(3) of the Income tax Assessment Act 1936 ('The Act')**
>
> … I, Cheryl-Lea Field, Acting Deputy Commissioner of Taxation, Large Business and International, in the exercise of the powers and functions delegated to me by the Commissioner of Taxation:
>
> 1. find that, for the purposes of para 136AD(3)(a) of the Act, Chevron Holdings Pty Ltd has acquired property under an international agreement;
>
> 2. am satisfied for the purposes of para 136AD(3)(b) of the Act, that having regard to
>
> (a) the connection between any 2 or more parties to the international agreement; and
>
> (b) to (sic) the other relevant circumstances,
>
> that the parties to the international agreement or any 2 or more of those parties were not dealing at arm's length with each other in relation to the acquisition;
>
> 3. find that, for the purposes of para 136AD(3)(c) of the Act, Chevron Holdings Pty Ltd gave or agreed to give consideration in respect of the acquisition and the amount of that consideration (that is, $162,854,342) exceeded the arms (sic) length consideration in respect of the acquisition (that is, $91,048,496); and
>
> 4. determine, for the purposes of para 136AD(3)(d) of the Act, that s 136AD(3) should apply in relation to Chevron Holdings Pty Ltd in relation to the acquisition.
>
> It follows from the above that, for all purposes of the application of the Act in relation to Chevron Holdings Pty Ltd, consideration equal to the arm's length consideration in respect of the acquisition shall be

deemed to be the consideration given or agreed to be given by Chevron Holdings Pty Ltd in respect of the acquisition.

Dated the 30 day of April 2010:
Cheryl-Lea Field [Signature of Gavin Roberts] p.p Gavin Roberts
Cheryl-Lea Field
Acting Deputy Commissioner of Taxation
Large Business and International'

[7] The determinations dated 30 April 2010 were accompanied by a document of the same date entitled 'Reasons for Decision to Apply s 136AD of the Income Tax Assessment Act 1936 (the Act)'.

NSD 151 to 156 of 2013

[8] These six tax appeals concern only the years ended 31 December 2005–2007 (2006–2008 tax years) inclusive.

[9] On 24 October 2012, the Commissioner made determinations under s 815–30 of the ITAA 1997 for each of these years. On 26 October 2012, the Commissioner issued notices of amended assessment to CAHPL for each of the 2006 to 2008 tax years, inclusive ('the 2012 amended assessments'). On 26 October 2012, the Commissioner issued notices of assessment of scheme shortfall penalty for these years ('the 2012 penalty assessments'). On 31 January 2013, CAHPL filed notices of appeal in this Court. CAHPL also filed notices of a constitutional matter under s 78B of the Judiciary Act 1903 (Cth) with respect to NSD 151 to 156 of 2013.

[10] The determinations made on 24 October 2012 took the following form, using the year ended 31 December 2005 as an example:

'Determination made pursuant to section 815–30 of Division 815 of the Income Tax Assessment Act 1997

I, Annette Chooi, Deputy Commissioner, Large Business and International, in the exercise of the powers and functions delegated to me by the Commissioner of Taxation, determine under paragraph 815–30(1)(a) of the Income Tax Assessment Act 1997 ("ITAA 1997") that the taxable income of Chevron Australia Holdings Pty Ltd … ("the taxpayer") be increased by the amount of $149,639,013 for the year ended 31 December 2005 (in lieu of the year of income ended 30 June 2006). I further determine under paragraph 815–30(2)(b) of the ITAA 1997, that the amount of the increase is attributable to a decrease of $149,639,013 in interest deductions of the taxpayer in the year ended 31 December 2005 (in lieu of the year of income ended 30 June 2006).'

NSD 440 of 2013

[11] On 14 March 2013, CAHPL filed an application for relief under s 39B of the Judiciary Act. This application challenged the validity of the

notices of amended assessment dated 20 May 2010 in respect of the years ended 31 December 2005, 31 December 2006 and 31 December 2007. Alternatively, the application sought a declaration that sub-division 815–A of the ITAA 1997, as introduced by the Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No. 1) 2012 (Cth), and when read with s 815–1 of the Income Tax (Transitional Provisions) Act 1997 (Cth), were not valid laws of the Commonwealth within s 51 of the Constitution and/or were laws with respect to the acquisition of property which contravened s 51(xxxi) of the Constitution and the notices called notices of amended assessment dated 26 October 2012 in respect of the years ended 31 December 2005, 31 December 2006 and 31 December 2007 were not valid notices of assessment under the ITAA 1936 and/or the ITAA 1997.

THE LEGISLATION

[12] Section 136AD of the ITAA 1936, so far as relevant, was in the following terms.

'136AD Arm's length consideration deemed to be received or given

… (3) Where:

(a) a taxpayer has acquired property under an international agreement;

(b) the Commissioner, having regard to any connection between any 2 or more of the parties to the agreement or to any other relevant circumstances, is satisfied that the parties to the agreement, or any 2 or more of those parties, were not dealing at arm's length with each other in relation to the acquisition;

(c) the taxpayer gave or agreed to give consideration in respect of the acquisition and the amount of that consideration exceeded the arm's length consideration in respect of the acquisition; and

(d) the Commissioner determines that this subsection should apply in relation to the taxpayer in relation to the acquisition;

then, for all purposes of the application of this Act in relation to the taxpayer, consideration equal to the arm's length consideration in respect of the acquisition shall be deemed to be the consideration given or agreed to be given by the taxpayer in respect of the acquisition.

(4) For the purposes of this section, where, for any reason (including an insufficiency of information available to the Commissioner), it is not possible or not practicable for the Commissioner to ascertain the arm's length consideration in respect of the supply or acquisition of property, the arm's length

consideration in respect of the supply or acquisition shall be deemed to be such amount as the Commissioner determines.'

Section 136AD(4) is reproduced to provide statutory context for the interpretation of the balance of the provision. No determination under that provision relevant to these proceedings was made by the Commissioner.

[13] Relevant definitions were set out in s 136AA of the ITAA 1936, as follows.

'(1) In this Division, unless the contrary intention appears:

acquire includes:

(a) acquire by way of purchase, exchange, lease, hire or hire-purchase; and

(b) obtain, gain or receive.

agreement means any agreement, arrangement, transaction, understanding or scheme, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings …

property includes:

(a) a chose in action;

(b) any estate, interest, right or power, whether at law or in equity, in or over property;

(c) any right to receive income; and

(d) services …

services includes any rights, benefits, privileges or facilities and, without limiting the generality of the foregoing, includes the rights, benefits, privileges or facilities that are, or are to be, provided, granted or conferred under:

(a) an agreement for or in relation to:

(i) the performance of work (including work of a professional nature);

(ii) the provision of, or the use or enjoyment of facilities for, amusement, entertainment, recreation or instruction;

(iii) the conferring of rights, benefits or privileges for which consideration is payable in the form of a royalty, tribute, levy or similar exaction; or

(iv) the carriage, storage or packaging of any property or the doing of any other act in relation to property;

(b) an agreement of insurance;

(c) an agreement between a banker and a customer of the banker entered into in the course of the carrying on by the banker of the business of banking; or

(d) an agreement for or in relation to the lending of moneys …

(3) In this Division, unless the contrary intention appears:
(a) a reference to the supply or acquisition of property includes a reference to agreeing to supply or acquire property;
(b) a reference to consideration includes a reference to property supplied or acquired as consideration and a reference to the amount of any such consideration is a reference to the value of the property;
(c) a reference to the arm's length consideration in respect of the supply of property is a reference to the consideration that might reasonably be expected to have been received or receivable as consideration in respect of the supply if the property had been supplied under an agreement between independent parties dealing at arm's length with each other in relation to the supply;
(d) a reference to the arm's length consideration in respect of the acquisition of property is a reference to the consideration that might reasonably be expected to have been given or agreed to be given in respect of the acquisition if the property had been acquired under an agreement between independent parties dealing at arm's length with each other in relation to the acquisition; and
(e) a reference to the supply or acquisition of property under an agreement includes a reference to the supply or acquisition of property in connection with an agreement.'

[**14**] Section 136AC of the ITAA 1936 was in the following terms.

'136AC International agreements
For the purposes of this Division, an agreement is an international agreement if:
(a) a non-resident supplied or acquired property under the agreement otherwise than in connection with a business carried on in Australia by the non-resident at or through a permanent establishment of the non-resident in Australia; or
(b) a resident carrying on a business outside Australia supplied or acquired property under the agreement, being property supplied or acquired in connection with that business; or
(c) a taxpayer:
(i) supplied or acquired property under the agreement in connection with a business; and
(ii) carries on that business in an area covered by an international tax sharing treaty.'

[**15**] Section 170 of the ITAA 1936 provided, so far as relevant:

'… (9B) Subject to subsection (9C), nothing in this section prevents the amendment, at any time, of an assessment for the purpose of

giving effect to a prescribed provision, a relevant provision, or Subdivision 815–A of the Income Tax Assessment Act 1997.

Note: Subdivision 815–A of the Income Tax Assessment Act 1997 is about cross-border transfer pricing.

(9C) Sub-section (9B) does not authorize the Commissioner, for the purpose of giving effect to a prescribed provision or a relevant provision, to amend an assessment made in relation to a taxpayer in relation to a year of income where:

(a) in a case where the purpose of the amendment is to give effect to the prescribed provision in relation to the supply or acquisition of property—the prescribed provision has been previously applied, in relation to that supply or acquisition, in making or amending an assessment in relation to the taxpayer in relation to the year of income; or

(b) in any other case—the prescribed provision, the relevant provision, or Subdivision 815–A of the Income Tax Assessment Act 1997, as the case may be, has been previously applied, in relation to the same subject matter, in making or amending an assessment in relation to the taxpayer in relation to the year of income …

Definitions

(14) In this section, unless the contrary intention appears:

double taxation agreement means an agreement within the meaning of the International Tax Agreements Act 1953.

limited amendment period, for an assessment, means the period within which the Commissioner may amend the assessment:

(a) under item 1, 2, 3 or 4 of the table in subsection (1); or

(b) under paragraph (3)(a) or (b).

prescribed provision means section 136AD or 136AE.

relevant provision means:

(a) a provision of a double taxation agreement that attributes to a permanent establishment or to an enterprise the profits it might be expected to derive if it were independent and dealing at arm's length; or

(b) paragraph 7, 8 or 9 of Article 5, or Article 7, of the Taxation Code in Annex G to the Timor Sea Treaty or a provision of any other international tax sharing treaty that corresponds with any of those paragraphs or that Article.

scheme has the meaning given by subsection 995–1(1) of the Income Tax Assessment Act 1997.

scheme benefit has the meaning given by section 284–150 in Schedule 1 to the Taxation Administration Act 1953.'

[16] Sections 175 and 177(1) of the ITAA 1936 provided:

> **'175 Validity of assessment**
> The validity of any assessment shall not be affected by reason that any of the provisions of this Act have not been complied with …
>
> **177 Evidence**
> (1) The production of a notice of assessment, or of a document under the hand of the Commissioner, a Second Commissioner, or a Deputy Commissioner, purporting to be a copy of a notice of assessment, shall be conclusive evidence of the due making of the assessment and, except in proceedings under Pt IVC of the Taxation Administration Act 1953 on a review or appeal relating to the assessment, that the amount and all the particulars of the assessment are correct.'

[17] Section 815–1 of the Income Tax (Transitional Provisions) Act provided as follows:

> **'815–1 Application of Subdivision 815–A of the Income Tax Assessment Act 1997**
> (1) Subdivision 815–A of the Income Tax Assessment Act 1997 applies to income years starting on or after 1 July 2004.
> (2) However, Subdivision 815–A does not apply to an income year to which Subdivisions 815–B and 815–C of that Act apply.
> Note: For the income years to which Subdivisions 815–B and 815–C apply, see section 815–15 of this Act.
> **815–5 Cross-border transfer pricing guidance**
> Despite section 815–20 of the Income Tax Assessment Act 1997, the documents covered by that section for an income year that starts before 1 July 2012 are taken to be 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 before the start of the income year;
> (b) the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as approved by that Council and last amended before the start of the income year.'

[18] Section 815–15 of that Act referred to the start date for sub-divisions 815–B, 815–C and 815–D of the ITAA 1997 in respect of tax other than withholding tax as the earlier of 1 July 2013 and the day the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013 (Cth) received the Royal Assent. That date was 29 June 2013.

[19] Sub-division 815–A of the ITAA 1997 was in the following terms. *a*

'815–1 What this Subdivision is about

The cross-border transfer pricing rules in this Subdivision are equivalent to, but independent of, the transfer pricing rules in Australia's double tax agreements … *b*

Operative provisions

815–5 Object

The object of this Subdivision is to ensure the following amounts are appropriately brought to tax in Australia, consistent with the arm's length principle: *c*

(a) profits which would have accrued to an Australian entity if it had been dealing at *arm's length, but, by reason of non-arm's length conditions operating between the entity and its foreign associated entities, have not so accrued; *d*

(b) profits which an Australian permanent establishment (within the meaning of the relevant *international tax agreement) of a foreign entity might have been expected to make if it were a distinct and separate entity engaged in the same or similar activities under the same or similar conditions, but dealing wholly independently. *e*

815–10 Transfer pricing benefit may be negated

(1) The Commissioner may make a determination mentioned in subsection 815–30(1), in writing, for the purpose of negating a *transfer pricing benefit an entity gets. *f*

Treaty requirement

(2) However, this section only applies to an entity if:

(a) the entity gets the *transfer pricing benefit under subsection 815–15(1) at a time when an *international tax agreement containing an *associated enterprises article applies to the entity; or *g*

(b) the entity gets the transfer pricing benefit under subsection 815–15(2) at a time when an international tax agreement containing a *business profits article applies to the entity. *h*

815–15 When an entity gets a transfer pricing benefit

Transfer pricing benefit—associated enterprises

(1) An entity gets a transfer pricing benefit if:

(a) the entity is an Australian resident; and

(b) the requirements in the *associated enterprises article for the application of that article to the entity are met; and *i*

(c) an amount of profits which, but for the conditions mentioned in the article, might have been expected to accrue to the entity, has, by reason of those conditions, not so accrued; and

(d) had that amount of profits so accrued to the entity:

(i) the amount of the taxable income of the entity for an income year would be greater than its actual amount; or

(ii) the amount of a tax loss of the entity for an income year would be less than its actual amount; or

(iii) the amount of a *net capital loss of the entity for an income year would be less than its actual amount.

The amount of the **transfer pricing benefit** is the difference between the amounts mentioned in subparagraph (d)(i), (ii) or (iii) (as the case requires).

Transfer pricing benefit—business profits

(2) A foreign resident entity gets a transfer pricing benefit if:

(a) the entity has a permanent establishment (within the meaning of the *international tax agreement) in Australia; and

(b) the amount of profits attributed to the permanent establishment falls short of the amount of profits the permanent establishment might be expected to make if it were a distinct and separate entity engaged, and dealing, in the manner mentioned in the *business profits article; and

(c) had the profits attributed to the permanent establishment included that shortfall:

(i) the amount of the taxable income of the entity for an income year would be greater than its actual amount; or

(ii) the amount of a tax loss of the entity for an income year would be less than its actual amount; or

(iii) the amount of a *net capital loss of the entity for an income year would be less than its actual amount.

The amount of the ***transfer pricing benefit*** is the difference between the amounts mentioned in subparagraph (c)(i), (ii) or (iii) (as the case requires).

Nil amounts

(3) For the purposes of working out whether an entity gets a *transfer pricing benefit, and of negating that benefit under subsection 815–30(1):

(a) treat an entity that has no taxable income for an income year as having a taxable income for the year of a nil amount; and

(b) treat an entity that has no tax loss for an income year as having a tax loss for the year of a nil amount; and

(c) treat an entity that has no *net capital loss for an income year as having a net capital loss for the year of a nil amount.

Multiple transfer pricing benefits

(4) To avoid doubt, an entity may get 2 or more *transfer pricing benefits, in one or more income years, in relation to one amount of profits, or one shortfall of profits.

Meaning of associated enterprises article

(5) An ***associated enterprises article*** is:

(a) Article 9 of the United Kingdom convention (within the meaning of the International Tax Agreements Act 1953); or

(b) a corresponding provision of another *international tax agreement.

Meaning of business profits article

(6) A business profits article is:

(a) Article 7 of the United Kingdom convention (within the meaning of the International Tax Agreements Act 1953); or

(b) a corresponding provision of another *international tax agreement.

815–20 Cross-border transfer pricing guidance

(1) For the purpose of determining the effect this Subdivision has in relation to an entity:

(a) work out whether an entity gets a *transfer pricing benefit consistently with the documents covered by this section, to the extent the documents are relevant; and

(b) interpret a provision of an *international tax agreement consistently with those documents, to the extent they are relevant.

(2) The documents covered by this section are as follows:

(a) the Model Tax Convention on Income and on Capital, and its Commentaries, as adopted by the Council of the Organisation for Economic Cooperation and Development and last amended on 22 July 2010;

(b) the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as approved by that Council and last amended on 22 July 2010;

(c) a document, or part of a document, prescribed by the regulations for the purposes of this paragraph.

(3) However, a document, or a part of a document, mentioned in paragraph (2)(a) or (b) is not covered by this section if the regulations so prescribe.

(4) Regulations made for the purposes of paragraph (2)(c) or subsection (3) may prescribe different documents or parts of documents for different circumstances …

815–30 Determinations negating transfer pricing benefit

(1) The determinations the Commissioner may make are as follows:

(a) a determination of an amount by which the taxable income of the entity for an income year is increased;

(b) a determination of an amount by which the tax loss of the entity for an income year is decreased;

(c) a determination of an amount by which the *net capital loss of the entity for an income year is decreased.

(2) If the Commissioner makes a determination under subsection (1), the determination is taken to be attributable, to the relevant extent, to such of the following as the Commissioner may determine:

(a) an increase of a particular amount in assessable income of the entity for an income year under a particular provision of this Act;

(b) a decrease of a particular amount in particular deductions of the entity for an income year;

(c) an increase of a particular amount in particular capital gains of the entity for an income year;

(d) a decrease of a particular amount in particular capital losses of the entity for an income year.

(3) If the Commissioner makes a determination under subsection (1), the Commissioner must make a determination under subsection (2), unless it is not possible or practicable for the Commissioner to do so.

Example: If section 815–25 is relevant in working out the transfer pricing benefit an entity gets, this subsection requires the Commissioner to make a determination relating to the debt deductions of the entity.

(4) Nothing done under subsection (2) affects the validity of a determination made under subsection (1).

(5) The Commissioner may take such action as the Commissioner considers necessary to give effect to a determination under this section.

(6) The Commissioner must give a copy of a determination under this section to the entity.

(7) A failure to comply with subsection (6) does not affect the validity of the determination.

(8) To avoid doubt, the Commissioner may include all or any determinations under this section in relation to a particular entity, including determinations of different kinds, in the same document.

815–35 Consequential adjustments

Consequential adjustment—associated enterprises

(1) The Commissioner may make a determination under subsection (4) in relation to an entity (the disadvantaged entity) if:

(a) the Commissioner makes a determination under subsection 815–30(1) in relation to a *transfer pricing benefit an entity gets under subsection 815–15(1); and

(b) the Commissioner considers that, but for the conditions mentioned in the *associated enterprises article:

(i) the amount of the taxable income of the disadvantaged entity for an income year might have been expected to be less than its actual amount; or

(ii) the amount of a tax loss of the disadvantaged entity for an income year might have been expected to be greater than its actual amount; or

(iii) the amount of a *net capital loss of the disadvantaged entity for an income year might have been expected to be greater than its actual amount; or

(iv) an amount of *withholding tax payable in respect of interest or royalties by the disadvantaged entity might have been expected to be less than its actual amount; and

(c) the Commissioner considers that it is fair and reasonable that the actual amount mentioned in subparagraph (b)(i), (ii), (iii) or (iv) (as the case requires) be adjusted accordingly.

Consequential adjustment—business profits

(1) The Commissioner may make a determination under subsection (4) in relation to an entity (the **disadvantaged entity**) if:

(a) the Commissioner makes a determination under subsection 815–30(1) in relation to a *transfer pricing benefit an entity gets under subsection 815–15(2); and

(b) the Commissioner considers that, if the permanent establishment were a distinct and separate entity engaged, and dealing, in the manner mentioned in the *business profits article:

(i) the amount of the taxable income of the disadvantaged entity for an income year might have been expected to be less than its actual amount; or

(ii) the amount of a tax loss of the disadvantaged entity for an income year might have been expected to be greater than its actual amount; or

(iii) the amount of a *net capital loss of the disadvantaged entity for an income year might have been expected to be greater than its actual amount; or

(iv) an amount of *withholding tax payable in respect of interest or royalties by the disadvantaged entity might have been expected to be less than its actual amount; and

(c) the Commissioner considers that it is fair and reasonable that the actual amount mentioned in subparagraph (b)(i), (ii), (iii) or (iv) (as the case requires) be adjusted accordingly …

Nil amounts

(3) For the purposes of this section:

(a) treat an entity that has no taxable income for an income year as having a taxable income for the year of a nil amount; and

(b) treat an entity that has no tax loss for an income year as having a tax loss for the year of a nil amount; and

(c) treat an entity that has no *net capital loss for an income year as having a net capital loss for the year of a nil amount.

Consequential adjustment—determinations

(4) The Commissioner may make one or more of the following determinations, in writing, for the purpose of adjusting an amount as mentioned in paragraph (1)(c) or (2)(c):

(a) a determination of an amount by which the taxable income of the disadvantaged entity for an income year is decreased;

(b) a determination of an amount by which the tax loss of the disadvantaged entity for an income year is increased;

(c) a determination of an amount by which the *net capital loss of the disadvantaged entity for an income year is increased;

(d) a determination of an amount by which the *withholding tax payable by the disadvantaged entity in respect of interest or royalties is decreased.

(5) The Commissioner may take such action as the Commissioner considers necessary to give effect to a determination under this section.

(6) The Commissioner must give a copy of a determination under this section to the disadvantaged entity.

(7) A failure to comply with subsection (6) does not affect the validity of the determination.

(8) To avoid doubt, the Commissioner may include all or any determinations under this section in relation to a particular entity, including determinations of different kinds, in the same document.

(9) An entity may give the Commissioner a written request to make a determination under this section relating to the entity. The Commissioner must decide whether or not to grant the request, and give the entity notice of the Commissioner's decision.

(10) If an entity is dissatisfied with the Commissioner's decision, the entity may object, in the manner set out in Pt IVC of the Taxation Administration Act 1953, against that decision.

815–40 No double taxation

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

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

[**20**] Section 6–25 of the ITAA 1997, relied on by the respondent Commissioner, was in the following terms:

'6–25 Relationships among various rules about ordinary income

(1) Sometimes more than one rule includes an amount in your assessable income:

- the same amount may be *ordinary income and may also be included in your assessable income by one or more provisions about assessable income; or
- the same amount may be included in your assessable income by more than one provision about assessable income.

For a summary list of the provisions about assessable income, see section 10–5.

However, the amount is included only once in your assessable income for an income year, and is then not included in your assessable income for any other income year.

(2) Unless the contrary intention appears, the provisions of this Act (outside this Part) prevail over the rules about *ordinary income.

Note: This Act contains some specific provisions about how far the rules about ordinary income prevail over the other provisions of this Act.'

[**21**] Relevant definitions were in s 995–1 of the ITAA 1997, as follows.

'… ***arm's length:*** in determining whether parties deal at arm's length, consider any connection between them and any other relevant circumstance …

associated enterprises article has the meaning given by subsection 815–15(5) …

business profits article has the meaning given by subsection 815–15(6) …

international tax agreement means an agreement (within the meaning of the International Tax Agreements Act 1953) to which that Act gives the force of law …

transfer pricing benefit has the meaning given by section 815–15.'

[22] The International Tax Agreements Act 1953 (Cth) provided in ss 3(1), 3(2) and 3AAA:

> **'3 Interpretation**
>
> (1) In this Act:
>
> ***agreement*** means a treaty or other agreement described in s 3AAA (about current agreements) or s 3AAB (about agreements for earlier periods).
>
> Note: Most of the conventions, protocols and other agreements described in these sections are set out in the Australian Treaty Series. In 2011, the text of an agreement in the Australian Treaty Series was accessible through the Australian Treaties Library on the AustLII website (www.austlii.edu.au) …
>
> (2) For the purposes of this Act and the Assessment Act, a reference in an agreement to profits of an activity or business shall, in relation to Australian tax, be read, where the context so permits, as a reference to taxable income derived from that activity or business.
>
> **3AAA Definitions—current agreements**
>
> (1) In this Act: …
>
> ***United Kingdom convention means:***
>
> (a) the Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains; and
>
> (b) the exchange of notes relating to that convention;
>
> each done at Canberra on 21 August 2003.
>
> Note: The text of this convention and notes is set out in Australian Treaty Series 2003 No. 22 ([2003] ATS 22).
>
> ***United States convention*** means the Convention between the Government of Australia and the Government of the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, done at Sydney on 6 August 1982.
>
> Note: The text of this convention is set out in Australian Treaty Series 1983 No. 16 ([1983] ATS 16).
>
> ***United States protocol*** (***No 1***) means the protocol, done at Canberra on 27 September 2001, amending the United States convention.
>
> Note: The text of this protocol is set out in Australian Treaty Series 2003 No 14 ([2003] ATS 14) …'

[23] Section 4 of the International Tax Agreements Act provided:

> **'4 Incorporation of Assessment Act**
>
> (1) Subject to sub-s (2), the Assessment Act is incorporated and shall be read as one with this Act.
>
> Note: An effect of this provision is that people who acquire information under this Act are subject to the confidentiality obligations and exceptions in Division 355 in Schedule 1 to the Taxation Administration Act 1953.
>
> (2) The provisions of this Act have effect notwithstanding anything inconsistent with those provisions contained in the Assessment Act (other than Pt IVA of the Income Tax Assessment Act 1936) or in an Act imposing Australian tax.'

[24] Section 5 of the International Tax Agreements Act provided:

> **'5 Current agreements have the force of law**
>
> (1) Subject to this Act, on and after the date of entry into force of a provision of an agreement mentioned below, the provision has the force of law according to its tenor.'

The United States convention was such an agreement.

[25] Section 6 of the International Tax Agreements Act provided:

> **'6 Convention with United States of America**
>
> The United States convention (as amended by the United States protocol (No 1)) does not subject to Australian tax any interest paid by a resident of Australia to a resident of the United States of America that, apart from that convention, would not be subject to Australian tax.'

[26] Articles 7 and 9 of the Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains (21 August 2003, [2003] ATS 22 (entered into force 17 December 2003)) (the United Kingdom convention) (see s 815–15(5) and (6) at [19] above) provided:

> **'ARTICLE 7**
>
> *Business profits*
>
> 1 The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated in that other State. If the enterprise carries on business in that manner, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2 Subject to the provisions of para 3 of this Article, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated in that other State, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment or with other enterprises.

3 In determining the profits of a permanent establishment, there shall be allowed as deductions expenses of the enterprise, being expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the Contracting State in which the permanent establishment is situated or elsewhere.

4 Nothing in this Article shall affect the application of any law of a Contracting State relating to the determination of the tax liability of a person in cases where the information available to the competent authority of that State is inadequate to determine the profits to be attributed to a permanent establishment. In such cases that law shall be applied, having regard to the information that is available, consistently with the principles of this Article.

5 No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

6 Where profits include items of income or gains which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

7 Nothing in this Article shall affect the operation of any law of a Contracting State relating to tax imposed on profits from insurance with non-residents provided that if the relevant law in force in either Contracting State at the date of signature of this Convention is varied (otherwise than in minor respects so as not to affect its general character) the Contracting States shall consult with each other with a view to agreeing to any amendment of this paragraph that may be appropriate …

ARTICLE 9

Associated enterprises

1 Where:

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State;

and in either case conditions operate between the two enterprises in their commercial or financial relations which differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another, then any profits which might, but for those conditions, have been expected to accrue to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2 Nothing in this Article shall affect the application of any law of a Contracting State relating to the determination of the tax liability of a person in cases where the information available to the competent authority of that State is inadequate to determine the profits accruing to an enterprise. In such cases that law shall be applied, having regard to the information that is available, consistently with the principles of this Article.

3 Where profits on which an enterprise of a Contracting State has been charged to tax in that State are also included, by virtue of the provisions of paras 1 or 2, in the profits of an enterprise of the other Contracting State and charged to tax in that other State, and the profits so included are profits which might have been expected to have accrued to that enterprise of the other State if the conditions operative between the enterprises had been those which might have been expected to have operated between independent enterprises dealing wholly independently with one another, then the first-mentioned State shall make an appropriate adjustment to the amount of tax it has charged on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.'

[27] Of primary relevance is the United States convention. Articles 7 and 9 were in the following terms:

'Article 7
Business profits

(1) The business profits of an enterprise of one of the Contracting States shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as

aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

(2) Subject to the provisions of para (3), where an enterprise of one of the Contracting States carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment or with other enterprises with which it deals.

(3) In the determination of the business profits of a permanent establishment, there shall be allowed as deductions expenses which are reasonably connected with the profits (including executive and general administrative expenses) and which would be deductible if the permanent establishment were an independent entity which paid those expenses, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

(4) No business profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

(5) For the purposes of the preceding paragraphs of this Article, the business profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

(6) Where business profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

(7) Nothing in this Article shall affect the application of any law of a Contracting State relating to the determination of the tax liability of a person in cases where the information available to the competent authority of that State is inadequate to determine the profits to be attributed to a permanent establishment, provided that, on the basis of the available information, the determination of the profits of the permanent establishment is consistent with the principles stated in this Article.

(8) Nothing in this Article shall in a Contracting State prevent the operation in that State of its law relating specifically to the taxation of any person who carries on the business of any form of insurance

(as long as that law as in effect on the date of signature of this Convention is not varied otherwise than in minor respects so as not to affect its general character) …

Article 9

Associated enterprises

(1) Where:

(a) an enterprise of one of the Contracting States participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one of the Contracting States and an enterprise of the other Contracting State,

and in either case conditions operate between the two enterprises in their commercial or financial relations which differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another, then any profits which, but for those conditions, might have been expected to accrue to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

(2) Where profits on which an enterprise of one of the Contracting States has been charged to tax in that State are also included, by virtue of paragraph (1), in the profits of an enterprise of the other Contracting State and taxed accordingly, and the profits so included are profits which might have been expected to have accrued to that enterprise of the other State if the conditions operative between the enterprises had been those which might have been expected to have operated between independent enterprises dealing wholly independently with one another, then the first-mentioned State shall make an appropriate adjustment to the amount of tax charged on those profits in the first-mentioned State. In determining such an adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

(3) Nothing in this Article shall affect the application of any law of a Contracting State relating to the determination of the tax liability of a person, including determinations in cases where the information available to the competent authority of that State is inadequate to determine the income to be attributed to an enterprise, provided that, on the basis of the available information, the determination of that tax liability is consistent with the principles stated in this Article.'

STRUCTURE OF APPLICANT'S CASE

[28] The applicant, CAHPL, outlined its primary and alternative cases as follows.

[29] CAHPL's primary case was that the determinations made under Division 13 of Pt III of the ITAA 1936 were invalid or inoperative and could not be relied upon by the Commissioner in support of the Division 13 2010 amended assessments because:

(a) they were made by a person who was not authorised to make them, or;

(b) in relation to the 2006–2008 years, because they ceased to be operative once the 2012 amended assessments were made under sub-division 815–A of the ITAA 1997 for those years.

[30] If the determinations made under Division 13 of Pt III of the ITAA 1936 were invalid, the Division 13 2010 amended assessments were excessive with the consequence that the only issue in relation to the 2004 and 2005 years was whether a liability arose directly under art 9 of the United States convention. In that respect CAHPL contended:

(i) art 9 did not confer a separate and independent power to tax; and even if it did,

(ii) there were no criteria for liability under art 9; or

(iii) if there were criteria for liability under art 9, they were not made out in the present case.

CAHPL needed to succeed on only one of those arguments to demonstrate that the amended assessments in respect of the 2004 and 2005 years were excessive.

[31] With respect to the 2006, 2007 and 2008 years, in addition to the issues set out in relation to art 9 there was a further issue which was whether the determinations under sub-division 815–A of the ITAA 1997 supported the sub-division 815–A 2012 amended assessments for those years. The alternative contentions raised by CAHPL in relation to that issue were:

(i) sub-division 815–A was constitutionally invalid; alternatively,

(ii) the statutory preconditions for the making of a sub-division 815–A determination were not satisfied.

CAHPL needed to succeed on only one of those arguments to demonstrate that the amended assessments in the 2006, 2007 and 2008 years were excessive.

[32] CAHPL's alternative case proceeded from the assumption that the determinations made under Division 13 of Pt III of the ITAA 1936 were valid and that they supported the Division 13 2010 amended assessments. In that case, the first consequence was that the sub-division 815–A determinations and 2012 amended assessments necessarily fell away because an essential precondition for the making of the sub-division

815–A determinations did not exist; there could be no 'transfer pricing benefit' and the Commissioner could not make a determination under s 815–10 'for the purpose of' negating a transfer pricing benefit that did not exist.

[**33**] Further, in any case, CAHPL submitted that the Division 13 2010 amended assessments, if valid, were still excessive because:

(a) the interest paid by CAHPL did not exceed 'the arm's length consideration' for the purposes of Division 13 of Pt III of the ITAA 1936; and

(b) art 9 did not confer a separate and independent power to tax; and even if it did, there were no criteria for liability under art 9, or, if there were criteria for liability under art 9, they were not made out here. On any view, the Division 13 2010 amended assessments could not be supported by reliance on art 9.

[**34**] Finally, if, contrary to CAHPL's submissions, both the determinations made under Division 13 of Pt III of the ITAA 1936 and the sub-division 815–A determinations were valid and simultaneously operative as alternatives, then the sub-division 815–A 2012 amended assessments of necessity supplanted the Division 13 2010 amended assessments (which thereby ceased to be operative). In that case, the contentions in [31] above were relied upon.

STRUCTURE OF RESPONDENT'S CASE

[**35**] The respondent submitted there was no foundation for the suggestion that 'alternative' assessments had been issued for the 2004–2008 income years. First, further amended assessments were issued in October 2012 in relation only to the 2006–2008 years, so that questions concerning the relationship between the two sets of determinations and assessments applied only to those years. As to those years, 2006–2008, there was nothing on the face of the notices of assessment issued in October 2012 to indicate that they were intended to operate otherwise than as amended assessments in the ordinary way so as to amend the existing assessments to operate as altered or added to. The true nature of what was intended was a change to the process of calculation of liability to tax which, in this instance, did not lead to a change in the amount of tax payable.

[**36**] For each of the 2006–2008 income years, the 2012 amended assessments became the definitive statement of CAHPL's income tax liability. However, the amendments made in 2010 continued to have effect. They remained extant and incorporated into the 2012 assessments. Further, the Division 13 determinations did not cease to be operative upon the making of the later amended assessments. The Division 13 determinations had not been revoked and therefore, to the extent that they

had operation when made, they continued to have that operation. The Division 13 determinations were relied on to support the 2010 amended assessments and they also supported the 2012 amended assessments. The amendment effected in 2012 was the inclusion of determinations under sub-division 815–A as an additional basis for the existing ascertainment of taxable income.

[37] For the income years to which the 2012 amended assessments applied, the Division 13 determinations and the sub-division 815–A determinations operated in the alternative to each other as support for the 2012 amended assessments. That was the consequence of s 815–40 and s 6–25. Alternatively, if the applicant was correct in submitting that the deeming effect of the Division 13 determinations correspondingly reduced or eliminated the 'transfer pricing benefits' upon which the sub-division 815–A determinations would operate, to that extent the sub-division 815–A determinations had no work to do and fell away. It might be that, if the Division 13 determinations were given their full effect, the amendments effected in October 2012 would be seen to be unnecessary, but it would not follow that the assessments were excessive. This was an example of the common case where the Commissioner defended an assessment on an alternative basis.

[38] As to the Division 13 determinations, the Commissioner submitted that the relevant determinations and the statements of reasons which accompanied them recorded the state of satisfaction referred to in s 136AD(3)(b) and it was not necessary to record the existence of that state of satisfaction in the Appeal Statement.

[39] The Commissioner did not submit that the state of satisfaction thus recorded was evidence of the relevant state of satisfaction having been personally held by Ms Field. It was accepted that the state of mind which the documents recorded was that of Mr Roberts.

[40] It was not in issue that at relevant times Mr Roberts was an Executive Level 2 ('EL2') officer and the Commissioner conceded that the instrument of authorisation (described at [41] below) did not confer authority on Mr Roberts to make a determination under s 136AD(3)(d). Otherwise, Mr Roberts had the general authority to form a state of satisfaction as to whether circumstances met a statutory description, such as that required by s 136AD(3)(b). Thus, if the state of satisfaction was an independent and separately examinable determinant of liability to tax, Mr Roberts had the necessary authority to form that state of satisfaction on behalf of the Commissioner or a delegate. On the other hand, if the existence of the relevant state of satisfaction was a factor going only to the validity of a determination under s 136AD(3)(d), it was an aspect of the 'due making' of the assessment which was not open to challenge on judicial review grounds in Pt IVC proceedings. It was accepted that the

relevant instrument of authorisation did not confer authority on Mr Roberts to make determinations under s 136AD(3)(d) and the effect of ss 175 and 177(1) of the ITAA 1936 was therefore critical. Authorities binding on the Court established the position that defects which would render a determination under s 136AD liable to be set aside in judicial review proceedings did not establish the excessiveness of the relevant assessment and were thus irrelevant in proceedings under Pt IVC.

[41] The instrument of authorisation dated 11 August 2009 authorised all officers from time to time holding or occupying positions or assigned to duties in Large Business and International and/or who exercised powers and functions in relation to any matters arising in Large Business and International to exercise in the name of the person from time to time holding or occupying the position or assigned to the duties of Deputy Commissioner of Taxation, Large Business and International, all the powers and functions delegated to the office of the Deputy Commissioner of Taxation, Large Business and International, and the powers and functions which the Deputy Commissioner of Taxation, Large Business and International, exercised in his or her own right, including those under the Acts listed in Sch 1 and the regulations made under those Acts, subject to the limitations listed in Schs 2–9. Schedule 2 dealt with authorisations for EL2 officers, and subtracted from the authority of those officers, relevantly, the authority to: 'make determinations under Division 13 of Pt III of the Income Tax Assessment Act 1936 and make decisions on the business profits and associated enterprises articles of international tax agreements and associated treaties relating to profit shifting'.

CONSIDERATION OF THE PARTIES' ADMINISTRATIVE SUBMISSIONS

[42] In my opinion, a consideration of the instrument of authorisation shows that Mr Roberts was authorised to form a view as to whether or not a taxpayer had acquired property under an international agreement (s 136AD(3)(a)); to be satisfied (or not) that the parties were not dealing at arm's length with each other in relation to the acquisition (s 136AD(3)(b)); and to form a view on whether the amount of the consideration given or agreed to be given by the taxpayer in respect of the acquisition exceeded the arm's length consideration (s 136AD(3)(c)). Mr Roberts was not authorised to make the determination that the subsection should apply in relation to the taxpayer in relation to the acquisition (s 136AD(3)(d)).

[43] Next to be considered is the function of s 136AD(3) and its relationship with ss 175 and 177(1). The judgment in *WR Carpenter Holdings Pty Ltd v Comr of Taxation* [2007] FCAFC 103, (2007) 161 FCR 1 at [43] and [48] shows that in a tax appeal the determination under s 136AD(3)(d) is not subject to examination on judicial review grounds, including the ground that the person who made the

determination was not authorised to make it. The Full Court said as follows:

> '[W]here Parliament has exhaustively set out the criteria for liability by reference to objective matters, but has made the application of those criteria dependent upon a step being taken by the Commissioner, the step is procedural in the sense that it is not a step which forms part of the criteria for liability. The due making of such a determination is not subject to examination on judicial review grounds … [T]he Commissioner's determination under s 177F(1) is posited not on the Commissioner's opinion about the tax benefit or that such a benefit results in connection with the scheme, for these are matters of objective fact. They are elements or criteria for liability to tax, but the Commissioner's opinion about them is not. In this sense, the determination is procedural and the due making of it is beyond examination.'

[**44**] To the same effect are the earlier observations at [27]–[29] as follows:

> 'Division 13 sets up a number of objectively ascertainable criteria, the satisfaction of which will create liability. Relevantly for present purposes, those are:
>
> an international agreement
> between parties not dealing with each other at arm's length
> under which property
> is supplied
> for less than the arm's length consideration in respect of the supply or for no consideration.
>
> In Pt IVC proceedings a taxpayer may challenge, by evidence and argument, the existence of all or any of those criteria. The taxpayer bears the burden of doing so. However, the matters in respect of which the applicants in the present case seek particulars do not concern the existence or otherwise of any of these criteria.
>
> In making the para (d) determination that s 136AD(1) or s 136AD(2) should apply, the Commissioner is not making any finding as to an element or criterion of tax liability.'

[**45**] The reasoning of the Full Court in *WR Carpenter Holdings Pty Ltd v Comr of Taxation* (2007) 161 FCR 1, particularly at [48], was expressly approved in *Comr of Taxation v Trail Bros Steel & Plastics Pty Ltd* (2010) 186 FCR 410 at [57].

[**46**] The applicant CAHPL relied on what Lindgren J had said at first instance in *WR Carpenter Holdings Pty Ltd v Comr of Taxation* [2006] FCA 1252, (2006) 234 ALR 451 at [144]:

> 'Neither section [177F nor 136AD] makes the existence of any particular state of mind of the Commissioner in relation to the making of the determination, a condition of the power to make it. *Sleight* [*Comr of Taxation v Sleight* [2004] FCAFC 94, (2004) 136 FCR 211] should be regarded as establishing that the legislature has revealed an intention that even in an appeal under Pt IVC of the TAA [Taxation Administration Act], the Commissioner's reasoning that led him to make the determination is shielded by s 177(1) of the ITAA 1936 from attack on judicial review grounds as part of the "due making" of the assessment. Of course, the fact itself of the making of the determination goes to the substantive liability to tax: if a determination was not even purportedly made, or if a determination purportedly made was not authorised by the ITAA 1936 because the statutorily prescribed conditions of the enlivening of the power were not satisfied, or, I suggest, failed to satisfy the *Hickman* principle, the assessment will be shown to be excessive.'

[47] In the present case, however, there was a determination which was purportedly made, by Mr Roberts. It follows that I reject the applicant's submission that because Mr Roberts was not authorised to make determinations under Division 13, the determinations are a nullity and cannot be relied upon to defend the amended assessments and that as a consequence the Division 13 2010 amended assessments are excessive. I do not accept the submission that what the High Court said in *WR Carpenter Holdings Pty Ltd v Comr of Taxation* [2008] HCA 33, (2008) 237 CLR 198 at [40], in referring to the vitiation of a determination by extraneous purposes amounting to jurisdictional error, applies to the present case, as their Honours' reference to *Comr of Taxation v Futuris Corp Ltd* [2008] HCA 32, (2008) 237 CLR 146 makes clear. (In *Futuris* at [25] the High Court referred to tentative or provisional assessments which for that reason do not answer the statutory description in s 175 and which may attract a remedy for jurisdictional error, and to conscious maladministration of the assessment process.) It follows that I also reject the applicant's submission that s 175 is not engaged as the applicant does not seek to impugn the validity of the amended assessment, but rather relies on the invalidity of the determination to demonstrate excessiveness of the assessment based upon it. In my opinion, since s 177(1) establishes, on the production of a notice of assessment, or of a copy of a notice of assessment under the hand of an officer there specified, the 'due making' of the assessments, a defect of the kind presently under consideration in a determination under s 136AD(3)(d) which forms part of the making of the assessments does not demonstrate excessiveness of the assessment. Neither, in my opinion, does it lead to the assessments being liable to be set aside in

circumstances outside those with which *Futuris* deals.

[48] I regard the cases on s 170 of the ITAA 1936, on which the applicant relied, as distinguishable. In particular, the applicant relied on what was said in *McAndrew v Comr of Taxation* [1956] HCA 62, (1956) 98 CLR 263 at 271 concerning s 170(2) which conferred authority on the Commissioner to amend an assessment where the taxpayer had not made to the Commissioner a full and true disclosure of all the material facts necessary for his assessment and there had been an avoidance of tax. Dixon CJ, McTiernan and Webb JJ said, at 271:

> 'But bearing in mind that the word "excessive" relates to the amount of the substantive liability it is not difficult to see that it will extend over the area in which the conditions mentioned in s 170(2) find a place. For the fulfilment of those conditions goes to the power of the commissioner to impose the liability by amendment. If he cannot amend consistently with s 170(2) and so increase the amount of the assessment then it must be excessive.'

[49] In the present case, however, what is excluded is whether the decision to issue a determination was made in accordance with the statutory requirements. It remains to consider whether the assessment is or is not excessive by reference to what may be called the objective facts.

ARTICLE 9 OF THE UNITED STATES CONVENTION

[50] In relation to art 9 of the United States convention and the ITAA 1936, the respondent Commissioner submitted that art 9 operated by itself without s 815. I understood this submission to mean that art 9 could be relied on also in relation to the amended assessments under the ITAA 1936. Reference was made by the respondent to the decision of the primary judge in *Comr of Taxation v SNF (Australia) Pty Ltd* [2010] FCA 635, (2010) 79 ATR 193 and to the decision of the Full Court in *Comr of Taxation v SNF (Australia) Pty Ltd* [2011] FCAFC 74, (2011) 13 ITLR 954.

[51] The applicant submitted that art 9 did not, and could not, confer a separate and independent imposition of taxation on its income (or deemed income). This contention went, in part, to whether art 9, independently of the transfer pricing provisions in the domestic legislation, could be relied on to support the amended assessments. The applicant submitted that existing authority supported the contention that art 9 could not, by itself, be so relied on. The applicant referred to the Full Court in *Comr of Taxation v Lamesa Holdings BV* (1997) 1 OFLR 380, (1997) 77 FCR 597; to *Ngee Hin Chong v Comr of Taxation* [2000] FCA 635, (2000) 2 ITLR 707; to *GE Capital Finance Pty Ltd v Commissioner of Taxation (Cth)* [2007] FCA 558, (2007) 159 FCR 473; to *Re Roche Products*

Pty Ltd [2008] AATA 639, (2008) 11 ITLR 92; to *Undershaft (No 1) Ltd v Comr of Taxation* (2009) 11 ITLR 652; and to the Full Court in *Comr of Taxation v SNF (Australia) Pty Ltd* (2011) 13 ITLR 954.

[52] In my opinion, the decisions to which the respondent refers in this respect do not establish a freestanding substantive operation for art 9. Further, in my opinion, the authorities on which the applicant relies tend strongly against that conclusion. Different considerations arise in relation to the role of art 9 when considered in the context of sub-division 815–A of the ITAA 1997. I turn to consider the authorities relied on by the parties.

[53] *Lamesa* concerned the Netherlands-Australia Double Taxation Agreement. The Full Court said that the Agreement substantially concerned allocation of taxing powers. Their Honours said, at 600–601:

> 'The Agreement is an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. Although, therefore, the Agreement has this dual object, the Agreement substantially concerns allocation of taxing power. Thus, as will be seen, the agreement allocates to the State, where business is carried on or through a permanent establishment, the right to tax business profits of that State (art 7). It allocates to the country of residence the power to tax aircraft and ship profits (art 8). Sometimes, as with arts 7 and 8, the power allocated to the jurisdiction named is exclusive. Sometimes, as is the case with interest, both jurisdictions may tax but with a nominated limit of 10% in one (art 11). The allocation is of the right to tax. There is nothing in the Agreement which compels a jurisdiction to exercise that right. Australia, for example, does not tax "exempt income", although such income could fall within the business profits article.'

So far as the treaty then under consideration was concerned, these observations tend against the submission that a double taxation agreement is a grant of a stand-alone taxing power.

[54] In *GE Capital Finance*, Middleton J said, at [27] and [36]:

> 'The USA Double Tax Treaty is one of the many double tax treaties entered into by Australia, and has been entered into for the avoidance of double taxation with respect to taxes on income. To achieve its aim of avoiding double taxation, the USA Double Tax Treaty allocates taxing "rights" between the treaty partners. As with all international treaties to which Australia is a party, it forms part of domestic law only because there is legislation which provides for the treaty to be incorporated into Australian law. The Agreements Act gives the force of law to the various international double taxation agreements scheduled to it …'

'It is important to recall that s 3(11) was introduced to amend the Agreements Act and to impact upon the operation of the USA Double Tax Treaty. The Agreements Act and the USA Double Tax Treaty, and in particular art 7, establish the scope within which the Australian legislature may impose tax. Article 7 provides that in certain circumstances the Contracting State *may* tax the business profits (which is permissive), but only so much of the business profits as is attributable to the permanent establishment (which involves a prohibition or limitation). Section 3(11) is similarly directed to the ability to impose a tax or the allocation of the power to tax. It is a provision which is to be read and used 'for the purpose of determining whether the beneficiary's share of the income *may* be taxed in Australia (emphasis added).' (Original emphasis.)

This analysis also tends against the respondent's present submission.

[55] In *Ngee Hin Chong v Comr of Taxation* (2000) 2 ITLR 707, Goldberg J considered the Malaysian tax treaty, in particular art 18(2). The respondent in that case, the Commissioner, appears to have put a different argument to the one presently advanced. The Commissioner's argument was dealt with by Goldberg J, at [24]–[26]:

'The respondent submitted that double tax agreements do not allocate the right to tax as such a right already exists by domestic law. Rather, it was said that double tax agreements qualify or limit that right by imposing limitations on the right to tax. The respondent said that a more accurate way to describe the purpose and effect of a double tax agreement was the language used by the Full Court [in *Lamesa*] at 607 where it said (at 607): "If art 13 applies, then profit from the alienation is authorised to be taxed in the place where the realty referred to in the Article is".'

'I do not consider that there is a significant difference between the concept of allocating taxing power and authorising the subject to be taxed in this context. When the Full Court in *Commissioner of Taxation v Lamesa Holdings BV* referred to the allocation of taxing power it was referring to the fact that as between two sovereign States with power to impose taxation on particular persons, receipts and events, the agreement was concerned to identify those areas where such power would not be applied. The Full Court saw the concept of the allocation of taxing power as involving the acceptance, if so agreed, of a limitation on an existing taxing power. This view is demonstrated by art 23 of the Malaysian Agreement which recognises that the taxation laws of each Contracting State continue to govern the taxation of income in that State except where the Agreement provides otherwise.'

'*As a matter of principle it is appropriate to describe the purpose and effect of a double tax agreement, where there are two existing tax systems in two contracting states, as one where areas of taxation are allocated between the two contracting states. The allocation of taxing power in a double tax agreement is predicated on the existence of a sovereign right by a contracting state to impose taxation and the existence of taxation legislation.* When one refers to an allocation of taxing power one is doing no more than saying that in an area where both contracting states have the right to impose taxation, and may have already imposed taxation, they have agreed that one contracting state, rather than the other or, as the case may be, both contracting states, shall have the right to impose taxation in that area. Whether one uses the language of allocation of power or the language of limitation of power, the result is the same; there is designated or agreed who shall have the right under the agreement to impose taxation in the particular area.' (Emphasis added. Citation omitted.)

[56] This approach, with respect, seems to me to be correct and it avoids any difficulties otherwise arising from the terms of s 55 of the Constitution. Section 55 provides that laws imposing taxation shall deal only with the imposition of taxation, and any provision therein dealing with any other matter shall be of no effect and laws imposing taxation shall deal with one subject of taxation only.

[57] *Undershaft (No 1)* (2009) 11 ITLR 652, concerned whether a capital gain on the sale of shares was not subject to income tax in Australia by reason of art 5 of the United Kingdom Agreement (a predecessor to the 2003 United Kingdom convention) and whether a capital gain was not subject to income tax in Australia by reason of art 7 of the Netherlands agreement. Articles 5 and 7 were referred to as 'Business Profits' Articles. If the respective capital gains fell within the Business Profits Articles, Australia was prevented from taxing those capital gains. At [45]–[46], Lindgren J said:

'A purpose of a DTA [double taxation agreement] is to avoid the potential for the imposition of tax by both of the Contracting States on the same income. It is appropriate to say that the Contracting States achieve their objective by "allocating" as between themselves the right to bring to tax a particular item to one Contracting State while the other State agrees to abstain from doing so ([*Lamesa* (1997) 77 FCR 597 at 600; *Chong v Federal Commissioner of Taxation* (2000) 101 FCR 134 at [24]–[27]]) … A DTA does not give a Contracting State power to tax, or oblige it to tax an amount over which it is allocated the right to tax by the DTA. Rather, a DTA avoids

a the potential for double taxation by restricting one Contracting State's taxing power.'

This latter dictum stands squarely against the respondent's present contention.

b [58] In *Comr of Taxation v SNF (Australia) Pty Ltd* (2010) 79 ATR 193 at first instance, Middleton J noted at [18] the Commissioner's submission that the associated enterprises articles of the double taxation agreements there under consideration themselves empowered the Commissioner to assess the taxpayer on profits so included, characterising each double c taxation agreement as being a stand-alone taxing power. However, at [19] Middleton J noted that the Commissioner was content to 'follow' the taxpayer in relying solely on Division 13, and, his Honour said at [20], in view of that approach he would proceed on the basis that Division 13 contained the statutory provisions the Court needed to interpret and apply d and the Court needed to go no further. His Honour observed that a similar approach was taken by Downes J in *Re Roche Products Pty Ltd v Comr of Taxation* [2008] AATA 639, (2008) 11 ITLR 92. In light of the approach of the primary judge in *SNF* (2010) 79 ATR 193, one would not expect to e find, and one does not find, any consideration of that issue by the Full Court in *Comr of Taxation v SNF (Australia) Pty Ltd* (2011) 13 ITLR 954.

[59] In *Re Roche Products*, Downes J, sitting as the Administrative Appeals Tribunal, dealt with this issue at [189]–[191] as follows:

f 'Submissions were put to me on 2 particular matters I have not dealt with so far. The first was whether the double tax treaties as incorporated into Australian law conferred a power to assess … So far as the first is concerned I note that the submissions were limited g (particularly those of the Commissioner) and both parties accepted that the result in this case would not be affected if the treaties conferred no power to assess. This is because the issues in this case concerned pricing and, to the extent that the double tax treaties relate to profits, the only ultimate relevance of profit was that it reflected h prices. Notwithstanding the different tests of independent pricing and arm's length dealing it was accepted that these are essentially the same tests, a proposition which is supported by the OECD Guidelines … In the result I do not need to decide the issue although I note that there is a lot to be said for the proposition that the treaties, even as enacted as i part of the law of Australia, do not go past authorising legislation and do not confer power on the Commissioner to assess. They allocate taxing power between the treaty parties rather than conferring any power to assess on the assessing body. On this basis Division 13 of Pt III of the ITAA 1936 should be seen as the relevant legislative

enactment pursuant to the power allocated.' *a*

[60] As to the terms of the Treaty in question, I see nothing in the terms of the United States convention which counts against this conclusion. For example, art 9 speaks of profits which '*may be*' included in the profits of the enterprise and taxed accordingly. Thus the Article may, as art 9(3) *b* contemplates, affect the application of any law of a Contracting State relating to the determination of the tax liability of a person.

[61] I reject the respondent's submission that art 9 of the United States convention, independently of the transfer pricing provisions in the domestic legislation, may be relied on to support the 2010 or the 2012 *c* amended assessments.

[62] I note that the applicant relied on an affidavit by Professor Harry Rosenbloom who was asked to address the question whether under the law of the United States in the period from 2003–2009 art 9 of the United States convention imposed tax. His conclusion was that under the law of *d* the United States in those years art 9 did not impose tax. The applicant submitted that it was important to take into account the practice of each Treaty partner in relation to the Treaty by reference to uniformity of practice. The applicant submitted that the fact that the United States *e* regarded the United States convention as not capable of imposing tax was an important fact in concluding whether it could do so from an Australian point of view. I note that Professor Rosenbloom was not required for cross-examination. Nevertheless, I do not find it necessary to rely on Professor Rosenbloom's opinion in reaching my conclusion that art 9 may *f* not independently of the transfer pricing provisions in the domestic legislation be relied on to support the amended assessments.

DIVISION 13 OF THE ITAA 1936

[63] I proceed to consider s 136AD of the ITAA 1936 in accordance *g* with its terms.

Arm's length consideration

[64] I turn to the question of arm's length consideration for the purposes *h* of s 136AD of the ITAA 1936. At [121] and [122] in *Comr of Taxation v SNF (Australia) Pty Ltd* (2011) 13 ITLR 954, the Full Court described as a correct statement what Middleton J had said at first instance at [44]:

> 'The essential task is to determine the arm's length consideration in respect of the acquisition. One way to do this is to find truly *i* comparable transactions involving the acquisition of the same or sufficiently similar products in the same or similar circumstances, where those transactions are undertaken at arm's length, or if not taken at arm's length, where suitable adjustment can be made to

determine the arm's length consideration that would have taken place if the acquisition was at arm's length.'

[65] The Full Court in *SNF* rejected the Commissioner's submission (set out at [95] of the Full Court's reasons) that the statutory hypothesis was to consist of all of the facts in the real world with one fact changed by the deeming provision, namely, the fact that the taxpayer and its parent were not independent of each other and that this required one to assume a set of facts in which the purchaser was an entity with all of the qualities of the taxpayer except its relationship to the parent manufacturers. At [96]–[99] the Full Court said:

> 'The Commissioner's argument hinges, as he submitted in reply, on the proposition that one of the independent parties referred to in the definition of "arm's length consideration" in s 136AA(3)(d) was the taxpayer. This was the case, so he submitted, because the definition provision had to "be read in the context of s 136AD, the operative provision" and that provision commenced "its inquiry with the 'taxpayer' and it is the 'taxpayer' which is the subject of the hypothetical in s 136AA". The three propositions for which the Commissioner contends are, therefore:
>
> (a) the definition provision must be read in the context of the operative provision; and
>
> (b) the operative provision—s 136AD(3)—begins its inquiry with the taxpayer;
>
> (c) therefore the hypothesis required by the definitive provision—s 136AA(3)(d)—must relate to the taxpayer so that "arm's length" in that provision means "arm's length from the taxpayer".
>
> The critical words of s 136AA(3)(d) in question are "between independent parties dealing at arm's length". It is the burden of the Commissioner's argument that one of the independent parties to whom the provision refers must necessarily be the taxpayer. That observation lays bare an ambiguity in the expression "independent parties at arm's length". In the context of ss 136AD(3) and 136AA(3)(d) those words could equally cover any of the following three situations:
>
> (a) a purchase by the taxpayer from a hypothetical arm's length supplier;
>
> (b) a purchase by a hypothetical purchaser from the taxpayer's actual supplier;
>
> (c) a purchase by a hypothetical purchaser from a hypothetical arm's length supplier.
>
> That ambiguity underscores the fact that the description of a

transaction as being at arm's length is a statement about the independence of two parties from each other. The connexion thus disclosed is a relative one. Generally speaking a statement that two parties have a relative connexion of a particular kind does not carry with it any information about their absolute status. A requirement, for example, that two businesses be more than 20km apart says nothing about where either business is situated. If one were to look at the definition provision in s 136AA(3)(d) in isolation it would be unsound to read it as requiring any more than that the two parties in question should be independent of each other; that is, the ordinary meaning is not as the Commissioner contends.

The question then is whether the ordinary meaning is somehow displaced or modified by the fact that the definition provision feeds into an operative provision—s 136AD(3)—which in turn utilises it to assess the position of the taxpayer. There is no doubt that s 136AD(3) is, as the Commissioner submits, about the taxpayer; that it requires a comparison between that which was actually paid by the taxpayer and an arm's length consideration; and, that, in appropriate circumstances, it then substitutes one for the other. However, it does not follow from acceptance of all those features that arm's length consideration—which does not, in general, refer to the actual position of either party—must be treated as overlaid by a further requirement that the consideration not only be at arm's length but that the arm in question be attached to the taxpayer.'

The statutory integers—ITAA 1936

[66] I next address in turn each of the statutory integers, so as to provide a framework within which to consider the evidence.

[67] Section 136AD(3), set out at [12] above, proceeds by reference, first, to whether a taxpayer has acquired property under an international agreement; second, to whether the parties to the agreement were not dealing at arm's length with each other in relation to the acquisition (of property); and third, to whether the taxpayer gave or agreed to give consideration in respect of the acquisition and the amount of that consideration exceeded the arm's length consideration in respect of the acquisition. It is then that, relevantly, on a determination by the Commissioner that the subsection should apply, consideration equal to the arm's length consideration in respect of the acquisition is to be deemed to be the consideration given or agreed to be given by the taxpayer in respect of the acquisition.

[68] Section 136AA(1), set out at [13] above, provides that in Division 13, unless the contrary intention appears, 'acquire' includes 'obtain, gain or receive'; 'agreement' means any agreement, arrangement, transaction,

understanding or scheme, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; 'property' includes a chose in action; any estate, interest, right or power, whether at law or in equity, in or over property; any right to receive income; and services; and 'services' includes any rights, benefits, privileges or facilities and, without limiting the generality of the foregoing, includes the rights, benefits, privileges or facilities that are, or are to be provided, granted or conferred under, relevantly, an agreement for or in relation to the lending of moneys.

[69] By s 136AA(3), unless the contrary intention appears, 'a reference to the arm's length consideration in respect of the acquisition of property is a reference to the consideration that might reasonably be expected to have been given or agreed to be given in respect of the acquisition if the property had been acquired under an agreement between independent parties dealing at arm's length with each other in relation to the acquisition'.

[70] The parties accepted that the Credit Facility Agreement was an international agreement for the purposes of s 136AC.

[71] I do not accept the submission of the applicant that 'property' is to be read down or that 'services' is to be read down so as to refer, relevantly, only to an agreement for or in relation to the lending of moneys, given the non-limiting characteristic of the examples in light of the words 'without limiting the generality of the foregoing' in the definition of 'services' in s 136AA(1).

[72] There remain, however, a number of questions. Beginning with the operative provisions in s 136AD(3), the taxpayer has acquired property under an international agreement and the question is whether the consideration it gave or agreed to give in respect of the acquisition exceeded the arm's length consideration, that is, the consideration that might reasonably be expected to have been given or agreed to be given in respect of the acquisition if the property had been acquired under an agreement between independent parties dealing at arm's length with each other in relation to the acquisition.

[73] Before making the statutory comparison, therefore, it is necessary to identify the property, that is, the rights, benefits, privileges or facilities that are, or are to be provided, granted or conferred by the agreement and acquired by the taxpayer, and, if there has been an agreement between independent parties dealing at arm's length to acquire that property, to proceed by reference to what is the consideration that might reasonably have been expected to have been given or agreed to be given in respect of the acquisition. It is that latter consideration, the consideration equal to the arm's length consideration in respect of the acquisition, that is deemed to be the consideration given or agreed to be given by the taxpayer in

respect of the acquisition 'for all purposes of the application of this Act in relation to the taxpayer'. In my opinion, the property CAHPL acquired under the international agreement, the Credit Facility Agreement, was the rights or benefits granted or conferred under that Credit Facility, including the sums lent.

[74] The first question, therefore, is whether CAHPL gave or agreed to give consideration and the amount of the consideration exceeded the arm's length consideration in respect of the acquisition. It is for the applicant to show that the amended assessments were excessive: Taxation Administration Act s 14ZZO(b).

[75] I do not accept the applicant's submission that the Commissioner has declined to plead as a fact that the state of satisfaction referred to in s 136AD(3)(b) was in fact reached and that the Court should therefore conclude that the state of satisfaction was never duly reached by an authorised officer of the Commissioner. The state of satisfaction is set out in the evidence reproduced at [6] above.

[76] What is required, in my opinion, is to depersonalise the agreement to acquire so as to make it, hypothetically, between independent parties dealing at arm's length, but not so as to alter the property acquired. Division 13 of the ITAA 1936 does not, in my opinion, require or authorise the creation of an agreement with terms different from those of the actual agreement, other than the consideration. I reject the Commissioner's submission that the use of the word 'an' in s 136AA(3)(d) showed that terms different from those of the actual agreement could be taken into account. In my opinion, the indefinite article is used because the agreement there referred to is the hypothetical agreement. By way of contrast, references earlier in the same paragraph are to 'the acquisition of property', 'the consideration', 'of the acquisition' and 'the property'.

[77] The questions posed by the concept of arm's length consideration 'cannot include the requirement of any investigation or consideration … of motive and purpose': *WR Carpenter Holdings Pty Ltd v Comr of Taxation* (2008) 237 CLR 198 at [38]: *Comr of Taxation v SNF (Australia) Pty Ltd* (2011) 13 ITLR 954 at [7].

[78] But the hypothesis must be made to work: it is clear, for example, from the terms of the definition of 'property' in s 136AA that property a taxpayer acquires under an international agreement may include the rights, benefits, privileges or facilities that are to be provided under an agreement for or in relation to the lending of moneys. It is not enough, in my opinion, to proceed on the basis that hypothetical independent parties would not have made an agreement on the same terms.

[79] One issue of statutory construction between the parties was whether s 136AA(3)(d) required that the borrower as an independent party be considered as a stand-alone company. In my opinion, the answer

is 'no' as this would be to use the word 'independent' as if it meant entirely independent rather than, in a case such as the present, independent of the lender.

[80] For present purposes, it is useful to adopt the tool of analysis that, in the hypothetical, the hypothetical independent parties have the characteristics relevant to the pricing of the loan so as to enable the hypothesis to work. Thus, for example, the borrower will be an oil and gas exploration and production (E&P) subsidiary.

[81] This has implications for the interest rate, which would change depending on the borrower's credit rating (and on the rating of the loan agreement), and on whether or not the interest rate should reflect the absence of security, the absence of guarantee or the absence of covenants given by a borrower for the protection of a lender.

[82] Implicit in this approach is that the word 'consideration' in s 136AA(3)(d), which is not exhaustively defined but is extended by s 136AA(3)(b), should not be taken to mean more than it otherwise would, in context. This means that I do not construe 'consideration' in s 136AA(3)(d) to mean the terms of the contract which do no more than affect the interest rate. For example, although the interest rate will be affected by the financial viability of the borrower, I do not construe the word 'consideration' as extending to those characteristics.

[83] The applicant submitted that the issue was to price the loan, which I understood to mean that the only permissible variable was the interest rate. The primary evidence called by the applicant was directed to the interest rate. The respondent Commissioner submitted that the term 'consideration' in the context of legislation dealing with the acquisition of property looked to what was received by the acquiring party 'so as to move' the transaction, and could include both money and money's worth: *Archibald Howie Pty Ltd v Comr of Stamp Duties (NSW)* (1948) 77 CLR 143 at 152 per Dixon J; *Chief Commissioner of State Revenue v Dick Smith Electronics Holdings Pty Ltd* (2005) 221 CLR 496 at [71]–[72] per Gummow, Kirby and Hayne JJ. In the context of a loan, it was the promise to repay principal with interest, and any promises to provide security and covenants, which moved the advance of the lender's funds. Each of those promises was to be examined when determining the arm's length 'consideration' for the transaction under Division 13. There was nothing in Division 13 which restricted the 'consideration' in respect of a loan to the interest rate only. Earlier in his submissions, the respondent contended that the promise to repay with interest was the consideration which flowed from the borrower in exchange for the sum paid to him and cited *McGain v Comr of Taxation* (1965) 112 CLR 523 per Taylor J (upheld in *McGain v Commissioner of Taxation* [1966] HCA 34, (1966) 116 CLR 172 at 173); *ASIC v Great Northern Developments Pty Ltd*

[2010] NSWSC 1087, (2010) 242 FLR 444 at [62] per White J. The respondent referred to the consideration which flowed from the borrower in a loan transaction (that is, the promise to repay with interest and any other covenants) with the consideration which flowed from the lender (that is, the advance of funds). In its very terms s 136AD(3) drew an important distinction between the property acquired and the consideration given. The proper analysis was that CFC paid over $US2.45 billion *in return for* CAHPL's promise to pay the principal in AUD on maturity and to pay interest: *McGain v Comr of Taxation* [1965] HCA 41 (1965) 112 CLR 523 at 529.

[84] In my opinion, neither the context provided by s 136AD(3) nor the non-inclusive definition of 'consideration' in s 136AA(3) provides a basis for concluding that the word 'consideration' is limited, in the case of a loan, to the interest rate. Insofar as the applicant contended otherwise, I reject that submission.

[85] In *McGain v Comr of Taxation* (1965) 112 CLR 523, Taylor J was considering the definition of 'gift' in s 4 of the Gift Duty Assessment Act 1941 (Cth), that word being defined to mean 'any disposition of property … without consideration in money or money's worth passing from the disponee to the disponor, or with such consideration so passing if the consideration is not, or, in the opinion of the Commissioner, is not, fully adequate'. The expression 'disposition of property' was also defined. Justice Taylor held that a loan of money was a 'disposition of property' within the meaning of s 4. In that context, Taylor J said, at 529: 'From the point of view of the lender, he has paid over or alienated his money in return for a promise to repay the whole or part of it in money or money's worth.' Later in his reasons, at 530–531, Taylor J asked what was the consideration which passed from the company, the borrower. His Honour held that the consideration was not money but a promise by the company to make payments and repayments extending over a period of many years. What the lender got in return for each disposition was a contractual promise enforceable from time to time in accordance with the agreed terms. As such, it was money's worth. On appeal, Barwick CJ, Menzies and Owen JJ rejected the appellant's contention that the loan transactions involved no disposition of property within the meaning of s 4. Their Honours said, (1966) 116 CLR 172 at 174, that the real question was whether the payment of money by the lender to the borrower constituted a disposition of property, not whether a loan was a disposition of property. Having concluded that the payments were dispositions of property, the question arose whether such a payment constituted a gift and it then became necessary to look to the consideration for the payment. At 174–175, their Honours said the consideration which passed to the lender from the borrower was a cash payment and a promise to pay the balance

of the purchase price over 50 years without interest. What passed at the time of the disposition was, in part, a promise to pay. It could not be said that the promise, together with the money paid, was the equivalent of the property transferred and the inadequacy of the consideration arose from the terms of the promise itself, that is, that the present value of the property, less the cash payment, should be paid over 50 years without interest.

[86] In *Archibald Howie* (1948) 77 CLR 143 the High Court was concerned with the Stamp Duties Act 1920 (NSW) and in *Dick Smith Electronics* with the Duties Act 1997 (NSW). In *Archibald Howie*, Dixon J held, at 152, that the word 'consideration' in s 66 should receive the wider meaning or operation that belonged to it in conveyancing rather than the more precise meaning of the law of simple contracts. Under s 66, his Honour said, the consideration was not involved with offer and acceptance but rather with the money or value passing which moved the conveyance or transfer. In *Dick Smith Electronics*, the parties accepted that 'consideration' in s 21 was not to be read as requiring identification of the consideration sufficient to support a contract. At [71], Gummow, Kirby and Hayne JJ said that so much followed inevitably from the recognition of the fact that s 21(1)(a) (and the expression 'the consideration … for the dutiable transaction') would find application in cases in which a transfer of dutiable property was not made pursuant to contract.

[87] Applying ss 136AD(3) and 136AA(3) of the ITAA 1936 in the present case, I accept that the promises by the borrower, CAHPL, were the consideration given or agreed to be given by it. I also accept that the wide definitions of 'agreement' and of 'acquire' in s 136AA(1) mean that the acquisition of property by a taxpayer under an international agreement is not limited to acquisitions made pursuant to contract. In the present case I find that CAHPL did not give security or operational and financial covenants, which would have affected that part of the consideration which was the interest rate: the interest rate was higher in the absence of those promises or covenants. If the property had been acquired under an agreement between independent parties dealing at arm's length with each other, I find that the borrower would have given such security and operational and financial covenants and the interest rate, as a consequence, would have been lower. The limited scope of the consideration given or agreed to be given by CAHPL resulted in the consideration which CAHPL did give, the promise to pay the interest rate, exceeding the arm's length consideration in respect of the acquisition. It follows, on that basis, that the applicant has not shown that the arm's length consideration assessed by the respondent Commissioner was excessive.

[88] However, in my opinion, s 136AD does not require or allow a

different agreement to be substituted, on the basis that two independent parties would not have entered into a loan agreement on the same terms as the Credit Facility Agreement. It is not, therefore, an appropriate approach under Division 13 of the ITAA 1936 to ask what the terms, other than the consideration, would have been if CAHPL had been negotiating with a third party lender unrelated to it or if two unrelated parties neither of whom was CAHPL or CFC had been negotiating.

[89] I turn now to the evidence.

THE EVIDENCE

[90] It is important, in my opinion, to consider the evidence of each witness as it was given and in its context. Because of the variety of complex assumptions, and factual permutations, to take one or two sentences out of their context may be to misstate the evidence. Where the evidence is of limited or no relevance to my ultimate factual conclusions it is referred to more shortly in these reasons.

Applicant's overview of its witnesses

[91] The applicant relied on the evidence of two experienced commercial lenders, Mr Eugene Martin and Mr Richard Gross. They prepared reports as to how lenders would go about pricing the loan. Their evidence was supported by Mr Timothy Long formerly of the United States Office of the Comptroller of the Currency ('OCC'). The applicant submitted that those expert reports were evidence in support of its primary case that the Court could and should stop in pricing a loan in accordance with the tests in the legislation. The balance of the applicant's expert evidence was directed to responding to the case or cases put by the respondent Commissioner. First, in a series of further reports, both Mr Gross and Mr Martin responded to criticisms made of them by one of the Commissioner's witnesses and economists, Mr John Hollas, who had had some banking experience. Mr Gross was also criticised by, and responded to, two further witnesses for the Commissioner, Ms Tanya Azarchs and Mr Matthew Taylor. Mr Martin responded to the respondent's other expert with banking experience, Mr John McCormick. (I note that ultimately the Commissioner did not call Mr McCormick to give evidence). Mr Long was criticised by another of the respondent's witnesses, Mr Neil Gaskell, and Mr Long responded to this criticism.

[92] Secondly, the applicant responded to the case which the Commissioner put forward on pricing the loan, which asserted that it would be done by reference to how a credit rating agency would rate the actual borrower in this case. In the alternative therefore, the applicant relied upon the evidence of Mr John Thieroff who assigned a BB rating to the applicant on a stand-alone basis. For that purpose, Mr Thieroff was

instructed not to take into account parentage. In his second report he was asked to take into account the effect of parentage in the process of a rating's agency rating and that caused him to increase the rating by one notch, resulting in a BB+ rating, which was still non-investment grade. Mr Thieroff also responded to the Commissioner's ratings witnesses, Mr Edward Emmer, who was in management at Standard & Poor's ('S&P'); Mr Taylor, who was a ratings advisor at a merchant bank; and Ms Azarchs who was a financial institutions analyst at S&P. An aspect of Mr Thieroff's evidence was supported by a further ratings witness, Ms Andrea Esposito. Ms Esposito confirmed Mr Thieroff's evidence that caution must be exercised in moving from a non-investment grade rating to an investment grade rating. She also responded to the report of Ms Azarchs.

[93] Thirdly, the applicant responded to the respondent's re-characterisation case with four strands of further evidence. In the first strand the applicant relied on the evidence of Dr Brian Becker, an economist, who had put on a series of reports responding to the Commissioner's economist, Dr Thomas Horst. Dr Becker also responded to Mr Hollas in another series of reports. Dr Becker was not put forward as a primary or pricing witness, but to demonstrate the deficiencies in the work undertaken by Dr Horst and Mr Hollas to the extent that that was necessary. The second strand in the evidence was that of Ms Caroline Silberztein, the former head of the OECD transfer pricing unit whose report concerned the interpretation of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('the OECD Guidelines'), in response to Dr Horst's reliance on his own construction of those Guidelines. The third strand comprised the evidence of Mr Peter Wasow and Mr Marcus Rowland who gave evidence as to the borrowing practices of oil and gas companies. Also Dr Anthony Webber, an economist, gave evidence about the natural hedging benefit that arose for oil and gas companies borrowing in Australian dollars at the time this loan was made and criticised the evidence of two of the Commissioner's witnesses, Mr Gaskell and Mr McCormick. The fourth strand of evidence was expert accounting evidence. The applicant relied on the evidence of Professor Robert Walker, and he responded to the report of Professor David Boymal, the Commissioner's expert accountant, who opined that the optimal currency of the loan was US dollars.

[94] In response to the Commissioner's argument that art 9 of the United States convention contained an independent power to tax, there was one further leg to the applicant's expert evidence. The evidence of Professor Rosenbloom, formerly international tax counsel at the US Department of Treasury, and the evidence of Mr Leslie Schreyer, who was directly involved in the 14-year negotiation of the United States convention.

Neither Professor Rosenbloom nor Mr Schreyer was required for cross-examination. I held that the report of Mr Schreyer was inadmissible (see [318] below.)

[95] As to the lay witnesses, the applicant relied primarily on the evidence of Australian Chevron employees, Mr William Dalzell and Mr David Lewis, who gave the background to the loan the subject of the pricing dispute. Mr Dalzell was the person who prepared the report that went to the Board of the applicant for the meeting at which the loan was approved. Further evidence in relation to the background and actual pricing of the loan was given by Ms Sezaneh Taherian who was responsible for communicating with Goldman Sachs and Deutsche Bank engaged to advise on the quantum and price of the loan. The applicant also relied on the evidence of Mr Steven Callaghan, an accountant employed by Chevron Australia. He gave evidence about how the functional currency of the applicant's accounts, Australian dollars, was determined; the structure of the ownership of the assets of the applicant's subsidiaries; and the nature of the revenue of the applicant's subsidiaries. The applicant also relied on the evidence of Mr Paul Oen who was a director of the applicant from its incorporation until November 2001. From 2002 to August 2005 he was the general manager of the Greater Gorgon area. Mr Oen explained the status of that project at the time the loan was entered into. Mr Oen was not required for cross-examination.

[96]–[479] are available via the Federal Court of Australia website: http://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2015/2015fca1092.

CONSIDERATION

Division 13 of the ITAA 1936

[480] I approach this question in light of the reasoning of the Full Court in *Comr of Taxation v SNF (Australia) Pty Ltd* (2011) 13 ITLR 954 at [128] as follows, recognising that in that case the Commissioner had made a determination under s 136AD(4) whereas in the present case he has not:

> 'Of course, it is true that s 136AD operates to engage the statutory fiction that the consideration paid was "the arm's length consideration" and that the existence of more than one such value may give rise to practical problems of administration. But it is precisely to situations of that kind that the Commissioner's power conferred by s 136AD(4), to determine the arm's length consideration, is apposite: "where, for any reason (including an insufficiency of information available to the Commissioner), it is not possible or not practicable for the Commissioner to ascertain the arm's length consideration … [it]

shall be deemed to be such amount as the Commissioner determines". Where there is more than one arm's length price (as often there will be), the Commissioner may determine which he will apply. Correspondingly, in review proceedings the taxpayer will be entitled to succeed if it shows that the prices paid by it were arm's length prices or less than arm's length prices. If it pursues the latter course there is no need for it to establish a particular price as *the* arm's length price. It will be sufficient to show that it paid less than *an* arm's length price.' (Original emphasis.)

[**481**] The applicant submitted that for s 136AD(3)(c) to be satisfied, the amount of the consideration which the taxpayer gave or agreed to give in respect of the acquisition must have exceeded 'the arm's length consideration in respect of the acquisition'. The applicant submitted, first, that the subject of the inquiry mandated by s 136AD(3)(c) was the 'consideration in respect of *the acquisition*': those words confined the inquiry to the actual acquisition. They were only concerned with an examination of the consideration in respect of the acquisition of the particular property *in fact* acquired. Here, the acquisition was of a particular bundle of rights conferred by the Credit Facility Agreement. Secondly, the applicant submitted, the phrase 'consideration that might reasonably have been expected to have been given … [by] … independent parties' was one that necessarily required the removal of all the connections between the actual parties in the hypothesis or comparison mandated by the provision. Unless all the connections were removed, parties would not be independent of each other. That included the common ownership by a single ultimate parent. Thirdly, the applicant submitted, given that the only question posed by s 136AD(3) was whether the consideration in fact given was an arm's length one, the section warranted no investigation or consideration of motive or purpose for the actual acquisition.

[**482**] As to the first of these matters, the applicant submitted CAHPL acquired rights to borrow a sum expressed in AUD. The cost of acquiring and exercising this right was CAHPL's promise to repay principal and interest, denominated in AUD. It was not open to the Commissioner to challenge the commercial choice to prefer AUD: CAHPL borrowed from CFC in AUD to refinance debts that had been incurred in AUD. It was the arm's length consideration for the rights and benefits in fact conferred by the Credit Facility Agreement, which must be determined. As to the second of these matters, in addressing the hypothetical enquiry required by s 136AA and in determining the 'arm's length consideration', the legislation ordinarily required one to exclude the particular attributes of the parties in question, and to focus instead upon the intrinsic value of the

property or services in question. As a consequence, s 136AD should be construed as requiring the specific circumstances of the taxpayer to be disregarded. Because the hypothetical was concerned with truly 'independent' parties, ss 136AA and 136AD(3) required the negation of any connection between the actual parties in formulating the attributes of the hypothetical independent parties dealing at arm's length with each other. In the present case, the matters to be excluded were: (a) the fact that CAHPL and the lender (CFC) were in a parent-subsidiary relationship (that is, the ownership of CFC by CAHPL); and (b) the fact that CAHPL and the lender were each ultimately wholly owned by CVX, that is, the source of their common ownership. It was these 'connections' which resulted in CAHPL and CFC not being independent and in order to hypothesise how independent parties would have transacted, one needed to eliminate both.

[483] The applicant submitted that where the pricing of the supply or acquisition of goods or services was necessarily affected by the attributes of the purchaser, the general rule against introducing such attributes to the Division 13 hypothetical inquiry needed to be qualified. The provision of financial accommodation was an example of such a transaction. From an economic perspective the characteristics of the borrowing entity were of utmost importance in determining an interest rate on a loan, and it may be accepted that from the perspective of the hypothetical lender the creditworthiness of the purchaser of the financial accommodation (together with other objective attributes, such as the size of the loan and its currency) should affect the price for such a supply.

[484] CAHPL accepted that the pricing of the loan between CAHPL and CFC must take into account the assets, risks and functions of CAHPL which informed the likelihood of CAHPL repaying both principal and interest. Assumptions about the assets, risks and functions of the purchaser of financial accommodation were needed in order to price such a supply. In that respect, the Commissioner agreed with CAHPL.

[485] However, the applicant submitted, the assets, risks and functions of CAHPL to be attributed to the hypothetical inquiry were those of CAHPL as a stand-alone entity. This was the point of disagreement with the Commissioner. Assets, functions and risks in fact attributable to it by reason of its ownership by the Chevron group must be excluded from the hypothetical because of the need for independence mandated by the words of the statute. Those attributes resulting from membership of the Chevron group constituted 'connections' between CAHPL and CFC and therefore did not form part of the required hypothetical. That would require the exclusion of what rating agencies refer to as 'implicit support', namely the assumed existence of a willingness (or the perception of the existence of a willingness) of a parent of the borrower to provide the borrower with

credit support in the event of default on the obligation to repay the loan, in the absence of any legally enforceable obligation to do so. The concept of 'implicit support' or credit benefit obtained by reason of the taxpayer's affiliation with CVX was the very product of the non-arm's length relationship. To take account of so called implicit support required a preservation of a key aspect of the non-arm's length relationship between CAHPL and CFC, which was contrary to, and incompatible with, the concept of 'independent parties' prescribed by s 136AA(3).

[486] Turning to the actual circumstances of the present case, the applicant submitted that the task was to remove the aspects of the actual transaction that arose from the non-independence and non-arm's length dealing between the parties and to price that transaction. That was not a reconstruction of the transaction. It was an acceptance of the transaction but a rejection of all non-arm's length relationships between the parties to it.

[487] The applicant submitted that, in effect, the pricing evidence of the expert witnesses it called was unchallenged, that evidence being in the reports of Mr Martin and Mr Gross as to how lenders would price the facility that was actually entered into by CAHPL and in the first report of Mr Thieroff which applied the credit rating methodology used by S&P contemporaneously with the Credit Facility Agreement to CAHPL as an independent entity on a stand-alone basis.

[488] The applicant submitted that there were six features of the Credit Facility Agreement that went to the essential nature of the 'property acquired' and constituted the 'rights, benefits' conferred upon CAHPL. Those features were: (a) the size or quantum of the loan, being a loan facility that was the AUD equivalent of $US2.5bn; (b) the term was five years; (c) the facility did not contain any onerous financial covenants; (d) the loan was unsecured; (e) the loan was non-amortising; and (f) the currency of the loan was AUD. The applicant submitted that the closest analogue was an institutional loan, known as a 'Term Loan B'. This was the best and closest comparator: a Term Loan B, like the CAHPL loan, typically required little to no principal amortisation, had a 5–7 year tenor, and had a bullet maturity. There were differences between a *typical* Term Loan B and the CAHPL facility, namely that the CAHPL facility was unsecured and lacked the financial covenants one would expect to find in a typical Term Loan B, and it provided for the borrower to prepay the loan without penalty. However, none of these differences would cause institutional investors any difficulty in pricing the loan. Provided it was appropriately priced, there would have been sufficient global market capacity to place an institutional loan of this size (AUD equivalent of $US2.5bn) in 2003 to a non-investment grade rated borrower without a parental guarantee. It followed that the CAHPL facility could be priced

like an institutional loan, with adjustments for the differences between the CAHPL facility and typical institutional loans to companies with similar credit profiles to CAHPL. Those adjustments reflected the additional amounts institutional investors would charge to compensate them for the increase in risk. After making such adjustments, Mr Martin concluded that the price paid by CAHPL did not exceed the arm's length price.

[489] The applicant submitted that the relevant evaluation process involved the following principles. First, in assessing credit quality, sophisticated lending institutions (banks and institutional investors) did not rely on agency credit ratings. They performed their own credit analysis in a manner that differed markedly from the credit rating agency methodology. Secondly, sophisticated lenders did not rely on so called 'implicit credit support' in pricing a loan. Mr Martin said that lenders evaluated the creditworthiness of the borrower on a stand-alone basis without assuming any support from a corporate parent, in the absence of an obligation to provide support. Mr Gross' view was that 'parentage is not worth much': what lenders relied on were enforceable parental guarantees. That view was supported by Mr Long. From the perspective of a lender, significant upgrades in rating based on such 'implicit credit support' were 'ludicrous'. Thirdly, the CAHPL facility could be priced by reference to the institutional loan market with, as necessary, adjustments for differences with the CAHPL facility. Those differences would not disqualify CAHPL from being able to access credit in the amount and on the terms that it did.

[490] Mr Martin performed a credit analysis of CAHPL, concluding that it would be rated a 'weak BB', which is non-investment grade. He observed that the institutional loan market would be the market in which debt of this kind would be raised at arm's length, principally due to the size of the facility, which would require a large number of lenders (75–100), the lack of security, the lack of covenants and the fact that the loan was a non-amortising bullet loan. While many banks would have difficulty with such a loan, the institutional market was more flexible, and institutional investors were prepared to bargain an increase in price for the absence of typical features like covenants. Hence, relevant differences between the CAHPL facility and typical institutional loans could be dealt with by way of a pricing adjustment. Mr Martin began his pricing exercise by considering the 'borrowing spreads' charged by institutional lenders. He then moved to consider more specific borrowing spreads, namely those in relation to institutional loans to oil & gas companies. Mr Martin made an adjustment to that spread to reflect the underwriting fees that would likely be charged, and he made adjustments for the lack of financial covenants and the lack of security. Further, he made an adjustment to reflect a 'size premium': given the very large size of the facility it would

have to be priced at a level that would appeal to the widest possible audience. This resulted in a range between 6.06 per cent and 7.73 per cent. As a cross check Mr Martin then considered borrowing spreads on High Yield Bonds in order to see how institutional investors would have priced unsecured credit in 2003. He found an implied high yield spread range of 4.34–6.74 per cent, and made an adjustment of 2.5–3.00 per cent for size and the lack of 'yield enhancers'.

[491] Mr Gross also commenced with a credit analysis of CAHPL and settled on a risk rating of 7 (B equivalent). In this case, at a stretch the most that the parent company, CVX, would be taken to affect the risk rating of the subsidiary borrower, CAHPL, was one notch on the risk rating scale, taking it to between a '6' and '7' (B+ equivalent). Like Mr Martin, Mr Gross began with spreads on institutional term loans, which for B+ borrowers was 4.00 per cent. He made an adjustment of 0.25 per cent to take into account upfront fees and a discount for prepayment. A further adjustment of 0.75 per cent was made for the lack of covenants. Mr Gross also conducted a cross check by reference to spreads on High Yield Bonds.

[492] Mr Rowland was the CFO of Chesapeake for 18 years, from 1992–2010. Chesapeake was a non-investment grade rated energy company, and for several years was the largest producer of natural gas in the United States. It raised billions of dollars of debt despite its noninvestment credit rating, including by way of senior unsecured notes totalling $US2.1bn in 2003. Those notes provided Chesapeake with flexibility that it would not have enjoyed if it had used other available forms of cheaper debt with more onerous covenants. From this one could conclude that a sub-investment grade rating did not affect an energy company's ability to carry on business and to raise debt in a growth phase. The applicant submitted that Mr Rowland displayed a nuanced understanding of a complex and uncertain industry from the perspective of an independent company and expressed himself in a clear manner. The evidence in the proceedings had demonstrated that upstream E&P activities were uniquely characterised by: (a) a high level of risk; (b) a long period of time before a return on investment is received; (c) a lack of any definitively predictable relationship between the magnitude of expenditures and the value of any resulting reserves; (d) a high level of government regulation, with the continuing prospect of major intervention including with respect to taxation and environmental matters; (e) unique cost-sharing agreements between ostensible competitors.

[493] The applicant submitted that Mr Rowland was uniquely positioned to opine on the strategies for navigating those treacherous waters, particularly without the support of the capital of a supermajor. The Commissioner's attempt to characterise Chesapeake as a

non-investment grade company with investment grade strength, was misplaced: in fact Chesapeake did have an issuer credit rating at the relevant time, and it was B+ (non-investment grade). Mr Rowland was exposed to an environment (unlike Mr Gaskell) where he, and those responsible for other companies in Chesapeake's position, would seldom know the source of the funding that would be provided for the entire length of a project. In managing a strategy for Chesapeake, Mr Rowland dealt with the reality that whilst he always hoped that capital markets would be available to the company, there were numerous cases where they were not and Chesapeake had to curtail its expenditure. His stress on the importance of flexibility and the boon of a secured, mostly undrawn 'rainy day' fund to maintain the company's funding and ratings was self-evident in that context. Mr Gaskell accepted that expensive debt that avoided the constraints of covenants would be preferred if it was in the aggregate interest of shareholders.

[494] Mr Wasow explained that a financing strategy for an oil and gas business was designed to facilitate its business strategy. While many independent oil and gas companies sought to maintain an investment grade rating, borrowers with non-investment grade ratings were able to access the high yield market. Companies would typically not borrow in a foreign currency to lower interest cost beyond their ability to hedge the liability by offsetting it against 'natural hedges' such as foreign currency assets. The actual practice of Australian oil and gas companies in 2003 was only to borrow in USD to the extent that the liability could be hedged against USD assets. In that respect, CAHPL did not have any significant USD assets. Borrowing in USD would thus have been contrary to accepted practice and would have increased CAHPL's exposure to foreign exchange gains and losses.

[495] The respondent Commissioner submitted that the Credit Facility Agreement was not one which would have been entered into between independent parties dealing with each other at arm's length. This was not a case where the Court was dealing with a commodity with an established market or an item such as listed shares which might have a value independent of the character of the parties to the relevant agreement. The applicant's case, the respondent submitted, was effectively that CAHPL was a considerably uncreditworthy borrower, one in the 'speculative' category, and that this would lead any lender to demand a very high rate of interest, if indeed any lender was prepared to lend. The respondent Commissioner submitted that the correct approach was that all the facts and circumstances of the parties (other than their non-arm's length relationship) be imported into the hypothetical parties, thus avoiding speculation. The respondent Commissioner submitted [closing submissions at 49] that it would defy not only the language, but also the object and

purpose of the transfer pricing legislation to permit only the price under a non-arm's length agreement to be altered despite the agreement's other non-arm's length terms. A multinational enterprise could insert various unattractive and unrealistic terms in its related party agreements, terms which are commercially meaningless to it because of the pre-existing relationship between the parties, and which serve only to increase the price for tax purposes.

[**496**] The respondent submitted that if a company in the position of CAHPL were borrowing from an independent party, CVX or a company in the position of CVX would have provided a guarantee of the borrowing.

[**497**] The respondent submitted that on the assumption that the borrower was 'stand-alone', it would have provided covenants and security, and/or it would have borrowed less and obtained the balance of the $US2.45 ($AUD3.7) billion by way of equity, in order to reduce the interest rate payable from an unsustainable AUD LIBOR +4.14 per cent. It would certainly not have borrowed in AUD when the Deutsche Bank report had stated that the maximum leverage based on an AUD interest rate (Deutsche Bank assumed 9 per cent) was $US2.1bn, and Goldman Sachs had calculated the maximum debt of $US2.5bn based on a USD interest rate of 5.38 per cent.

[**498**] The respondent Commissioner submitted that the interest rate which would be payable by the borrower if it borrowed at arm's length was:

(a) On the basis that the borrower was a member of a group like the Chevron group:

(i) USD LIBOR plus the margin for a AA rated borrower, which on 2 June 2003 was 0.09 per cent;

(ii) Alternatively, USD LIBOR plus the margin for a borrower rated in the A range (conservatively using the A- margin), which on 2 June 2003 was 0.73 per cent;

(iii) In the second alternative, AUD LIBOR plus the margin for an AA rated borrower.

(b) If, which the Commissioner disputed, the borrower was deemed to be a stand-alone company:

(i) USD LIBOR plus the margin for a BBB rated borrower (on the basis that CAHPL would have borrowed $US1.7bn in order to obtain an investment grade credit rating), which was 0.95 per cent;

(ii) Alternatively, USD LIBOR plus 1.75 per cent, being the upper end of the range of interest margins represented by the comparable uncontrolled transactions identified by Mr Hollas;

(iii) In the second alternative, USD LIBOR +4.01 per cent, which on 15 January 2003 equalled 5.38 percent and was the basis on which the Goldman Sachs analysis, which the CAHPL Board relied upon, was undertaken.

[499] In my opinion, the approach in the present circumstances should go past shorthand expressions such as 'reconstruction of the transaction' to address an agreement between two parties independent of each other, neither party being an actual party to the actual loan. I would add that, although the construct is hypothetical, this does not mean that the exercise should depart from reality more than is necessary for the hypothesis. In my view, the exercise, although hypothetical, should remain close to undertaking the actual loan. Thus I would give little weight to factors which a lender and a borrower, at arm's length to each other, in the circumstances would not take into account. I do not accept the Commissioner's submission that ss 136AD and 136AA ask what form an agreement might have taken if it had been negotiated by entities dealing with each other at arm's length. In my opinion, this construction does not centre on the identification of the property, as I understood how it was put, but on the use of the indefinite article in the expression 'if the property had been acquired under an agreement between independent parties …' In my opinion, 'an agreement' does not, in context, mean that the hypothetical agreement is to have the property acquired as its only matter coincident with the actual agreement.

[500] 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.

[501] It is easy to see, at one end, that the loan is one made at a certain time, in a certain amount, for a certain period, at a certain interest rate and with or without a certain security. At the other end, it is more difficult to apply the hypothesis required by s 136AD to a hypothetical borrower in place of CAHPL. Here, it seems to me, the statutory hypothesis must include what has been shown on the evidence to be relevant in the market in question. For example, if the evidence showed that a lender would take into account in pricing the loan that a borrower independent from the lender was in a particular industry and that the creditworthiness of a borrower in that industry was affected by particular matters going to its capacity to repay the loan and the likelihood that it would do so, then those factors would be relevant. It must therefore be a factor that the borrower was in the oil and gas E&P industry.

[502] Another related question is whether the statutory hypothesis permits or requires to be taken into account that a borrower, the hypothetical borrower not being the taxpayer, has at the time of the loan certain financial resources which the lender would regard as relevant to the

pricing of the loan. In principle, the answer must be 'yes'. In the present case, does the fact that the non-arm's length nature of the Credit Facility Agreement stems from the common ownership of the borrower and the lender by CVX point to a different answer? Of itself, in my view the answer is 'no'. But that does not have the consequence that the particular relationship between CVX and CAHPL is determinative in the context of the statutory hypothesis. That would be to import the actual entity, CAHPL, into the hypothesis contrary to the decision of the Full Court in *Comr of Taxation v SNF (Australia) Pty Ltd* (2011) 13 ITLR 954.

[503] Applying these general considerations to the facts of this case means the following. In my opinion, the correct perspective is that of a commercial lender. A commercial lender would not approach the question of the borrower's creditworthiness in the same way as would a credit rating agency.

[504] CAHPL put its positive case primarily by reference to the expert reports of Mr Gross and Mr Martin.

[505] As to Mr Gross, it will be recalled that the question he was asked was whether the interest rate in the Credit Facility Agreement exceeded the consideration that might reasonably have been expected to have been given by CAHPL to an independent third party for the provision of the Credit Facility. His conclusion was that the correct pricing of the Credit Facility provided by CFC to CAHPL was 500 basis points over 1 month AUD LIBOR BBA. Therefore the interest rate in the Credit Facility Agreement, in his opinion, did not exceed the consideration that might reasonably have been expected to have been given by CAHPL to an independent third party for the provision of the Credit Facility.

[506] In my opinion, there are a number of difficulties with Mr Gross' reasoning and, therefore, his conclusion. I mention first that the appropriate question does not necessarily involve CAHPL giving consideration to an independent third party for the provision of the Credit Facility, but two parties independent of each other. It was also, in my opinion, incorrect to frame the question for Mr Gross' opinion as whether the interest rate specified in the Credit Facility Agreement exceeded the consideration that might reasonably have been expected to been given by CAHPL to an independent third party for the provision of the Credit Facility. It would have been preferable, with respect, to have asked a question less closely aligned with the ultimate issue, the question taking the form of identifying the property acquired and the non-consideration terms and asking what consideration might reasonably be expected to have been given under an agreement between independent parties. The question asked led to Mr Gross calculating CAHPL's metrics on the basis of the actual margin in the credit agreement. I accept, however, that the answers given by Mr Gross to the question he was asked may be relevant to

deciding whether or not the amended assessments under the ITAA 1936 were excessive.

[507] I take into account that Mr Gross' conclusion was based on his prior opinion that, although he did not use rating agency ratings, the risk rating he gave to CAHPL was approximately equal to a B rating by S&P. This led him to consider loan spreads of B+/B loans and new issuances in the bond market for B to B+. Mr Gross said he looked for any E&P loans issued between January 2003 and May 2003 which were institutional loans and rated B or B+ and could not identify more than one or two over the whole period. However, the case put by the applicant was that the relevant rating was BB or BB+. Mr Gross' did not give an opinion as to the appropriate margin if CAHPL were not rated B or approximately B.

[508] Further, I would be reluctant to place weight on an analysis, such as that of Mr Gross, where he accepted that there could not have been a single lender under an agreement between independent parties and no lender would lend absent financial covenants. Mr Gross wrote:

> 'In fact, such a lender would not make a five-year bullet loan without restrictive financial covenants. It would have been impossible to either syndicate a loan or use a high-grade or high yield bond without those covenants.'

He also said that there were no loans or bonds in the market with such a lack of financial covenants.

[509] Mr Gross also agreed that an absence of restrictive or negative covenants meant that CAHPL, and I would infer an independent borrower, could not have entered into the Credit Loan Facility.

[510] I also find unpersuasive the interest rate analysis made by Mr Gross which appeared to begin, under the heading 'An Acceptable Rate of Return', with the proposition that the Bank of America's expectation was a minimum fee of 300 basis points to earn the required hurdle rate. He said the minimum fee of 300 basis points would have to be supplemented by the other factors such as term, market pricing and conditions of the loan. In light of the crossexamination of Mr Gross by reference to actual borrowings from the Bank of America, I do not accept the 300 basis points minimum fee. I am also unpersuaded by Mr Gross' evidence as to the balance of these matters. I accept the respondent's submissions in this respect. The add-on by reference to the five-year term of the loan, was evidence which was not supported otherwise. Under the heading 'Market Pricing for Loans with the Same Rating and Term', Table 4 related to all industries, did not deal with the average spreads of loans to particular industries such as the E&P sector and did not indicate the low point or the high point of the yields. Tables 5 and 6 were directed to B+/B loans. Under the heading 'Terms and Conditions of the Loan', Mr Gross

dealt with the fact that the Credit Facility was unsecured and contained no restrictive covenants and concluded that the terms and conditions of the Credit Facility had the characteristics of a high yield bond and should therefore be priced like a bond. Yet Mr Gross accepted that Term Loan Bs to non-investment grade borrowers had to be secured and that they always contained financial covenants and restrictive covenants. I consider the Term Loan B issue further below.

[511] As to Mr Martin, the question on which his opinion was sought was very similar. His opinion was based on the weak BB rating he gave to the borrower CAHPL and his view of the markets in 2003. In his opinion, the interest rate on the Credit Facility did not exceed what would reasonably be expected to be obtained in an arm's length transaction at the time and he estimated the interest rate would have likely been much higher than the rate charged by CFC.

[512] Mr Martin rated CAHPL as a weak BB borrower. Having discounted the prospect that a bank would participate in such a loan, Mr Martin focused on a Term Loan B form of transaction.

[513] I do not accept the applicant's submission that a Term Loan B was an appropriate comparator for the hypothetical where, most significantly, the borrower would be an E&P company with a BB risk rating equivalent; there were no financial covenants for the borrowing; there were no restrictive covenants for the borrowing; and the borrower could repay the loan at any time such that the lender would have the risks but not the benefit for potentially a short period. It follows, in my opinion, that Mr Martin's evidence that the Credit Facility could be priced as a Term Loan B lacks a realistic foundation.

[514] In addition, I find that Mr Martin did not sufficiently take into account the credit metrics specific to an E&P company, those credit metrics being relevant to the assessment of risk. The only such metric he did take into account was debt to proved reserves. A substantial reason for this was that he did not profess to be a specific E&P lender. I have set out at [177] above the relevant parts of the cross-examination of Mr Martin.

[515] Further, I find Mr Martin's opinion as to the interest rate chargeable on a Term Loan B rested predominantly on Table 6 in his first report which was an analysis of BB new issue spreads versus CAHPL borrowing spread (institutional basis) and concerned the whole market. I accept the respondent's submissions and find as follows. Table 6 had an unreliable starting point against the item 'June 2003 Ave BB New Issue Spread' said to be sourced in S&P Capital IQ. The average in June 2003 was not in fact 300 basis points but 278.57 basis points. At one point Mr Martin said that the figure was for the quarter ended June 2003. Mr Martin later said that what he was doing in Table 6 was giving an average for the first half of 2003. He said the difference between 278.57

and 300 basis points was not material, a bare assertion which is difficult to accept. He also said there was trading data for June 2003 which would have indicated the average spread was around LIBOR plus 500 on a trading basis. No foundation for that statement was evident or was provided. More significantly, Mr Martin's Table 6 had a methodological flaw in that he did not know and could not say the extent to which the basis points he added on, in total 258–425, were already included in the beginning point of 300. For example, Mr Martin added a premium of between 50–100 basis points 'required for size of credit facility' although the average already included all large loans which did not reflect a size premium, and he added between 33–75 basis points for underwriting fees spread over an assumed average life of three years despite the all-in spread being one which included in it underwriting fees spread over an assumed average life of three years. I find that Table 6 provides an unreliable basis on which to assess the arm's length interest rate for the Credit Facility.

[**516**] Mr Martin relied to a lesser extent on Table 7 in his first report for his opinion as to the interest rate chargeable on a Term Loan B and which concerned the oil and gas market. I accept the respondent's submissions and find as follows. Table 7 was entitled 'Analysis of Oil & Gas New Issue Spreads vs. CAHPL Borrowing Spread'. It showed a credit spread range of 606–773 basis points. It recorded a starting figure of 348 basis points which was originally designated 'June 2003 Ave. New issue Spread' with the comment 'Observed BB Spreads in US Institutional Loan Market June 2003–30 transactions'. These statements required correction in Mr Martin's oral evidence in chief so as to refer to the full year 2003 rather than June 2003 and to 33 transactions rather than to 30. A further important change had to be made because the documents on which Mr Martin relied did not relate to BB borrowers. The letters 'BB' needed to be changed to read 'oil and gas'. One effect of this change is that Table 7 related to the entirety of the non-investment grade rather than to BB specifically. Table 7 did not therefore assist in answering the question of at what rate a BB or higher rated borrower would borrow. As to the number of observations, whether 33 or 30, Mr Martin accepted that he did not know how the document from which he had taken the observations was prepared. I find also that the figure of 348 basis points used by Mr Martin as the starting point was not persuasive as it was not made clear what the range was from which the figure of 348 was derived. Mr Martin accepted that one end of the range could have been as low as 1.5 per cent. Mr Martin did not know whether the spreads from which he had derived Table 7 were all-in spreads or straight spreads. Mr Martin added between 33–75 basis points for underwriting fees although he accepted that the starting figure of 348 basis points already included a weighted average of all the loans of 2003. I find that Table 7 provides an unreliable basis on

which to assess the arm's length interest rate for the Credit Facility.

[**517**] Mr Martin also, in his Table 9, sought to find support for his opinion in giving an 'Overview of US High Yield Market—June 2003' and showing effective yield and implied yield spread. However, the percentages were the yield over the US Treasury rate and thus provided no valid basis for comparison: as submitted by the respondent Commissioner, it did not appear to me that it was valid to compare directly a yield over US Treasuries for bonds with a margin over LIBOR for institutional loans.

[**518**] The evidence of Mr Long did not go directly to the question of the arm's length consideration but to the question of whether notching up due to implied parental support was appropriate. I refer to my finding on this issue at [606] below.

[**519**] The evidence of Mr Rowland, formerly of Chesapeake, did not establish that Chesapeake was in a similar position to CAHPL or to a hypothetical company in CAHPL's position in 2003. In any event, his evidence went to how Chesapeake made its funding arrangements. His evidence did not provide an alternative basis on which to reach an arm's length consideration.

[**520**] I refer also to the evidence of Dr Becker, a transfer pricing economist. He was not asked to provide an opinion as to the arm's length price of the Credit Facility Agreement. His evidence was primarily in response to the evidence of Mr Hollas and of Dr Horst and was directed to loan agreements which Dr Becker said were closer matching to CAHPL than those of Mr Hollas and in that sense essentially negative. He did, however, seek to identify from DealScan agreements for 70 companies in the energy sector, not limited to an E&P specific search, five loans made to non-investment-grade companies which he said were better or closer matching as a point of comparison with the Credit Facility Agreement. Three of the five loans had premiums over LIBOR substantially higher than the Credit Facility Agreement and the other two, referable to Planes Resources Inc, had lower amounts. As will appear, I accept the respondent's submissions in this respect and I do not find Dr Becker's evidence to be useful in addressing the statutory questions.

[**521**] The first loan related to Abraxas Petroleum Corp but this was a CC rated company, that is, one highly vulnerable to non-payment. Plainly this rating would affect the interest margin. Further, the loan agreement was in relation to a $US4.2m loan, there was a maximum revolving amount of $US50m and the borrower could not repay the term loan until the revolving loan was repaid. The loan did not have a LIBOR option but was a base rate (US Prime) loan with a base rate margin of 4.5 per cent. In my opinion, Abraxas as a company was not comparable to CAHPL and the loan was not comparable to the Credit Facility Agreement. Further, I do not accept the validity of Dr Becker's method of calculating the spread

at which he arrived: the US prime rate comprised not only the cost of funds, but other expenses of the bank and therefore would be higher than a LIBOR rate which only comprises the cost of funds to which the bank then adds a spread to cover operating costs, credit risk and profit.

[522] The second loan facility was in respect of KCS Energy Inc. This was a $US40m term loan facility, there was a rating for subordinated debt of C, and the company's financial position provided no realistic point of comparison to CAHPL: it appeared that KCS Energy was financially distressed. In my opinion, KCS energy as a company was not comparable to CAHPL and the facility was not comparable to the Credit Facility Agreement. Again, I do not accept Dr Becker's method of calculating the spread at which he arrived.

[523] The third loan facility was in respect of Mission Resources Corp. This was an $US80m facility with a senior debt rating of CCC+. Mission Resources was in financial difficulties and was not comparable to CAHPL.

[524] The fourth and fifth loan facilities were in respect of Plains Resources Inc. One had an agreement date of December 2002 and was for a loan amount of $US45m and the second had an agreement date of June 2003 and was for a loan amount of $US60m. Both these loans were substantially smaller than the CAHPL/CFC loan. Plains Resources had proved reserves and revenues and income very much smaller than CAHPL. The earlier loan agreement was a margin loan for a specific purpose. As to the later loan agreement, Plains Resources was not rated.

[525] In my opinion, therefore, the applicant has not shown that the consideration in the Credit Facility Agreement was the arm's length consideration or less than the arm's length consideration nor proved that the amended assessments under Division 13 of the ITAA 1936 were excessive. Division 13 does not permit reasoning that reaches a non-arm's length interest rate on the basis that the actual interest rate is as high as it is because of the rating attributed to the borrower or borrowing, which rating relies on the absence of arm's length consideration given by the borrower. This reasoning is an addition to, and independent of, my conclusion at [87] above. I also reject the applicant's submission, set out at [29] above, that the determinations made under Division 13 of the ITAA 1936 ceased to be operative once the 2012 amended assessments were made under the ITAA 1997. There is nothing in the statutes or in the facts which suggests or supports that contention.

Division 815 of the ITAA 1997

[526] In light of my conclusion as to the 2010 amended assessments under Division 13 of the ITAA 1936, the following consideration of Division 815 of the ITAA 1997 proceeds in the alternative.

[527] It will be recalled that the determinations made by the

Commissioner under s 815–30 of the ITAA 1997 were in respect of the tax years 2006, 2007 and 2008.

[**528**]–[**553**] are available via the Federal Court of Australia website: http://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2015/2015fca1092.

PRECONDITIONS TO THE MAKING OF THE SUB-DIVISION 815–A 2012 DETERMINATIONS

[**554**] The applicant submitted that one of the statutory preconditions for the making of the sub-division 815–A determinations which was not satisfied was the requirement in s 815–10(2) that an international tax agreement containing an associated enterprises article applies to the entity. The applicant submitted that the requirement was not satisfied because the Treaty in the present case did not contain an 'associated enterprises' article.

[**555**] Under s 815–15(5) an 'associated enterprises article' is defined to mean either art 9 of the United Kingdom convention or a corresponding provision of another international tax agreement.

[**556**] The applicant also submitted that the sub-division 815–A 2012 determinations were invalid as, in making them, no proper attempt was made to determine whether CAHPL had obtained a 'transfer pricing benefit' or to calculate the amount of that benefit. The Court was entitled to, and should, infer that the Commissioner issued the sub-division 815–A determinations by simply nominating the same amount that had been specified in the corresponding Division 13 determinations and, accordingly, no real attempt was made to ascertain the proper taxable income of CAHPL. The applicant referred to *Avon Downs Pty Ltd v Comr of Taxation* [1949] HCA 26, (1949) 78 CLR 353 at 360 and to *R v Comr of Taxation (WA), ex p Briggs* (1986) 12 FCR 301 at 308. The applicant also submitted that this aspect of the making of the sub-division 815–A determinations was not shielded by s 177(1) of the ITAA 1936 as part of the 'due making' of the sub-division 815–A 2012 amended assessments. This was because the discretionary power in s 815–10(1) was not enlivened, the applicant submitted, unless the Commissioner had first identified a transfer pricing benefit.

[**557**] The respondent submitted that the 'supporting document' did not demonstrate anything other than a genuine consideration of whether the applicant had obtained a 'transfer pricing benefit'. Given the close parallels between s 815–15(1)(c) and (d)(i) and the closing words of s 136AD(3), no breach of any requirement could be inferred from the fact that consideration of the same transactions under sub-division 815–A led to an identical adjustment to that which had been made pursuant to Division 13. Further, the respondent submitted that the power to make a determination

under s 815–10(1) and 815–30(1) was not conditioned on the Commissioner having any particular state of satisfaction, and the obtaining of such a benefit and its quantum were objective matters which may be contested in proceedings under Pt IVC. Thus the taxpayer bore the onus of proving that in fact no such benefit was received or that the actual benefit was less than the figure upon which the relevant assessment proceeded. The respondent also submitted that the authorities established that the making of a determination such as that provided for in sub-division 815–A was an aspect of the 'due making' of the assessment and errors affecting the determination did not have any relevance in proceedings relating to the validity or correctness of the assessment.

[**558**] In my opinion, the challenge to the validity of the sub-division 815–A determinations on the ground that no real attempt was made to ascertain the proper taxable income of the applicant fails at the evidentiary level. I would not draw from the 'supporting document' the inference for which the applicant contends.

[**559**] The reference to *Avon Downs* (1949) 78 CLR 353 does not, in my opinion, in the circumstances of this case, assist the applicant. I assume that the applicant's reference was to the dictum of Dixon J at 360 that the conclusion that the Commissioner had reached may, on a full consideration of the material that was before him, be found to be capable of explanation only on the ground of a [legal] misconception, so that it could be seen that in some way the Commissioner must have failed in the discharge of his exact function according to law. But, in my opinion, the factual basis for this inference has not been established in the present case. The mere fact that the numbers are the same as in the Division 13 assessments does not suffice.

[**560**] Further, *Briggs* (1986) 12 FCR 301 is to be distinguished. In *Briggs*, it is to be recalled, one of the agreed facts was that none of the Deputy Commissioner of Taxation and three other officers of the Australian Taxation Office had made any attempt to ascertain the prosecutor's taxable income nor intended to undertake any relevant process of calculation prior to the issue and service of the notices of amended assessment and assessment, but the Commissioner issued the notices for the purpose of forcing the prosecutor to consult with him or his officers. A further agreed fact was that the Commissioner decided to issue the notices of amended assessment and assessment knowing that they did not reflect any rational assessment of a liability of the prosecutor or with reckless indifference to whether they did or did not reflect any such assessment. It was these agreed facts which the Full Court was referring to at 308 in saying that the respondent had admitted that the documents issued by them were not, in truth, assessments of taxable income, and it was a case of the respondents asserting that they had abused their powers.

Their Honours distinguished this situation from the case where there had been a genuine attempt to ascertain the taxable income of a taxpayer, even if carried out cursorily or imperfectly.

[561] The applicant also submitted that other statutory preconditions for the making of the sub-division 815–A determinations were not satisfied.

[562] First, as I have noted at [554] above, the applicant submitted the 'treaty requirement' in s 815–10(2) was not satisfied because the United States convention did not contain an 'associated enterprises article'. That term was defined in s 815–15(5) to mean art 9 of the United Kingdom convention or a corresponding provision of another international tax agreement. The applicant submitted that the United Kingdom convention did not contain any provision that corresponded to art 1 of the United States convention. The construction of art 9(1) of the United States convention was affected by the presence of art 1. Furthermore, art 9 was agreed in 1982, prior to the publication of the relevant OECD Guidelines and prior to the entry into force of art 9 of the United Kingdom convention. It followed, the applicant submitted, that art 9 of the United States convention did not 'correspond' to art 9 of the United Kingdom convention. In order to correspond, the provisions must, at the very least, convey an analogous or similar meaning: they must be similar in character and function. Where two provisions contained similar text, but one was substantially modified by its context, that test could not be satisfied. Where there was an ambiguity, the domestic legislation would be construed consistently with the Treaty. To read sub-division 815–A as not applying to the United States convention was to favour a construction of a Commonwealth statute which accorded with the obligations of Australia under the international Treaty.

[563] The respondent submitted that art 9 of each convention was headed 'Associated Enterprises'. The language and structure of the two articles was the same save for some minor differences and the fact that the order of paras 2 and 3 of the United Kingdom convention was reversed in the United States convention. The respondent submitted that art 9 of the United States convention was amply within the description of a 'corresponding provision' to art 9 of the United Kingdom convention. The respective articles were in sufficiently similar language.

[564] The respondent also submitted that, first, art 1 of the United States convention did not alter the meaning of art 9. Secondly, even if the effect of art 1(2)(a) was to read into art 9(1) a prohibition against Australia using art 9 to increase a taxpayer's assessment whereas art 9 of the United Kingdom convention could have that effect, the respective arts 9 would still correspond to each other. The differences between the United States and United Kingdom conventions that the applicant contended for could

not be relevant in the statutory context. Thirdly, the language of s 815–15(5) and the extrinsic material, being the explanatory memorandum in relation to the Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No 1) 2012, para 1.68, demonstrated that to be corresponding the relevant aspect which the articles must share was the subject matter to which they applied: they were each to be the article of the respective convention that applied to and defined 'associated enterprises'. This was art 9 of the United States convention and art 9 of the United Kingdom convention.

[565] I accept the respondent's submissions in this respect, although I do not find it necessary to rely on the extrinsic material. In my opinion, 'corresponding provision' does not focus on the detail but refers to another provision the gist of which is the same: see *New South Wales v Corbett* [2007] HCA 32, (2007) 230 CLR 606 at [7] per Gleeson CJ, acknowledging that the meaning of 'corresponding provision' depends on the context, see also *Sackville-West v Viscount Holmesdale* (1870) LR 4 HL 543 at 576 per Lord Cairns, discussed in *Samarkos v Commissioner for Corporate Affairs* [1988] NTSC 10, (1988) 52 NTR 1 at 10, per Asche CJ. See also *Seaton v Mosman Municipal Council* [1998] NSWSC 75, (1998) 98 LGERA 81 at 98 per Mason P with whom Meagher and Sheller JJA agreed.

[566] In *Greenock Harbour Trustees v Greenock Corporation* (1905) 13 SLT 367, the question was whether the Police Acts in force in Greenock had 'corresponding' provisions to those in the Burgh Police Act of 1892. The Lord Chancellor, with whom Lord Robertson agreed in separate reasons (Lord Ashbourne dissenting), said at 368:

> 'The words "corresponding assessment" are not technical, and it must be admitted that such a mode of referring to other sections of other Acts of Parliament is calculated to confuse and embarrass. Still, the very looseness of it is what makes it, I think, applicable here. I think one would say, colloquially, if you were referring to the two statutes in question, which are the two corresponding sections? And I think the answer would be favourable to the appellants' contention. They do correspond in object and purpose, though to some extent they may differ in machinery. The force of the Lord Ordinary's reasoning, I think, is applied to the difference between the sections of the General Improvement Assessment of the Act of 1892. It is true the 42nd and the 43rd sections [of the Greenock Local Act of 1877] only give limited powers of improvement and not general improvement. I cannot think that that prevents their being corresponding sections. I think it would be a very intelligible thing to say the corresponding sections differ in such and such particulars, and indeed the use of the word

suggests that the language or even the substance of the enactment is not identical in omnibus, otherwise the simplest form would be instead of "corresponding" to say "identical".'

[**567**] In *Winter v Ministry of Transport* [1972] NZLR 539 Turner J, for the Court of Appeal, said at 541:

> '[Counsel] confined his argument exclusively to the submission that the sections were not "corresponding" sections. This submission was founded upon the proposition that the 1970 provisions, taken as a whole were different from those of 1968. But this must be so whenever a new statutory provision is substituted for an old one. We read "corresponding" … as including a new section dealing with the same subject matter as the old one, in a manner or with a result not so far different from the old as to strain the accepted meaning of the word "corresponding" as given in the Shorter Oxford English Dictionary—"answering to in character and function; similar to". The new [section] answers to the old one … in character and function; it is similar in purpose, prescribes the same thing to be done, and is designed to produce the same result. We hold it to be a "corresponding section".'

This passage was expressly approved by the Privy Council in *Vela Fishing Ltd v Comr of Inland Revenue* [2003] UKPC 32, [2003] STC 732 at [17].

[**568**] In my opinion, art 9 is a provision of the United States convention corresponding to art 9 of the United Kingdom convention. It is sufficient that art 9 of the United Kingdom convention deals with 'associated enterprises' as does art 9 of the United States convention and that the gist of each article is the same. Therefore, art 9 of the United States convention answers the definition of an 'associated enterprises article' in s 815–15(5)(b) of the ITAA 1997. It is a different question, which I consider at [580]–[585] below, whether 'the requirements in the *associated enterprises article for the application of that article to the entity are met' for the purposes of s 815–15(1)(b) for the purpose of deciding whether the entity 'gets a transfer pricing benefit'.

[**569**] The applicant also submitted that even if art 9 of the United States convention could be said to 'correspond' to art 9 of the United Kingdom convention, it was not the case that art 9 applied to CAHPL (s 815–10(2)) or contained 'requirements' which applied to CAHPL (s 815–15(1)(b) and (c)). The reason for this was the presence of art 1 and art 9(3) in the United States convention. If art 9 of the United States convention did not and could not operate to increase the tax burden of taxpayers resident in Australia, it must follow that in the context of the proposed adjustment to

increase the Australian taxable income of an Australian resident, art 9 did not 'apply' to that Australian resident; nor contain 'requirements' for its application. The applicant submitted that even without art 1, it may be doubted whether art 9 of the United States convention here had any 'requirements' capable of 'application' to CAHPL, in the sense required by s 815–15(1)(b). That was because art 9 did not contain any rules of law which were capable of applying to delineate the liability of a particular taxpayer. Rather, art 9 established a broad principle, capable of being used as a basis for drafting such rules for domestic application. But, by its terms, it was too vague and general to constitute in and of itself, rules of law which could be used to impose tax upon a taxpayer.

[570] The applicant submitted there was a further reason why art 9 did not 'apply' to CAHPL in this case. Article 9 of the United States convention must also be read in the context of art 11. Article 11 dealt with the taxation of interest arising in Australia or the United States. It was art 11(8) which permitted amounts that are interest to be re-characterised for the purposes of the United States convention. The applicant submitted that in the case of a payment of interest between a resident of Australia and a resident of the United States, art 11 (and in particular art 11(8)) supplanted the operation, if any, which art 9 might otherwise have. It was art 11 which governed the taxing rights of the Contracting States in relation to amounts of interest—it was, in that respect, an exhaustive code. To read art 9 as permitting an adjustment to interest was to ignore its context and to offend the principle that a general provision is to give way if it is applicable to the same subject matter as a specific provision. It was also contrary to the last sentence of art 11(8), which was an allocation mechanism that operated to permit other articles of the United States convention to operate only in relation to the amount not treated as interest for the purposes of the United States convention. What followed from this was that art 9 could not be said to 'apply' to an Australian resident where what was sought to be done was the exercise specifically provided for in art 11(8) with respect to an amount of interest. If any article of an international tax agreement could be said to 'apply' to CAHPL, that article was art 11. Furthermore, if there were any 'requirements' to be met, those requirements were to be found in art 11, not art 9. It followed that sub-division 815–A had no field of application to CAHPL in the context of the interest here in issue.

[571] The respondent submitted that art 9(1) of the United States convention, the associated enterprises article, contained a participation requirement and a conditions requirement. The former requirement related to CAHPL participating directly or indirectly in the management, control or capital of CFC or, in the alternative, the same persons at CVX participating directly or indirectly in the management, control or capital of

CAHPL, an enterprise of Australia, and CFC, an enterprise of the United States. The latter requirement was that conditions operated between CAHPL and CFC in their commercial or financial relations which differed from those which might be expected to operate between independent enterprises dealing wholly independently with one another.

[572] As to the applicant's argument based on art 1 and art 9(3), the respondent submitted that art 9(3) of the United States convention was relevantly the same as art 9(2) of the United Kingdom convention and it could not have been intended to exclude art 9 of the United Kingdom convention in light of the express inclusion of that article by s 815–15(5). Thus art 9(3) of the United States convention did not deprive art 9 of any 'requirements'. Secondly, the respondent submitted, art 1 and art 9(3) of the United States convention did not alter the meaning of art 9(1) of that convention. Thirdly, even if the effect of art 1 and art 9(3) was to read into art 9(1) a prohibition against Australia using art 9 to increase CAHPL's assessment, it did not follow that art 9 ceased to have requirements that could apply to CAHPL. The respondent submitted that under s 815–15, meeting the requirements of the relevant associated enterprises article was a precondition to making a determination under s 815–30 but it was the application of the provisions of sub-division 815–A and those provisions relating to assessment or amending an assessment that caused the increase or decrease in the taxpayer's liability. Thus art 1 of the United States convention would not be engaged even on the applicant's reading of the Treaty.

[573] As to the applicant's alternative argument that art 9 of the United States convention had no requirements for the purposes of s 815–15(1)(b) because art 9 lacked rules of law which were capable of applying to delineate the liability of any particular taxpayer, the respondent again submitted that it was not the associated enterprises article of the United States convention that delineated the taxpayer's liability which instead came about through the operation of all of the provisions of sub-division 815–A and the provisions of the ITAA 1936 relating to assessment. The respondent in any event disagreed with the proposition that art 9 was too vague and general.

[574] As to the applicant's contention that art 11 of the United States convention was an exhaustive code in relation to interest and that this caused art 9 to be outside s 815–15(1)(b) in the present case, the respondent submitted that art 11 was not an exhaustive code for all taxation relating in some way to interest but rather it set out certain restrictions on Contracting States imposing tax on interest income. For example, art 11 had no application in the present proceedings which were not about Australia taxing the interest income earned by CFC. Secondly, even if art 11 were an exhaustive code it would not affect s 815–15(1)(b).

That provision was a precondition which applied to all potential associated enterprises transfer pricing adjustments, not just those relating to interest. It went to the relationship between the parties. art 9(1) of the United States convention applied in terms in relation to CAHPL. The precondition in s 815–15(1)(b) was met.

[575] In my opinion, the applicant seeks to give the expression 'the requirements in the associated enterprises article for the application of that article to the entity' too large an operation. It is clear that art 9 of the United States convention contains requirements, one being the participation requirement, which includes an alternative, and the other the ultimate satisfaction of which is better to be considered in the context of whether CAHPL gets a transfer pricing benefit. To that extent that requirement is not a threshold issue. I reject the applicant's submission that, at the threshold, art 9 did not 'apply' to CAHPL, nor contain 'requirements' for its application. In my opinion, any separate submission that art 9 did not apply to CAHPL with reference to s 815–10(2) fails to recognise that that provision is concerned with whether the entity gets the transfer pricing benefit at a time when an international tax agreement applies to the entity. It is that time which is the focus of the provision and there is then a further requirement that the international tax agreement applying at that time contains an associated enterprises article.

[576] I also reject the submission based on art 1 and art 9(3) in the United States convention. I am not persuaded that art 1 has any present application. Neither it nor art 9(3) alters the meaning of art 9(1) or has the consequence that art 9 no longer contains requirements for the application of that article to the entity. In my view, the applicant's submissions do not sufficiently recognise that the requirements referred to in s 815–15(1)(b) are requirements having that character, that is, for the application of that article to the entity.

[577] I also reject the applicant's submission that because art 9 did not contain any rules of law which were capable of applying to delineate the liability of a particular taxpayer and that therefore, as I understood the argument, art 9 did not apply or its requirements to the entity were not met. Again, in my view, this is to seek to give art 9 too great a substantive operation. As the respondent submitted, the taxpayer's liability comes about through the operation of all of the provisions of sub-division 815–A and the provisions of the ITAA 1936 relating to assessment. It follows that I reject the applicant's submission that there were no criteria for liability under art 9.

[578] As to the applicant's art 11 submission, this travels outside the terms of s 815–15(1)(b) which relates only to the requirements in the associated enterprises article for the application of that article to the entity being met. Even if art 11 were an exhaustive code in relation to interest

this would not cause art 9 to be outside s 815–15(1)(b). I reject the submission. I am also not persuaded, in any event, that art 11 is an exhaustive code for all taxation relating to interest.

[579] There remains to consider, again in the alternative given my conclusions in relation to the 2010 amended assessments under Division 13 of the ITAA 1936, the question whether CAHPL 'gets a transfer pricing benefit'. Before turning to that issue, which centred on s 815–15(1)(c) of the ITAA 1997, I should record that the parties agreed that if that paragraph was satisfied, s 815–15(1)(d)(i) posed the relevant question. That is, had the amount of profits so accrued to the entity CAHPL, the amount of the taxable income of CAHPL for an income year would be *greater* than its actual amount. In that case the amount of the 'transfer pricing benefit' is the difference between the amounts mentioned in s 815–15(1)(d)(i): see the closing words of s 815–15(1).

[580] The first issue arises from the terms of s 815–15(1)(c) which states that an entity gets a transfer pricing benefit if an amount of profits which, but for the conditions mentioned in the article, might have been expected to accrue to the entity, has, by reason of those conditions, not so accrued. The conditions are those mentioned in art 9 of the United States convention and this refers to where 'conditions operate between [CAHPL and CFC] in their commercial or financial relations which differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another …'

[581] The applicant submitted that it was not apparent from the 'conditions' set out in para 45(b) of the respondent's appeal statement how the identified conditions were said to differ from those which might be expected to have operated between independent enterprises. The 'arm's length' conditions had not been identified by the respondent Commissioner. Nor was it apparent, the applicant submitted, from para 45(b) how some or all of the identified conditions were said to have impacted on the pricing of the loan to CAHPL and to have resulted in the non-accrual of profits.

[582] In relation to this issue, the respondent submitted there were some eleven conditions which differed from those which might be expected to operate between independent enterprises dealing wholly independently with one another. These included: that CAHPL owned CFC and they both had a common parent, CVX; CVX Treasury decided how much debt and at what interest rate CAHPL should borrow from CFC; there was no bargaining or negotiation between CAHPL and CFC; the terms and conditions of the Credit Facility Agreement, including the terms in respect of the interest rate charged, the duration and the currency of the loan and the absence of covenants; the sole reason for CFC's incorporation, and the purpose of its commercial paper program, was to raise funds solely to

on-lend to its parent CAHPL; that the credit profiles of CFC and CAHPL could be controlled by decisions made by CVX; that CFC profited from lending to CAHPL at a high interest rate; and the higher the interest-bearing loan from CFC and the higher the interest rate, the more profit CAHPL stood to make.

[583] As to the currency of a loan, although it is not necessary to my conclusion, I am not persuaded that the condition as to the AUD currency which was operational between CAHPL and CFC differed from the condition as to currency which might have been expected to operate between independent enterprises dealing wholly independently with one another. I accept the applicant's submission in this respect that borrowings in AUD would avoid or limit foreign currency gains and losses. I am not persuaded Professor Boymal's opinion to the contrary.

[584] I do not accept the applicant's implicit submission that for each identified condition it must be explicitly stated how it would differ from the condition which might be expected to have operated between independent enterprises or that the 'arm's length' conditions must be explicitly identified by the respondent Commissioner. It is enough, in my opinion, for the respondent Commissioner to identify, as he has, which conditions operate between the two enterprises which differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another.

[585] Neither do I accept the applicant's further implicit submission that the Commissioner must identify how each identified condition was said to have impacted on the pricing of the loan and to have resulted in the non-accrual of profits. In my opinion, once the differential conditions have been identified the question then arises, under s 815–15(1)(c), whether an amount of profits which but for the conditions might have been expected to accrue to CAHPL has, by reason of those conditions, not so accrued and whether, here under s 815–15(1)(d)(i), had the amount of profits so accrued to CAHPL the amount of CAHPL's taxable income for an income year would be greater than its actual amount.

[586] The applicant also submitted that if the Division 13 determinations remained effective, then s 136AD(3) operated to deem the consideration for the loan to CAHPL to be the consideration given by the taxpayer 'for all purposes of the application of this Act in relation to the taxpayer'. It followed that there could be no 'transfer pricing benefit' within s 815–15 of the ITAA 1997.

[587] In relation to this issue, the respondent appeared to accept that there was not a contrary intention so that the definition of 'this Act' in s 6(1) of the ITAA 1936 did not apply to the ITAA 1997 but did not contend that the two determinations, one under the ITAA 1936 and one under the ITAA 1997, for each income year operated cumulatively. The

respondent submitted that if the Division 13 adjustments were wholly upheld, the sub-division 815–A determinations did not need to be considered. On the other hand, if Division 13 did not apply then the Division 13 determinations could have no effect on the availability of s 815–15.

[588] I accept the respondent's submission in this respect. Indeed, as I have indicated above, these reasons consider the sub-division 815–A issues in the alternative because, if the applicant's Division 13 case had succeeded, only then would it be necessary to consider sub-division 815–A.

[589] In any event, the applicant submitted, there was no amount of profits which, but for the conditions, might have been expected to accrue to CAHPL and therefore s 815–15(1)(c) was not satisfied. The applicant's primary submission in support of that proposition was that art 9 and the test in s 815–15 did not permit: a re-characterisation of the entire transaction or a rewriting of the terms of the loan; and ratings, and in particular the credit rating agency concept of so-called 'implicit credit support', to be taken into account in determining the arm's length interest rate for the loan. In the alternative, the applicant submitted, when viewed in its totality, it could not also be said that there were any 'profits' which did not accrue to CAHPL in its commercial or financial relations with CFC and thus the requirements of art 9 were not satisfied. CAHPL paid interest on the loan to CFC and received dividend income from CFC. The respondent had ignored entirely the dividend income CAHPL received in the years in dispute, totalling $1,110,559,595. The applicant submitted that the word 'profits' in art 9 did not refer to taxable income but profits in its more generic sense.

[590] The respondent Commissioner submitted that but for the conditions he identified, CAHPL would have derived an additional amount of profits. Its interest expenses would have been less, with the difference representing an additional amount of profits. The respondent submitted the precise amount of profits which CAHPL would have derived depended on whether CAHPL was treated as a subsidiary of CVX, or a group having the same characteristics as the CVX group, or as a stand-alone company, whatever that meant.

[591] In my opinion, the question posed under s 815–15(1)(c) has a focus different from that which arises under Division 13. What is here required is the assessment of an amount of profits which might have been expected to accrue but for the conditions identified by reference to art 9 but which, by reason of those conditions, have not so accrued. It follows, in my view, that the question of re-characterisation of the transaction in question or rewriting the terms of the loan does not directly arise. If, as I understand it to be, the applicant's proposition is that the statutory regime does not permit a departure from the actual 'commercial or financial

relations' between the parties which in this case was the relationship of debtor and creditor in respect of an AUD credit facility in the sum of $AUD3.707bn, then I do not accept the width of that proposition.

[592] Neither do I accept the related submissions by the applicant that where the thin capitalisation rules (Division 820) were engaged, it was those rules that expressed the legislature's determination of the appropriate amount of debt with which an entity can be financed and the transfer pricing rules should not be taken to override or interfere with that limit. Section 815–25 modifies the transfer pricing benefit an entity gets, or apart from that section would get, in an income year in the circumstances there set out. One of those circumstances is if Division 820 applies to the entity for the income year. This shows that Division 820 does not stand outside sub-division 815–A. It follows, in my opinion, that the applicant's reliance on what was said at [1.76]–[1.77] in the explanatory memorandum to the New Business Tax System (Thin Capitalisation) Bill 2001 is misplaced for the reason that it cannot qualify or contradict the terms of the statute, s 815–25, which remains paramount, and because the explanatory memorandum was not directed to sub-division 815–A, a later enactment. Further, a reading of [1.78] of the explanatory memorandum suggests that the thin capitalisation rules do not always prevail. That paragraph states as follows:

> 'However, the thin capitalisation rules do not have the same scope as Division 13 and comparable provisions of DTAs—the latter apply to a wider range of transactions. Further, there may be instances where the purpose of the application of the arm's length principle under Division 13 and comparable provisions of DTAs to a particular case is not the same as for applying the arm's length test under the thin capitalisation rules. In these cases, the arm's length principle articulated in Division 13 and comparable provisions of DTAs should apply. For example, the application of the arm's length principle to determine whether a rate of interest is greater than an arm's length amount can only be done under Division 13 and comparable provisions of DTAs.'

I therefore reject the applicant's submissions that the thin capitalisation rules are an exclusive code or that the thin capitalisation rules confer an entitlement outside the terms of sub-division 815–A.

[593] A related submission made by the applicant was that a negative inference should be drawn from the existence and terms of sub-division 815–B. The applicant submitted that there was no provision in sub-division 815–A that authorised the Commissioner to substitute for the actual terms of the loan other terms (including security or financial covenants or currency). Section 815–25 did not authorise such substitution and to the extent the explanatory memorandum suggested otherwise, it

was wrong. An express power to re-characterise could easily have been included, and was in fact drafted as part of the same programme of legislative reform: s 815–130 of sub-division 815–B of the ITAA 1997 expressly permitted a reformulation of the commercial and financial relations between the taxpayer and the other entity. The contrast between the language of Division 13 and sub-division 815–A, on the one hand, and the language contained in new sub-division 815–B—which was not in issue in these proceedings—on the other, was instructive. Section 815–115 expressly substituted the 'arm's length conditions' for the 'actual conditions' that operated between the parties. The starting point or 'basic rule' for determining the arm's length conditions was that one adopted the actual conditions, but those could be changed or re-characterised if one of the three express exceptions applied: s 815–130(2)–(4).

[**594**] The applicant expanded on its submission that art 9 of the United States convention and the test in s 815–15 did not permit a rewriting of the terms of the loan as follows. The applicant submitted a contextual analysis of art 9 revealed that it did not permit a rewriting of the terms of a loan but only an examination of the 'conditions'. Further, there was no provision in sub-division 815–A that authorised the Commissioner to substitute for the actual terms of the loan other terms (including security or financial covenants or currency). Further, there was nothing in the OECD Guidelines which permitted the Commissioner to substitute the actual loan for some other loan in determining the dealing that was to be priced. The circumstances in which the OECD Guidelines did contemplate the possibility of re-characterisation (assuming domestic legislation permitting this) were very limited. The applicant submitted, in applying these principles, that although the Commissioner disavowed re-characterising, his case was that the prohibition applied only to the characteristics of the parties and not to the terms of the transaction itself.

[**595**] The applicant referred to the explanatory memorandum to the Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No 1) 2012 and, I understood, particularly para 1.109 and example 1.6. The applicant submitted that at least the final paragraph of example 1.6 was wrong. It was that Bill, once enacted, which inserted sub-division 815–A into the ITAA 1997. For completeness I reproduce that material, so far as relevant:

> '1.109 The following examples illustrate the interaction of subdivision 815–A and Division 820. They are intended purely to illustrate the respective fields of operation of subdivision 815–A and the thin capitalisation rules and are not intended to suggest that a particular method for pricing debt must be applied to the circumstances of a particular case. Nor are the examples intended to

preclude the use of other methods that produce an arm's length outcome.

Example 1.4: Thin capitalisation adjustment and transfer pricing adjustment

Aus Co is an Australian resident subsidiary company of For Co, a resident of the UK. Aus Co is an "inward investment vehicle (general)" for the purposes of sub-division 820–C.

For an income year, Aus Co has:

- a "safe harbour debt amount", determined in accordance with s 820–195 of $375m;
- "adjusted average debt" determined in accordance with s 820–185(3) of $400m, of which $200m is borrowed from For Co at an interest rate of 15 per cent, and $200m from an independent lender at an interest rate of 10 per cent; and
- equity of $100m.

Aus Co's only debt deductions are for the interest incurred at a rate of 15 per cent on its $200m related party debt, and 10 per cent on its $200m debt from the independent lender, meaning that it has $50m of debt deductions for the income year.

The Commissioner considers whether Aus Co has received a transfer pricing benefit under s 815–15. In doing so, the Commissioner has regard to the arm's length rate in relation to the debt interest (that is, the arm's length interest rate), applied to the actual amount of the related party debt.

Assume that the loan from the independent lender is sufficiently similar to the loan from For Co and the circumstances in which each amount of debt funding was provided do not present material differences that would affect the rate applicable to the debt interest or Aus Co's ability to obtain $400m in debt funding (that is, the independent loan is directly comparable to the related party loan). As a result, the Commissioner determines that using a comparable uncontrolled price is the most appropriate method for determining the arm's length rate. In these circumstances it is commercially realistic for the Commissioner to determine that the arm's length interest rate is 10 per cent. In this case, Aus Co gets a transfer pricing benefit of $10m (being the difference between an arm's length rate of 10 per cent applied to the debt interest arising from the loan from For Co ($200m) and the actual interest rate of 15 per cent on the debt interest).

Further, to the extent that Aus Co has "excess debt", Division 820 will apply to deny a corresponding proportion of Aus Co's debt deductions remaining after the $10m reduction under sub-division 815–A.

a **Example 1.5: Transfer pricing adjustment and no thin capitalisation adjustment**

Assume the facts and circumstances are the same as in example 1.4, except that Aus Co has $300m of debt ($150m from For Co and $150m from an independent lender) and $100m of equity, producing a
b safe harbour debt amount for Division 820 purposes of $300m. The interest rate on Aus Co's debt to For Co is 15 per cent, so that, before applying sub-division 815–A and Division 820, Aus Co has total debt deductions of $37.5m.

c As was the case in example 1.4, the Commissioner determines that an arm's length interest rate of 10 per cent is to be applied to the debt interest from For Co. As such, Aus Co gets a transfer pricing benefit of $7.5m (being the difference between the arm's length rate of 10 per cent applied to the debt interest from For Co ($150m) and the
d actual interest rate of 15 per cent on the debt interest).

Example 1.6: Transfer pricing adjustment and no thin capitalisation adjustment

Assume the facts and circumstances are the same as in example 1.5,
e except that the entire $300m of debt is borrowed from For Co at an interest rate of 15 per cent. Aus Co's debt deductions for the interest incurred on its $300m debt total $45m for the income year.

Unlike the previous examples, there is no internal comparable
f uncontrolled price that provides an arm's length rate. As such, the Commissioner determines the arm's length rate of interest for the loan having regard to available data of market reference rates and the credit standing that the capital markets would be likely to give Aus Co. The market data shows that Aus Co's credit standing would allow it to
g borrow $250m from independent lenders. Having regard to the information available, the Commissioner determines that the closest commercially realistic arm's length scenario at which a loan might reasonably be expected to exist between independent parties dealing wholly independently with one another is a loan of $250m at
h 10 per cent.

In this case, the Commissioner is able to determine the amount of the transfer pricing benefit by reference to an amount less than the actual amount of the debt interest (being an arm's length amount). (The fact that Aus Co's debt amount is less than its safe harbour debt
i amount for Division 820 purposes is not relevant to determining the amount of the transfer pricing benefit.)

The Commissioner determines that Aus Co's transfer pricing benefit is $15m (as required under s 815–25(2)). This is worked out by applying the 10 per cent arm's length interest rate to Aus Co's actual

debt amount ($300m), and comparing this to Aus Co's actual debt deductions of $45m.'

[596] The respondent submitted in this respect that sub-division 815–B provided no comfort to the applicant, first, because this was an inappropriate approach to construction and, secondly, because on the very terms of Division 13, sub-division 815–A and art 9 there was no warrant for an approach which set in stone all aspects of the non-arm's length agreement save as to interest rate.

[597] As to the first of these matters, the respondent submitted that sub-division 815–B was enacted after each of Division 13 and sub-division 815–A and was for a different purpose, which was to apply the arm's length principle to relevant dealings between both associated and non-associated entities, looking to supplies and acquisitions under international agreements. Further the machinery of sub-division 815–B was quite different from the determination provisions which appeared in sub-division 815–A and Division 13. Therefore no expressio unius implication arose. Sub-division 815–B did not apply to the income years in issue in the present proceedings. Sub-division 815–A continued to operate in respect of income tax years after 1 July 2004 and until the commencement of the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act on 29 June 2013 which repealed Division 13 and added sub-division 815–B at the end of Division 815. In those circumstances that Act shed no light on the earlier provisions and judicial authorities recognised the difficulties in attempting to construe words used in a statute by reference to later amendments, let alone later separate legislation: see *Ajinomoto Company Inc v NutraSweet Australia Pty Ltd* (2008) 166 FCR 530 at [92]–[99] and the authorities there referred to.

[598] I agree with this submission made by the respondent. It is necessary to start and finish with the words of sub-division 815–A, both as to what they do provide and as to what they do not.

[599] As to the broader point, the respondent submitted that the applicant would have the Court approach the arm's length pricing analysis by reference to the exact terms of the Credit Facility Agreement, which would not have been agreed between arm's length parties, as opposed to the terms that might be expected to have been agreed between CAHPL and CFC had they been independent of each other. The respondent submitted that the provisions in sub-division 815–A (as in art 9) required that there be an examination of the 'conditions' operating between the two associated enterprises—not just the price—and an evaluation of profits absent the identified 'conditions'. That is, the respondent submitted, sub-division 815–A did not envisage that one should take a related party

loan transaction exactly as one found it and price the interest payable on the transaction (if that was even possible). Rather, by focusing on 'conditions' as the matter that was to be hypothesised on the counterfactual analysis, sub-division 815–A recognised that associated entities may have dealings which are nonarm's length for reasons apart from the price that is attributed to them. It followed, in the respondent's submission, that the applicant's contention that the Commissioner or Court may not depart from any of the actual terms of the Credit Facility Agreement, other than interest rate, found no basis in the express terms of the provisions of sub-division 815–A.

[600] In my opinion, the applicant's submissions suffer from the use of a shorthand as to not 're-characterising' or not 'rewriting' as a substitute for the statutory language and thereafter to describe what the respondent Commissioner has done as impermissible because it involved 're-characterisation' or 'rewriting'. On the other hand, the respondent's submissions seek to align Division 13 and sub-division 815–A without sufficient regard to the different language of the two sets of provisions: Division 13 focuses on 'consideration' whereas sub-division 815–A focuses on the broader term 'conditions'. Having said that, I accept the respondent's submission that by focusing on 'conditions', sub-division 815–A recognised that associated entities may have dealings which are non-arm's length for reasons apart from the price that is attributed to them.

[601] Another significant difference between the parties in construing the provisions was that the applicant submitted, under the heading 'Implicit Support' that the terms of art 9 meant that one must consider the conditions that one might expect to see between a lender and a borrower who are *independent*, and are dealing *wholly independently* with one another. In the applicant's submission, the relationship between the lender and the borrower must therefore be eliminated in order to undertake this task, and in a situation where the entities in question were sister companies, so too must the relationship between each of them and their common parent. If that latter relationship were permitted to subsist, then it could not be said that the lender and borrower were independent or were dealing independently. Their hypothetical dealing would be infected by the characteristics of each party, the borrower in particular, that were referable to ownership by the common parent.

[602] The applicant submitted that a textual analysis of art 9 supported the contention that the concept of 'independent enterprises' was used in contradistinction to, and as the converse of, 'associated enterprises'. The OECD Guidelines provided that two enterprises were 'independent' if they were not 'associated enterprises'. It followed therefore, in the applicant's submission, that all and any attributes that give rise to entities being

'associated' within the meaning of art 9 must be disregarded in determining the attributes of the independent parties. Within art 9 there were two conditions that could result in parties being regarded as associated. The first was participation by one entity in the management, control or capital of the other. Negating this attribute required one to ignore the parent-subsidiary relationship that in fact existed between CAHPL and CFC. The second condition of association was the same persons participating in the management, control or capital of the two enterprises. Negating this attribute required one to ignore the ownership by CVX of each of CAHPL and CFC. The terms of art 9 thus required one to hypothesise a stand-alone borrower and a stand-alone lender. There was no room for implicit parental support which of necessity derived from the common owner, CVX. This was further confirmed in the OECD Guidelines, which said that art 9 required one to treat members of a multi-national group as if they were operating as separate entities rather than part of a single 'unified business', and thus 'attention is focused on the nature of the dealings between those members'.

[603] The respondent submitted that while the transfer pricing rules required the affiliation between the parties to the transaction to be ignored, there was no warrant for ignoring the affiliation between a party to the transaction in question and *other* members of the group of companies of which it formed a part. To do so, the respondent submitted, would be contrary to the natural language of the relevant provisions, their judicial interpretation and the object and purpose of the transfer pricing rules. Each of the relevant provisions focused on the relationship between the parties to the relevant transaction.

[604] While I accept the applicant's submission that one must consider the conditions that one might expect to see between a lender and a borrower who are independent, and are dealing wholly independently with one another, which is the language of art 9, it by no means follows that where, as here, the entities in question are sister companies, also to be eliminated is the relationship between each of them and their common parent on the basis that, otherwise, it could not be said that the lender and borrower were independent or were dealing independently. In my opinion, independent enterprises dealing wholly independently with one another may still be subsidiaries and may still have subsidiaries even if the enterprises are independent of each other. I therefore accept the respondent's submission insofar as he contended that there was no legislative warrant for ignoring affiliation between a hypothesised party to a transaction and other members of that party's group of companies. At the factual level, at [606] below, I have accepted the applicant's submission as to implied parental support.

[605] This conclusion means that the applicant's high-level contention

about 'implicit support' also fails. 'Implicit support' may be generally relevant when assessing a borrower's credit rating. The high-level contention fails because it relies on the proposition that the relationship between CAHPL and CVX and the relationship between CFC and CVX, CVX being the common parent, must be eliminated from the analysis.

[606] The applicant's submission that the existence and worth of 'implicit support' is a matter of fact remains unaffected. I accept the applicant's submission, that in the absence of a legally binding parental guarantee, implicit credit support had very little, if any, impact on pricing by a lender in the real world. This was the evidence of Mr Martin and Mr Gross and the conclusion of an article published in 2014 of which Mr Hollas was a joint author: 'Intercompany Financial Transactions: Factors to Consider in Analysing the Impact of Implicit Parental Support'.

[607] As to the applicant's reliance on a differentiation between the language of 'association' and 'independence', it seems to me that that distinction involves a non sequitur: to say that a party is independent of another party does not mean or require that either party is independent of all parties.

[608] A further broad submission put by the applicant was that art 9 mandated a determination of the 'profits' which might have been expected 'but for those conditions' and thus proceeded to consider a hypothetical situation in which commercial or financial relations take place, but absent the operation of the identified conditions. By its terms, the applicant submitted, art 9 did not permit the addition of new 'conditions' but was, instead, an 'annihilation' provision.

[609] In my opinion, the correct approach is to identify the conditions mentioned in art 9 and then ask if there was an amount of profits which, but for those conditions, might have been expected to accrue to the entity but which has, by reason of those conditions, not so accrued: s 815–15(1)(c). As I have set out above at [27], art 9 involves a comparison between, here, conditions which operate between CAHPL and CFC in their commercial or financial relations and whether those conditions differ from those conditions which might be expected to operate between independent enterprises dealing wholly independently with one another. It seems to me a distraction, in that context, to speak about 'annihilation' provisions: conceptually the comparison between the actual conditions and the conditions which might be expected to operate between independent enterprises dealing wholly independently with one another is straightforward although its application may not be. In my opinion, nothing is 'annihilated' but I accept that what must be compared are conditions which operate.

[610] Once the approach I have outlined is borne in mind, in my view, the applicant's submission: 'By its terms [art 9] does not permit the

addition of new "conditions" ' does not assist. It follows that I do not accept the applicant's submission that 'art 9 negates non-arm's length conditions but does not supply any condition which is absent and leaves the commercial or financial relations (as opposed to its terms) exactly as it finds it'. It follows that I reject the applicant's submission that the 'requirements' of art 9 permit only an adjustment to the price of a transaction (in this case an adjustment to the rate of interest) for the purpose of determining the quantum of profits which might have been expected to accrue, and they might justify, but go no further than, the elimination of other terms or conditions upon which CFC lent to CAHPL. As I have said, in the present case art 9 involves identifying conditions which operate between CAHPL and CFC in their commercial or financial relations and seeing where they differ from conditions which might be expected to operate between independent enterprises dealing wholly independently with one another.

[611] It is necessary to return to the applicant's submission, referred to at [589] above, that viewed in its totality, it cannot also be said that there were any profits which did not accrue to CAHPL in its commercial or financial relations with CFC and thus the requirements of art 9 were not satisfied. The applicant's submission was that CAHPL paid interest on the loan to CFC and received dividend income from CFC. The Commissioner ignored the dividend income CAHPL received in the years in dispute. It may be that the Commissioner overlooked the dividends received by CAHPL because he did not consider them to be 'profits' of CAHPL for the purposes of art 9. He may have read 'profits' to mean 'taxable income' because of s 3(2) of the International Tax Agreements Act, set out at [22] above.

[612] The applicant submitted that the word 'profits' where first appearing in art 9 did not refer to taxable income, but profits in its more generic sense. The applicant submitted that this was supported by the history of art 9. The reference to profits in this part of art 9 was the same profit referred to in the old art 5 of the 1933 Draft Convention for the Allocation of Business Income between States for the purposes of Taxation: it was a diverted profit which must be allocated to 'one of the enterprises'. It would make no sense, the applicant submitted, to read the word 'profits' in that phrase as meaning taxable income, as the enterprise which may get allocated those profits may not be resident in Australia. The profits which might be expected to accrue as mentioned in art 9 were therefore to be taken to refer to profits generally. Once this condition of art 9 was satisfied, namely that there were profits which might be expected to have accrued to one of the enterprises, the mechanism whereby such profits may be domestically taxed (i e included in the taxable income computation) followed in art 9 with the concluding language of that

article: 'may be included in the profits of that enterprise and taxed accordingly'. It followed that the profits of CAHPL included the dividends it had received from CFC for the purposes of the first condition in art 9 relating to profits. In that respect, it could not be suggested that because of the conditions operating between CFC and CAHPL, 'profits' did not accrue to CAHPL which should have. In other words, there had been no diversion of profits to CFC, and CAHPL's expense, precisely because they had returned to CAHPL. The respondent Commissioner submitted that s 3(2) of the International Tax Agreements Act applied to the profits referred to in art 9(1) and deemed them to be taxable income derived by CAHPL. Neither party referred to any authority on the point.

[613] In my opinion, s 3(2) of the International Tax Agreements Act has a limited purpose, as set out in the explanatory memorandum to the Income Tax (International Agreements) Bill 1953, circulated by the Treasurer, the Rt Hon Sir Arthur Fadden:

> 'The proposed sub-s (2) is, subject to minor drafting variations, the same as the corresponding provision enacted in 1947 as sub-s (2) of s 160F of the Assessment Act. Its purpose is to permit references in agreements to profits to be construed, unless the context requires otherwise, as references to taxable income. The provision is required because the Australian law imposes tax upon taxable income and not upon profits as such.'

I do not, therefore, regard s 3(2) as having a substantive or deeming operation. The applicant's argument based on the former art 5 seems to me to be unnecessary to reach this conclusion which involves construing the different language of the present art 9. It seems to me that the words 'and taxed accordingly' are included in the text of art 9(1) so as to make it clear what the relevant Contracting State may do. Subsection 815–15(1)(c) has effect accordingly. I am not, however, persuaded of the correctness of the applicant's consequential argument that 'profits' means that in the present case there can be a net profit position arising from the particular arrangements between the parties. What is being dealt with by art 9 is profits which, but for the difference between the actual conditions operating and the conditions which might be expected to operate, have not accrued to, here, CAHPL. I therefore do not accept the applicant's submission that there were no profits which accrued to CAHPL.

[614] Having rejected the applicant's submissions, primarily submissions as to the proper construction of art 9 and of sub-division 815–A, and having considered at [505]–[524] above the evidence of the applicant's main witnesses, I find that the requirements in the *associated enterprises article for the application of that article to CAHPL are met. I also accept the respondent's submission identifying conditions, set out at [582] above.

I find that but for the conditions operating between CAHPL and CFC which differ from those which might be expected to operate between independent parties dealing wholly independently with one another an amount of profits might be expected to have accrued but has not so accrued. It follows that the applicant has failed to show that the assessments under the ITAA 1997 were excessive. As I have said, my consideration of these matters is in the alternative to my conclusion as to the assessments made under Division 13 of the ITAA 1936.

PENALTIES

[615] The applicant submitted that because CAHPL had obtained no 'scheme benefit' it was not liable to an administrative penalty under either s 284–145(1) or s 284–145(2) of Sch 1 to the Taxation Administration Act. As set out at [15] above, the content of 'scheme benefit' is given by s 284–150 in Sch 1 to the Taxation Administration Act which provided that an entity gets a scheme benefit from a scheme if a *tax-related liability of the entity for an accounting period is, or could reasonably be expected to be, less than it would be apart from the scheme or a part of the scheme.

[616] The applicant submitted that if, contrary to its submissions, CAHPL did obtain a 'scheme benefit', no penalty was here payable pursuant to s 284–145(1) in Sch 1 to the Taxation Administration Act because it was not reasonable to conclude that CAHPL entered into the facility for the sole or dominant purpose of obtaining a 'scheme benefit'.

[617] The central provision of s 284–145 was as follows:

> '(1) You are liable to an administrative penalty if:
> (a) you would, apart from a provision of a *taxation law or action taken under such a provision (the adjustment provision), get a *scheme benefit from a *scheme; and
> (b) having regard to any relevant matters, it is reasonable to conclude that:
> (i) an entity that (alone or with others) entered into or carried out the scheme, or part of it, did so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme; …'

[618] The applicant submitted that it could not be reasonably concluded that CAHPL entered into the Credit Facility Agreement for the dominant purpose of obtaining a scheme benefit—its dominant purpose was to refinance its existing Australian dollar denominated debt. True it was, it obtained a deduction for interest incurred in respect of that debt. But that was a consequence of choosing to use debt funding. CAHPL's choice to use such debt was lawful. It was permitted by Division 820, and was not impugned by the Commissioner.

[619] The difference between the parties, the applicant submitted, was that the applicant relied upon the majority decision in *Comr of Taxation v Star City Pty Ltd* (*No 2*) [2009] FCAFC 122, (2009) 180 FCR 448 for the proposition that a purpose had to be subjective, not objective.

[620] The applicant submitted that by reason of s 815–10 of the Income Tax (Transitional Provisions) Act 1997, the penalty provisions in sub-division 284-C in Sch 1 to the Taxation Administration Act—which included ss 284–145 and 284–150—had no application. The respondent Commissioner agreed. Thus the only penalty that could arise would be by reference to Division 13.

[621] The respondent Commissioner submitted that CAHPL would have obtained a 'scheme benefit' because apart from the scheme, it was reasonable to expect that CAHPL would not deduct the interest under the Credit Facility Agreement but instead would have borrowed at an arm's length interest rate and deducted that lower interest expense. Accordingly, its liability to income tax would be correspondingly greater.

[622] The Commissioner further submitted that a reasonable person could conclude that each of CAHPL, CFC and CVX had the relevant dominant purpose. He submitted the factual context amply supported the drawing of such an inference. The matters pointed to by the Commissioner included:

> (a) The objectives of the leveraging project as articulated by Mr Krattebol, global Treasurer of Chevron, were 'to obtain the lowest cost of funding and achieve the Finance function's merger synergy objectives'. Mr Dalzell acknowledged that the 'merger synergy' objectives referred to by Mr Krattebol included the tax benefits that would arise from the gearing of the balance sheet of the Australasian Business Unit;
>
> (b) Mr Lewis said in November 2002 that delays to the transaction meant 'there is a real risk that we will not meet the Corporations merger synergy deadline' and that 'we are chasing a merger synergy of around $US50MM per annum. Furthermore, we are leaving in excess of $US100,000 cash and earnings on the table each day that this transaction is delayed.' He also noted that one of the 'benefits' of the CAHPL loan being in AUD was that it would 'create an interest rate margin' which 'would not be subject to tax in either the US … or Australia'. He also estimated that the USD commercial paper interest rate would be around 2 per cent whereas the AUD interest rate payable by CAHPL would be around 8.5 per cent;
>
> (c) Mr Dalzell accepted that the merger synergy could be calculated by multiplying the interest rate margin (or uplift) earned by CFC each year by the Australian corporate tax rate of 30 per cent, and accepted that a $US50 million merger synergy could

only be achieved with an AUD interest rate whereas a USD interest rate would result in a $US30m smaller merger synergy;

(d) The tax benefits of interest deductions for the CAHPL group were referred to on a number of occasions by officers of CVX;

(e) There was no bargaining or negotiation between CAHPL and CFC in relation to the Credit Facility Agreement.

[623] As to the applicant's submission that its dominant purpose was to refinance existing Australian dollar denominated debt, the Commissioner submitted that the purpose of refinancing would equally be achieved if CAHPL refinanced by borrowing at an arm's length interest rate. It would also be achieved more cost effectively. Accordingly, refinancing could not be a purpose of CAHPL in entering into the scheme as opposed to borrowing at an arm's length interest rate. It was not CAHPL's choice of 'debt funding' that gave rise to the relevant dominant purpose inference, it was its choice (and that of CFC and CVX) of an interest rate of AUD LIBOR +4.14 per cent.

[624] The respondent Commissioner did not dispute that the applicant had a reasonably arguable position.

[625] In my opinion, which penalty rule applies depends on which transfer pricing rule is engaged, as in either case the Commissioner conceded that the position adopted was reasonably arguable. The matter for judgment therefore is whether the penalty of 25 per cent has been made out, that is, the Commissioner's position on purpose. If it has not, the penalty of 10 per cent would apply, the applicant accepting that the conditions of s 284–145(2) in Sch 1 to the Taxation Administration Act are satisfied and the Commissioner agreeing that this subsection was satisfied if the purpose requirement of s 284–145(1)(b)(i) was not met.

[626] I accept the respondent's submission as to 'scheme benefit', that is, that apart from the scheme, it was reasonable to expect that CAHPL would not deduct the interest under the Credit Facility Agreement but instead would have borrowed at an arm's length interest rate and deducted that lower interest expense. The question under s 284–145(1) is therefore whether, having regard to any relevant matters, it is reasonable to conclude that CAHPL (alone or with others) entered into or carried out the scheme, or part of it, with the dominant purpose of CAHPL getting a scheme benefit from the scheme.

[627] In approaching the question of purpose I apply *Comr of Taxation v Ludekens* [2013] FCAFC 100, (2013) 214 FCR 149 at [243]. There the Full Court said:

> 'In assessing the purpose and evaluating its importance, and whether it is dominant, one must appreciate that it is the scheme in question to which the enquiry is directed, not a general state of affairs other than

> the scheme. Persons engaged in trade and commerce do so for personal gain. The purpose of all commercial arrangements is, in a broad sense, the making of profit: cf, by way of example, [*Comr of Taxation v Hart* [2004] HCA 26, (2004) 6 ITLR 997 at [52]] and the authorities cited and *Comr of Taxation v Consolidated Press Holdings Ltd* [2001] HCA 32, (2001) 207 CLR 235 at [96]. Here the respondents undoubtedly wished to make profits from the purchase of woodlots and from running a foreign exchange business. They chose the Plan to effect that. Integral to the Plan was that the entities acquiring woodlots on 30 June 2007 … would obtain scheme benefits from the GST refunds from the purchase of the woodlots and that the Secondary Investors would obtain scheme benefits from tax deductions and tax refunds from their participation. Those are not two purposes: they comprise one purpose …'

[628] I do not accept the applicant's submission that the end of the inquiry is that CAHPL's dominant purpose was to refinance its existing Australian dollar denominated debt. I accept the Commissioner's submission that refinancing was not the dominant purpose of the scheme as refinancing could be achieved by borrowing at an arm's length interest rate which CAHPL did not. To limit the scope of matters to be taken into account merely to refinancing is artificially to exclude from consideration the circumstances of that refinancing.

[629] In my opinion, it is reasonable to conclude that CAHPL entered into the Credit Facility Agreement for the dominant purpose of obtaining a 'scheme benefit'. I refer to my conclusion in [628] above. Further, I rely on some of the factors pointed to by the Commissioner in this respect, those factors being: that the 'merger synergy' objectives referred to by Mr Krattebol, the global treasurer of Chevron, included the tax benefits that would arise from the gearing of the balance sheet of the Australasian business unit; that delays to the transaction meant 'there is a real risk that we will not meet the Corporations merger synergy deadline' and that:

> 'we are chasing a merger synergy of around $US50MM million per annum. Furthermore, we are leaving in excess of $US100,000 of cash and earnings on the table each day that this transaction is delayed.'

He also estimated that the USD commercial paper interest rate would be around 2 per cent whereas the AUD interest rate payable by CAHPL would be around 8.5 per cent. I also rely on the evidence of Mr Lewis set out at [104] above and the evidence of Mr Dalzell set out at [121] above.

[630] I add that, contrary to the respondent's submission set out at [622] above, I do not regard *Star City Pty Ltd* (*No 2*) as standing for the proposition that the relevant approach is that a reasonable person could

conclude that each of CAHPL, CFC and CVX had the relevant dominant purpose: compare *Star City Pty Ltd* (*No 2*) at [74] per Dowsett J. I prefer directly to apply the statutory language, which raises the issue whether it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme, or part of it, did so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme. By reason of that statutory language, I do not accept that the question is solely subjective but I do accept that the purpose of the entity is its subjective purpose: see *Star City Pty Ltd* (*No 2*) at [31]–[32] per Goldberg and Jessup JJ and Ludekens at [243] which I have set out at [627] above.

[631] For these reasons, I find the penalty is 25 per cent of the scheme shortfall amount, pursuant to s 284–160(a)(ii).

RULINGS ON EVIDENCE

[632] There were a number of deferred rulings on objections to evidence on the ground of relevance. It will be apparent from these reasons which affidavits and reports I have found not to be relevant. I do not see it as necessary formally to rule on the balance of these objections as they turn on issues of statutory construction.

ORDERS

[633] I shall direct that, within 21 days, the parties bring in agreed short minutes to give effect to my conclusions. Those short minutes are also to deal with costs. Failing agreement, within a further 7 days the parties are to file the competing orders for which they contend and any written submissions in support, the submissions on each side to be limited to three pages.

Appeal dismissed.