FEDERAL COURT OF AUSTRALIA

Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCAFC 62

Appeal from:	*Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4)* [2015] FCA 1092
File numbers:	NSD 1667 of 2015, NSD 1668 of 2015 NSD 1669 of 2015, NSD 1670 of 2015 NSD 1671 of 2015, NSD 1672 of 2015 NSD 1673 of 2015, NSD 1674 of 2015 NSD 1675 of 2015, NSD 1676 of 2015 NSD 1677 of 2015, NSD 1678 of 2015 NSD 1679 of 2015, NSD 1680 of 2015 NSD 1681 of 2015, NSD 1682 of 2015 NSD 1683 of 2015
Judges:	**ALLSOP CJ, PERRAM AND PAGONE JJ**
Date of judgment:	21 April 2017
Catchwords:	**INCOME TAX** – transfer pricing – whether consideration exceeded arm's length consideration – consideration that might have been reasonably expected between independent parties dealing at arm's length – meaning of property – meaning of consideration – what constitutes arm's length consideration for acquisition of property **INCOME TAX** – whether determinations excessive – whether decision by delegate without authority makes assessment excessive **CONSTITUTIONAL LAW** – retrospective effect of taxation legislation – whether retrospectivity results in arbitrary and incontestable tax
Legislation:	*Income Tax Assessment Act 1936* (Cth) Division 13, s 117 *Income Tax Assessment Act 1997* (Cth) Division 815 *Income Tax (Transitional Provisions) Act 1997* (Cth) s 815-5 *International Tax Agreements Act 1953* (Cth) s 3(2) *Judiciary Act 1903* (Cth) s 78B *Taxation Administration Act 1953* (Cth) s 14ZZR, s 14ZZ, s 14ZY, s 350-10
Cases cited:	*Archibald Howie Pty Ltd v Commissioner of Stamp Duties*

(NSW) [1948] HCA 28; 77 CLR 143

Cadbury-Fry-Pascall [1944] HCA 31; 70 CLR 362

Cecil Bros Pty Ltd v Federal Commissioner of Taxation [1964] HCA 82; 111 CLR 430

Chief Commissioner of State Revenue v Dick Smith Electronics Holdings Pty Ltd [2005] HCA 3; 221 CLR 496

The Colonial Sugar Refining Co Ltd v Irving [1903] St R Qd 261

Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd [2014] HCA 51; 254 CLR 142

Commissioner of Taxation v Australia and New Zealand Savings Bank Limited [1994] HCA 58; 181 CLR 466

Commissioner of Taxation v Dalco [1990] HCA 3; 168 CLR 614

Commissioner of Taxation (Cth) v S Hoffnung & Co Limited [1928] HCA 49; 42 CLR 39

Commissioner of Taxation v Stokes [1996] FCA 1128; 72 FCR 160

Deputy Federal Commissioner of Taxation v Brown [1958] HCA 2; 100 CLR 32

Deputy Commissioner of Taxation v Truhold Benefit Pty Ltd [1985] HCA 36; 158 CLR 678

Federal Commissioner of Taxation v AusNet Transmission Group Pty Ltd [2015] FCAFC 60; 231 FCR 59

Federal Commissioner of Taxation v Futuris Corporation Ltd [2012] FCAFC 32; 205 FCR 274

Federal Commissioner of Taxation v Peabody [1994] HCA 43; 181 CLR 359

Federal Commissioner of Taxation v Radilo Enterprises Pty Ltd [1997] FCA 22; 72 FCR 300

Federal Commissioner of Taxation v SNF (Australia) Pty Ltd [2011] FCAFC 74; 193 FCR 149

Gashi v Federal Commissioner of Taxation [2013] FCAFC 30; 209 FCR 301

George v Federal Commissioner of Taxation [1952] HCA 21; 86 CLR 183

Hepples v Federal Commissioner of Taxation [1992] HCA 3; 173 CLR 492

MacCormick v Federal Commissioner of Taxation [1984] HCA 20; 158 CLR 622

Macquarie Finance Ltd v Federal Commissioner of Taxation [2004] FCA 1170; 57 ATR 115

March v E & MH Stramare Pty Ltd [1991] HCA 12; 171 CLR 506

McAndrew v Federal Commissioner of Taxation [1956]

HCA 62; 98 CLR 263

McGain v Commissioner of Taxation [1965] HCA 41; 112 CLR 523

Mutual Pools & Staff Pty Ltd v Commonwealth [1994] HCA 9; 179 CLR 155

Peabody v Commissioner of Taxation [1993] FCA 98; 40 FCR 531

Polyukhovich v Commonwealth [1991] HCA 32; 172 CLR 501

R v Kidman [1915] HCA 58; 20 CLR 425

Rigoli v Federal Commissioner of Taxation [2014] FCAFC 29; 96 ATR 19

Rigoli v Federal Commissioner of Taxation [2016] FCAFC 38; 102 ATR 612

Ronpibon Tin NL and Tongkah Compound NL v Federal Commissioner of Taxation [1949] HCA 15; 78 CLR 47

Roy Morgan Research v Federal Commissioner of Taxation [2011] HCA 35; 244 CLR 97

SNF (Australia) Pty Ltd v Commissioner of Taxation [2010] FCA 635; 79 ATR 193

Suntory (Aust) Pty Ltd v Federal Commissioner of Taxation [2009] FCAFC 80; 177 FCR 140

Strong v Woolworths Limited [2012] HCA 5; 246 CLR 182

Thiel v Federal Commissioner of Taxation [1990] HCA 37; 171 CLR 338

Victorian Stevedoring & General Contracting Company Pty Ltd v Dignan Informant [1931] HCA 34; 46 CLR 73

Wallace v Kam [2013] HCA 19; 250 CLR 375

Western Australia v Ward [2002] HCA 28; 213 CLR 1

WR Carpenter Holdings Pty Ltd v Federal Commissioner of Taxation [2006] FCA 1252; 63 ATR 577

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) ATS 16 Article 9 (entered into force 31 October 1983)

Date of hearing:	27 February-2 March, 14 March 2017
Registry:	New South Wales
Division:	General Division
National Practice Area:	Taxation

Category:	Catchwords
Number of paragraphs:	159
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ORDERS

NSD 1667 of 2015, NSD 1668 of 2015
NSD 1669 of 2015, NSD 1670 of 2015
NSD 1671 of 2015, NSD 1672 of 2015
NSD 1673 of 2015, NSD 1674 of 2015
NSD 1675 of 2015, NSD 1676 of 2015
NSD 1677 of 2015, NSD 1678 of 2015
NSD 1679 of 2015, NSD 1680 of 2015
NSD 1681 of 2015, NSD 1682 of 2015
NSD 1683 of 2015

BETWEEN:	**CHEVRON AUSTRALIA HOLDINGS PTY LTD** Appellant
AND:	**COMMISSIONER OF TAXATION OF THE COMMONWEATH OF AUSTRALIA** Respondent
JUDGES:	**ALLSOP CJ, PERRAM AND PAGONE JJ**
DATE OF ORDER:	**21 APRIL 2017**

THE COURT ORDERS THAT:

1. The appeal be dismissed with costs.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

ALLSOP CJ:

1 I have had the advantage of reading the reasons to be published of Pagone J. I agree with the orders proposed by his Honour and, subject to the following, which is not intended to be by way of qualification, with his reasons. It is unnecessary to repeat the background circumstances of the matter beyond what is necessary to explain why the appeal should be dismissed. I do not repeat, except where necessary, the statutory provisions and surrounding secondary materials.

Division 13 of the 1936 Act

2 Central to the operation of Div 13 is the meaning of the words and phrase "property", "consideration" and "might reasonably be expected to have been given or agreed to be given".

3 In reaching a view about the meaning of these words and this phrase and how they operate in a coherent and cohesive way, it is paramount to recognise the fiscal and commercial context in which the provisions (and the provisions in Sub-div 815A of the 1997 Act, to be discussed in due course) are operating. This is not to put to one side or to diminish the necessity to begin and end with the words of the statute. Nor is it to seek to find a purpose of the Division outside its words. To begin and end with the words of the statute does not reflect a call to narrow textualism; it is the recognition that, ultimately, it is the words used by Parliament which frame the question of meaning, and which will provide the answer to that question of meaning. Context, however, is indispensable, whether as an explicit or implicit consideration. It gives the place, the wholeness and the relational reality to words; it helps prevent linear thinking and sometimes beguilingly simple and attractive logic with words driving meaning to unrealistic and impractical ends; and it helps ascribe meaning conformable with commonsense and convenient purpose gained from the relevant part of the statute as a whole, here Div 13.

4 The fiscal and commercial context of Div 13 is the attempt to bring to tax in Australia, on a given hypothesis, income of a taxpayer whose affairs, but specifically the transaction in question, are, and is, international in character. The commercial character of the context of the Division means that the subject "international agreement" (as that phrase is defined in s 136AC) will be of infinite variety and possible complexity. In each case, however, the focus

of the Division is to bring a commercial reality based on an hypothesis of actors independent of each other to the viewing of a transaction (for the purpose of taxation) in circumstances where that commercial reality so based (for that fiscal purpose) has been distorted by considerations that can be described as a lack of relational independence or, to use metaphor, a lack of arm's length dealing between the parties to the transaction. That is not to say that there was not commercial reality to the transaction as made within the framework that reflected a lack of independence between the parties, that is, within the relevant group or related company relationship.

5 That is the broad context and purpose of the Division – to bring a transaction, an international agreement, from a state influenced by considerations of lack of independence, to a state reflective of arm's length dealing, for the purposes of fitting the transaction within the taxpayer's affairs in that form consistent with commercial reality based on hypothesised independent dealing.

6 The words used by Parliament for this task, particularly those in ss 136AA and 136AD, should therefore be given meaning and operation conformable with this purpose and conformably with the necessary flexibility of analysis that may be required in applying the statute to the infinite variety of circumstances of commercial life. The provisions should not be interpreted pedantically.

7 Section 136AD deals with circumstances where the taxpayer has either supplied or acquired property under an international agreement and that supply or acquisition was for an amount of consideration that was less or more than would have been the arm's length consideration for that supply or acquisition. Subsections 136AD(1), (2) and (3) deal with circumstances where the arm's length consideration can be ascertained. Subsection 136AD(4) deals with the circumstance where it is not possible or practicable for the Commissioner to ascertain the arm's length consideration.

8 The relevant provisions here are ss 136AD(3) and (4) which are in the following form:

> (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.

9 The concepts employed are: property and the acquisition of property; an absence of dealing at arm's length by parties to the agreement in relation to the acquisition of property; and the giving by the taxpayer of an amount of consideration in respect of the acquisition that exceeded the arm's length consideration.

10 These concepts are given content by various definitions in s 136AA.

11 The definitions of "acquire" (and hence "acquisition") and "property" are wide and inclusive terms. Together with the (also inclusive) definition of "services" (a word included in (d) of the definition of "property") they are sufficiently wide to embrace the consequences of entering into a commercial lending arrangement. Indeed, (d) of the definition of "services" refers to "rights, benefits, privileges or facilities that are, or are to be, provided, granted or conferred under … an agreement for or in relation to the lending of moneys". The text of these definitions is 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.

…

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.

12 Thus, the entry into, and the taking of the benefit of, an agreement to lend money by a borrower is the obtaining, or gaining, or receiving of the rights, benefits or facilities under an agreement for the lending of moneys.

13 The word "consideration" and the phrase "amount of consideration" are given some content by s 136AA(3)(b) as follows:

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

…

(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;

14 The phrase "arm's length consideration" is defined in s 136AA(3)(d) as follows:

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

…

(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;

15 A number of things are to be noted about ss 136AA(3) and 136AD(3). First, for s 136AD(3)(c), the consideration in the transaction in question (the international agreement in question) is given or agreed to be given **by the taxpayer**. Secondly, for s 136AA(3)(d), the concept of the consideration that might reasonably be expected to have been given or agreed to be given had the agreement been reached between independent parties dealing at arm's length involves a suppressed premise or assumption that, in the real world, commercial parties could (and so would) enter into such a transaction such that an arm's length consideration can be hypothesised. Thirdly, there is no provision requiring the conclusion that any term of an international agreement must be either the "property" (or part thereof) or "consideration" (or part thereof). Fourthly, the process of identifying what is property and what is consideration, in any particular circumstances, may involve a process of characterisation governed by the definition of the terms, the commercial context and the requirement to hypothesise what might reasonably be expected to have been given or agreed to be given assuming independent parties.

16 A critical, and first, step in the analysis is to identify the property the subject of the acquisition for s 136AD(3)(a). It is that property in respect of the acquisition of which the consideration was given or agreed to be given by the taxpayer for s 136AD(3)(c); and it is that property that is the subject of the hypothesis as to what consideration might reasonably be expected to have been given or agreed to be given for s 136AA(3)(d). In other words, the property the subject of the actual (s 136AD(3)(c)) and hypothesised (s 136AA(3)(d)) agreement does not change. The primary judge so concluded at [76] of the reasons.

17 Once the property is identified, it is necessary to identify, through an examination of the facts, the consideration given by the taxpayer in respect of its acquisition. This actual consideration is then to be compared with the hypothesised consideration that might reasonably be expected to have been given or agreed to be given in respect of the acquisition of the same property under an agreement between independent parties dealing at arm's length.

18 Elucidation of the operation of the provisions in question is best done by reference to the facts and evidence. The commercial background to the agreement entered into between the appellant, CAHPL, and its subsidiary, CFC, is described in the judgment of Pagone J.

19 The effect of the interest payments made at the rate of 9% under the agreement created a tax deduction for CAHPL against its operating revenue from its interest, through subsidiaries, in

the North West Shelf gas project. The interest as income in the hands of CFC was not taxable in the United States: [126] and [147] of the reasons. Further, because CFC was a wholly owned foreign subsidiary of CAHPL, the dividends declared by CFC from the profits thus made were not assessable income in the hands of CAHPL: s 23AJ of the 1936 Act. Thus, operating income that would otherwise have been assessable income was transformed, by the deduction for outbound interest and receipt of inbound non-assessable dividends, into non-assessable income.

20 The decisions as to the return of capital, the raising of funds in the United States and the debt level of CAHPL were made by officers of Chevron Treasury in particular by Mr David Krattebol, Global Treasurer of Chevron and a director of CFC. As found by the primary judge at [165] of his reasons, "CAHPL's debt level of USD 2.5 billion was chosen [by Chevron Treasury] because it was the most tax efficient corporate capital structure and gave the best after tax result for the Chevron group".

21 Though some consideration was given by the Commissioner to the possible application of Part IVA of the 1936 Act, no assessment was raised on that basis.

22 The written agreement made on 6 June 2003 between CAHPL and CFC was entitled "Credit Facility". Using the words of the definition of "property", the property in question is to be seen as the "rights, benefits, privileges or facilities … provided, granted or conferred under" the Credit Facility. The primary judge said at [73]:

> [T]he property… was the rights or benefits granted or conferred under that Credit Facility, including the sums lent.

23 The recitals of the agreement were short:

> Whereas, [CAHPL] desires to borrow an amount not exceeding in the aggregate the equivalent in Australian Dollars (determined at the time of each drawdown as the sum of the total principal amount of Advances then outstanding plus the amount to be loaned on such drawdown date) of Two Billion Five Hundred Million United States Dollars from [CFC] and [CFC] is prepared to make loans upon the terms hereof;

24 "Advance" was defined as each lending to CAHPL pursuant to sections 3.1 and 4.1 of the agreement. The "Maturity Date" for each Advance was 30 June 2008.

25 Article III dealt with loans. Section 3.1 dealt with Advances as follows:

> Subject to the provisions of this Agreement, [CFC] hereby agrees, at its sole discretion, to make Advances from time to time to [CAHPL] in the aggregate the equivalent in Australian Dollars (determined on the basis of the total of the then outstandings and the amount to be loaned at the time of each drawdown) of Two

Billion Five Hundred Million United States Dollars.

26 Thus, CAHPL had no right, benefit, privilege or facility by way of any right to call for funds. This was made pellucid by the first paragraph of section 3.2:

> [CFC] shall have no commitment to make any Advances and shall not be entitled to any commitment fee with respect to this Agreement.

27 The last paragraph of section 3.2 canvassed termination as follows:

> [CFC] may terminate this Agreement at any time without cause. [CFC] shall have no right to require prepayment of any Loans outstanding at the date of such termination. [CAHPL] may terminate this Agreement at any time no Advances are outstanding hereunder without cause.

28 Section 3.3 concerned payments by CAHPL. The principal of each Advance was to be paid on the Maturity Date and interest monthly in arrears in Australian dollars.

29 Section 3.4 expressed the only right granted to CAHPL under the agreement as follows:

> [CAHPL] shall have the right to prepay any Advance made to it. [CFC] shall have the right to demand prepayment of all or any part of the Advances upon a Change of Control. To exercise such right, [CFC] shall give [CAHPL] written notice specifying the principal to be prepaid and the date for such prepayment. On the date so specified by [CFC], [CAHPL] shall prepay the principal of the outstanding Advances specified in the Lender's aforesaid notice in full together with interest accrued thereon to the date of prepayment.

30 Section 3.5 provided that the proceeds of the Advances were to be used as agreed between CAHPL and CFC.

31 Section 3.6 concerned the Contractual Currency. It relevantly provided as follows:

> Each payment by [CAHPL] under this Agreement will be made in Australian Dollars (the "Contractual Currency"). To the extent permitted by applicable law, any obligation of [CAHPL] to make payments under this Agreement in the Contractual Currency will not be discharged or satisfied by any tender in any currency other than the Contractual Currency, except to the extent such tender results in the actual receipt by [CFC], acting in a reasonable manner and in good faith in converting the currency so tendered into the Contractual Currency, of the full amount in the Contractual Currency of all amounts due under this Agreement. If for any reason the amount in the Contractual Currency so received falls short of the amount in the Contractual Currency due in respect of this Agreement, [CAHPL] will, to the extent permitted by applicable law, immediately pay such additional amount in the Contractual Currency as may be necessary to compensate for the shortfall. If for any reason the amount in the Contractual Currency so received exceeds the amount in the Contractual Currency due in respect of this Agreement, [CFC] will refund promptly the amount of such excess.

32 Article IV deals with drawdowns. Section 4.1 relevantly provided as follows:

> [CAHPL] shall give [CFC] notice of each request for an Advance before 10:00am

> San Francisco time on the date such Advance is to be made which date shall be a Banking Day, specifying the information required by the form of Notice of Drawdown.
>
> In making any Advance, [CFC] shall be entitled to rely upon a telephonic request for an Advance from an Authorised Representative, followed by a written Notice of Drawdown signed by an Authorized Officer, *provided that* the making of any Advance shall be at sole discretion of [CFC].

33 The phrase "Notice of Drawdown" was defined as one substantially in the form attached to the agreement relevantly as follows:

> Pursuant to Section 4.1 of that certain Credit Facility (the "Agreement") dated June 6, 2003 between ChevronTexaco Australia Holdings Pty Ltd and you, as Lender, the undersigned [CAHPL] hereby requests an Advance in the principal amount of _____ Australian Dollars on the date hereof which is a Banking Day.

34 There were no financial or operational covenants in the agreement that might have bound CAHPL to conduct its business or to behave in any particular way. No security was provided by CAHPL. Chevron did not provide a guarantee.

35 Funds were drawn down in two tranches, on 6 June and 26 August 2003. I will treat the receipt of funds in Australian dollars. Thus the rights, benefits, privileges and facilities acquired were the rights under section 3.4 to prepay the facility and the funds in Australian dollars. Those funds, however, were not a gift, nor a purchase price; they constituted a loan. Merely to describe the property as money or funds (in whatever currency) is inadequate for the purpose of hypothesising an arm's length transaction. One must characterise the transaction in order to identify the property and how it is acquired and for what expected consideration. It can be accepted that the obligation to repay is not a right, benefit, privilege or facility; rather it is an obligation. Nevertheless, it is part of the essential character of the transaction attaching to the funds provided under the agreement, at the discretion of CFC. The obligation to repay is what gives the property its character as a loan. At the least, the property here was a five year loan.

36 There are a number of other features of the commercial transaction that were said by CAHPL to be part of the property acquired – the absence of security granted to CFC by CAHPL or anyone else, and the absence of financial or operational covenants given by CAHPL. These features were said to be part of the composition of the property acquired, for a consideration that was limited to the interest payable. In CAHPL's submission the consideration was the interest rate and the property was the borrowing under, and pursuant to, all the terms of the Credit Facility.

37 The lack of security provided by CAHPL was said to be explained by CAHPL's inability to grant security over the production assets held by its subsidiaries. For present purposes let that be accepted. This absence of security could be invoked to describe or characterise the property acquired as an unsecured five year loan. The lack of financial and operational covenants could be used to describe the freedom of commercial action by the borrower after receipt of the funds. These features amount to a lack of existence or an absence of the grant of some right or security, or the lack of a promised obligation, to the lender. Such a lack of existence or absence is not property (including services) acquired from the lender. The ability or willingness to grant security (from the borrower or a third party) or to give a promise that may better secure or make safe the lender's position are most readily conceived of, or characterised, as part of what the borrower is willing or able to provide to obtain the loan at an interest or discount rate that is commercially acceptable, that is as part of the consideration.

38 These features may arise in the transaction (or not, as the case may be) for different reasons. For instance, financial or operational covenants by the borrower as to how it will conduct its business, how it will deal with its assets and, whether or not, or to what extent, it will in the future utilise its asset base to secure other lenders are commercial considerations one might expect in a loan made at arm's length if the lending were commercial; but which one would not necessarily expect in an intra-group borrowing where the lender is protected by the common control of the affairs of the group, including those of the borrower. There may be an infinite variety of such covenants, the presence or absence of which, at least as between arm's length parties, affects risk and thus price or monetary consideration. On the evidence here, their absence was not dictated by any commercial or operational imperatives; rather their absence can be explained by the protection given to the lender by common control. Likewise the absence of security given by CAHPL or the absence of a parent company guarantee can be explained by a lack of commercial or legal capacity (the former) and intra-group choice (the latter).

39 These aspects of the transaction in question, all being the lack of existence of promises to the lender or rights granted to the lender, are best analysed as part of the universe of what could possibly have been, or was, given in return for the property in question, being the five year loan in the sum of AUD 2.5 billion. That is, they are best seen in the universe of the subject of consideration: that is had they been given, they would have formed part of it.

40 One then comes to s 136AA(3)(d). This is the expression of the arm's length consideration to be deemed to be the consideration given or agreed to be given in respect of the acquisition for the purpose of s 136AD(3). This deemed consideration given or agreed to be given replaces, for taxation purposes, the actual consideration given or agreed to be given by the taxpayer. So, for s 136AA(3)(d), one asks what consideration might reasonably be expected to have been given or agreed to be given between independent parties in respect of the acquisition of the right or benefit of a five year loan with a right in the borrower to prepay at any time.

41 At [64] of his reasons, the primary judge set out a statement of Middleton J at first instance in *SNF (Australia) Pty Ltd v Commissioner of Taxation* [2010] FCA 635; 79 ATR 193 at [44] which was approved by the Full Court on appeal in that case (*Commissioner of Taxation v SNF (Australia) Pty Ltd* [2011] FCAFC 74; 193 FCR 149 at [121]-[122]) as follows:

> 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 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.

42 This passage contains some of the subtleties within the essential task of determining the arm's length consideration for s 136AA(3)(d). There is or may be a comparison involved; there may be the same or similar products; there may be the same or similar circumstances; there may be a market for fungible products; some adjustment of differences may be required. But the ultimate purpose is to determine the consideration that would have been given (that is implicitly, by the taxpayer) had there not been a lack of independence in the transaction. How one comes to that assessment and the relationship between the posited arm's length dealing and what in fact occurred will depend on the circumstances at hand, and a judgment as to the most appropriate, rational and commercially practical way of approaching the task consistently with the words of the statutory provision, on the evidence available. There may be a free market into which disembodied independent third parties and the taxpayer alike could enter for substitutable or fungible goods; or there may be a market of sorts in which individually reached pricing will be available depending upon the precise characteristics of the party seeking to avail itself of the market. Given the great variety of commercial circumstances to which the provision may apply, it would be wrong either to approach the interpretation of the provisions pedantically or to dictate a rigid or fixed approach to the task of determining the arm's length commercial consideration.

43 There is no reason derived from the language of s 136AA(3)(d) why the hypothesis based on independence should, of necessity, do other than assess what the taxpayer or a person in the position of the taxpayer would be expected to give by way of consideration in respect of the acquisition of the property to a party independent from it. The independence hypothesis does not necessarily require the detachment of the taxpayer, as one of the independent parties, from the group which it inhabits or the elimination of all the commercial and financial attributes of the taxpayer being part of the circumstances that gave the commercial shape to the property the subject of the acquisition and that may be relevant to the consideration for the property. There is discussion in the Full Court in *SNF* 193 FCR at 179-181 [95]-[102] and in particular at [96]-[99] (the latter paragraphs being set out by the primary judge at [65] of his reasons) about the circumstances in which one can or should hypothesise the taxpayer as part of the exercise under s 136AA(3)(d). The expression of the matter by the Full Court in *SNF* 193 FCR at 179-180 [96]-[99] must be read in the context of the argument of the Commissioner and the circumstances of the case. The submissions of the Commissioner in that case which concerned the ascertainment of a market price (which were rejected by the Court) can be seen recorded in 193 FCR at 153 [9]:

> [T]he concept of "arm's length consideration" in s 136AD(3) required an examination of transactions "between independent parties dealing at arm's length" (s 136AA) and those words, viewed in their full context, required, indeed forbade any other consideration but, comparable transactions in which the purchasers shared each and every quality of the taxpayer bearing on price save for the solitary fact of its having been under the control of SNF France. So viewed, the only comparables lawfully permitted by s 136AD(3) were those in which the putative purchasers were themselves making losses; the failure of the taxpayer to search for and recruit comparable purchasers of that kind meant that it had proved nothing of value and that failure, in turn, was fatal where the taxpayer admittedly bore the onus of proof.

44 In *SNF*, the Commissioner's submissions were directed to the asserted inadmissibility of evidence of certain allegedly comparable transactions because the parties did not have the same features as the taxpayer, being a history of making losses. Some of the language in *SNF* may be seen to be broader than was necessary to deal with the arguments and controversy in question. I do not take from *SNF* any requirement for a rigid or fixed approach to the place of the circumstances of the taxpayer or the party posited in the position of the taxpayer, in particular, here, its position in the group of which the other party to the actual transaction was a member also. Naturally, the one fixed and rigid proposition is that the parties to the dealing posited by s 136AA(3)(d) must be independent from each other – mutually independent. It does not follow that the party in the position of the taxpayer in the real transaction (here the borrower) must be disassociated in the hypothesis from its place in

the group for whose interests it was borrowing. I do not read *SNF* as requiring the utter disembodiment of both parties from the circumstances of reality if one is seeking to understand not what a market price for goods was but the consideration that would be given for acquiring a characterised loan from an independent lender. The fundamental purpose of the hypothesis is to understand what the taxpayer, CAHPL, or a person in the position of the taxpayer and in its commercial context would have given by way of consideration in an arm's length transaction.

45 At [76] the primary judge said the following:

> 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".

The paragraph contains a number of important ideas. The first sentence refers to the depersonalisation of the agreement that was entered into. To a degree, the task required by s 136AA(3)(d) necessitates this – it is an hypothesis; but that does not of its nature require the complete "depersonalisation" of the hypothesis from the structure of the facts and relationship present in the reality. The degree and extent of the depersonalisation will be dictated by what is appropriate to the task of determining an arm's length consideration – that is one that satisfactorily replaces what the taxpayer gave by what it should be taken to have given had it been independent of its counterparty.

46 Secondly, the primary judge said that the property should not be altered in the hypothesis. The terms of ss 136AD and 136AA make that clear. That, however, is not to say that there must be no difference in the agreement as a whole. It will depend upon how the property is identified – how it is characterised. Thus, I do not consider the second sentence to be correct for all purposes. As will be seen in due course, the statutory hypothesis in s 136AA(3)(d) is one directed to a reasonable expectation as to what consideration would be given, implicitly by the party acquiring the property, that is the party in the position of the taxpayer. Whilst the property remains the same, what consideration would be given for it in a real world of independence may lead, depending upon the evidence, to the reasonable expectation of

different behaviour on the part of the person in the position of the taxpayer in relation to the giving of consideration for the property and of behaviour by another or others in relation to the dealing, and which would reflect rational commercial behaviour in the environment of an arm's length transaction. Such behaviour may affect the terms of the hypothetical agreement in question to the extent that they can be seen as part of the consideration.

47 Thus the questions are what is the property, and what, in all the circumstances, bearing in mind the evidence, would one reasonably expect the consideration to be given to acquire the property, and so take the place of the consideration actually given by the taxpayer.

48 As the primary judge said at [78] of his reasons, the hypothesis must be made to work. This is particularly the case where the agreement in question is not easily commercially replicated or posited in the real world. That may be so because the property may be such as to be of special particularity to the taxpayer or to the group in which the taxpayer is situated, or the agreement may have been structured with tax minimisation or "tax-efficiency" in mind such that it may be constructed in a way divorced from how such would be likely to appear as a dealing between independent parties. That the hypothesis must be made to work, if it can, is also to be taken from the commercially rational nature of the task – the property, the acquisition, the consideration are to be seen in their relationship to each other by reference to what can be reasonably expected, assuming independent commercial parties.

49 These considerations give force to the correctness of the primary judge's expressed views at [79]-[82] where he said:

> 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.
>
> 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.
>
> 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.
>
> 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.

50 The independence required is independence of the parties to the agreement from each other; it does not require any other hypothetical relationship; nor does it necessarily require the removal of characteristics of the party as the borrower that take it away from identity with the taxpayer in character or situation.

51 Also underpinning the correctness of the approach of the primary judge in [79]-[82] is the recognition that the task is to determine a consideration appropriate to replace that actually given by the taxpayer in order better to assess the affairs of the taxpayer for taxation.

52 At [83] and following the primary judge discussed the contending submissions before him about the meaning of the word "consideration." These arguments were rehearsed before us on appeal. There was a tendency to approach the question from a theoretical *a priori* position as if it were possible to conclude logically that a kind of term of an agreement (such as the provision of security by the borrower over its assets) was capable of necessary classification as "property" (as an aspect of a secured loan) or as "consideration" (as part of what is given for an accommodation or loan, not more narrowly characterised as a secured loan). These questions are best approached through the process of characterisation of the agreement and facts in question, bearing in mind the ultimate task – obtaining a commercially rational substitute based on arm's length independence for a non-arm's length consideration in fact given, so as to bring the taxation affairs of the taxpayer into conformity with commercial rationality based on independence of action.

53 The appellant approached the task dictated by s 136AA(3)(d) as it had before the primary judge by identifying the task at hand to price the interest rate that would be paid by a stand- alone borrower from an independent lender for a loan structured in the identical terms to the credit facility. This was based on a submission that the property and agreement must remain identical and only the consideration in the form of the interest rate could be the subject of adjustment by reference to what could be reasonably expected.

54 Thus, CAHPL, as applicant called witnesses with experience in lending and financing to say that a five year unsecured loan of AUD 2.5 billion with a borrower with the financial attributes of CAHPL giving no financial or operational covenants would likely be priced at above 9%. The primary judge found certain aspects of that evidence unsatisfactory; but, if the correct task was being essayed by CAHPL one could well accept, without difficulty, that

a stand-alone company with CAHPL's balance sheet which borrowed AUD 2.5 billion unsecured for five years with no operational or financial covenants would pay a significant interest rate, and in all likelihood on the evidence, above 9%.

55 That approach, however, almost dooms to failure the application of Div 13 if its task is to substitute commercial reality based on independence, for intra-group reality based on group control. All one would have to do would be to constrain internally the transaction to give the highest price and include or omit terms of the agreement that would never be included or omitted in an arm's length transaction and which are not driven or dictated by commercial or operational imperatives, as the foundation for assessing an hypothesised arm's length consideration. Such unrealistic inflexibility would undermine the sensible operation of the Division by a rigid construction of the hypothesis in a shape and form controlled by the taxpayer. The difficulty is not alleviated by giving s 136AD(4) a role to play in such circumstances.

56 The appellant submitted to the primary judge that the pricing of the loan in the hypothesised borrowing from the independent lender must take into account the assets, risks and functions of CAHPL which informed the likelihood of CAHPL repaying principal and interest, but not otherwise than as a stand-alone entity. He dealt with the evidence of the witnesses on this question.

57 The Commissioner submitted to the primary judge that the correct approach was that all the facts and circumstances of the parties (other than their non-arm's length relationship) should be imported into the hypothesis. Of particular relevance for this submission was Chevron as the parent and the likelihood of its giving a guarantee to the lender of the borrower's obligations.

58 The approach of the primary judge at [499] and [501]-[502] of his reasons was to accept neither of these submissions in its entirety, saying:

> 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.
>
> …
>
> 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.
>
> 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 *SNF* 193 FCR 149.

59 Nevertheless, the primary judge had said at [87] of his reasons:

> 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.
>
> (Emphasis added.)

60 A number of things arise from this. First, the primary judge thought himself to be constrained by the Full Court in *SNF* not to give determinative effect to the CAHPL/Chevron relationship. For the reasons that I have given, that takes the Full Court in *SNF* too far. I do not see why the hypothesis for s 136AA(3)(d) should not include a borrower in the position of CAHPL with its balance sheet in a group the parent of which is a company such as Chevron. Secondly, his Honour concluded that consideration in the nature of security or operational covenants would have been given. There may have been a question, on the evidence, whether CAHPL was in a position to give security. Certainly, on the evidence, the reasonable expectation would be that Chevron or a company in Chevron's position would give a guarantee; and so security and any covenants given by CAHPL or the company in its position would be of no relevant consequence. The evidence did not reveal any likelihood of Chevron charging a fee for such guarantee.

61 For the comparison here to be of utility one would compare what the taxpayer, CAHPL, gave (for s 136AD(3)(c)) and what it, or a borrower in its position, could reasonably be expected to give if dealing with an arm's length lender.

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

63 For the hypothesis for the purposes of s 136AA(3)(d) to include the parent company guarantee is not to alter the property the subject of an acquisition by the taxpayer. The task is to identify from the evidence the consideration that might reasonably be expected to have been given or agreed to be given by a party in the position of CAHPL (the taxpayer) in respect of obtaining a five year loan compared to the consideration actually given by the taxpayer. Part of the assessment of what consideration is reasonably to be expected to be given are the facts that are likely or reasonably to be expected to attend such a transaction

with an independent third party. If the evidence reveals (as it did here) that the borrower is part of a group that has a policy to borrow externally at the lowest cost and that has a policy that the parent will generally provide a third party guarantee for a subsidiary that is borrowing externally, there is no reason to ignore those essential facts in order to assess the hypothetical consideration to be given.

64 The property has not changed. As far as the borrower is concerned the loan remains repayable in five years. The consideration that might reasonably be expected to have been given or agreed to be given by an independent party in the position of CAHPL (the taxpayer) in these circumstances will be the interest rate charged by the lender for the borrowing taking into account the guarantee, not given by the taxpayer, but given by the parent in the position of Chevron.

65 There may be factual circumstances where the attributes of the taxpayer, or its position in a group of companies, or the nature of the subject matter of the transaction make it appropriate to assess a consideration for s 136AA(3)(d) as one struck between two disembodied parties without some or all of the attributes of the taxpayer. Ultimately, however, the purpose of the hypothesis is to identify what should be deemed to be the consideration instead of that actually given by the taxpayer in respect of the acquisition that occurred. Here, the ascertainment of that consideration naturally and rationally contemplates a company in the position of CAHPL with its attributes, including its inhabiting of the Chevron group, dealing at arm's length with an independent lender.

66 This approach makes it strictly unnecessary to canvass each of the appellant's complaints about the primary judge's treatment of its witnesses. On any view, whether the loan was in Australian or United States dollars, the ascertainment of the consideration for s 136AA(3)(d) with a parent company guarantee from a parent such as Chevron will conclude the question that the appellant has not shown the assessments under Div 13 to be excessive.

Sub-division 815-A of the 1997 Act

67 Sub-division 815-A concerns cross-border transfer pricing.

68 The relevant object of Sub-div 815-A is set out in s 815-5(a) as follows:

> **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:

(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;

69 Section 815-10(1) empowers the Commissioner to make a determination under s 815-30(1) for the purposes of negating a transfer pricing benefit. Relevantly here, the determination by the Commissioner was under s 815-30(1)(a) and was "of an amount by which the taxable income of the entity for an income year is increased."

70 Section 815-10(1) only applies, however, if the treaty requirement as set out in s 815-10(2) is met:

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

(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.

71 Here, relevantly for s 815-10(2)(a) there was an international tax agreement (being 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, as amended (the US Treaty)) in place at the time. An associated enterprises article is defined by ss 995(1) and 815-15(5) of the 1997 Act as:

(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.

72 Article 9(1) of the US Treaty is in substantially the same terms as Art 9 of the United Kingdom convention. Thus, there was at the time of the events in question an international tax agreement containing an associated enterprises article that applied to the entity, CAHPL.

73 Article 9(1) of the US Treaty is in the following terms:

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.

74 Whether an entity gets a transfer pricing benefit depends on the satisfaction of the test in s 815-15 (relevantly, here, s 815-15(1)) assisted by certain secondary materials referred to in s 815-20.

75 Section 815-15(1) is in the following terms:

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

(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).

76 Section 815-20 is concerned with "cross-border transfer pricing guidance". It is in the following terms:

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.

77 The effect of s 815-20(1) is modified by s 815-5 of the *Income Tax (Transitional Provisions) Act 1997* (Cth) which states that despite s 815-20, for any year of income before 1 July 2012, the documents to which s 815-20 is taken to be referring are the OECD Model Tax Convention on Income and Capital and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, in each case as last amended before the start of the income year. By reason of this provision the relevant OECD Transfer Pricing Guidelines were those of 1995. The parties did not specifically refer the Court to the OECD Model Tax Convention of any year, but that Model Convention formed the basis for the wording of Art 9 of the UK Convention and the US Treaty.

78 One must therefore turn to s 815-15 and Art 9 of the US Treaty, assisted by the 1995 Guidelines in order to ascertain whether an entity, here CAHPL, has got a transfer pricing benefit.

79 Section 815-15(1)(a) is satisfied – CAHPL is an Australian resident.

80 Section 815-15(1)(b) is satisfied – Chevron (an enterprise of the United States) participated directly or indirectly in the management or control of CAHPL (an enterprise of Australia).

81 Paragraph (c) of s 815-15(1) is central. It posits a causal relationship between the "conditions" referred to in Art 9 and "an amount of profits which … might have been

expected to accrue to the entity" but which has not so accrued "by reason of those conditions".

82 The notion of conditions in Art 9 refers to the circumstances or environment that can be seen to operate between the two enterprises in their commercial or financial relations which are different to the circumstances or environment which would operate between independent enterprises. The word "conditions" is broad and flexible. The primary judge, at [582]-[583] of his reasons, referred to a number of individual conditions identified by the parties. Looking at the facts here one can, conformably with the way the respondent identified various conditions, see conditions operating between CAHPL and CFC which differ from conditions that might be expected to operate between CAHPL and an independent lender. Those conditions included the direction of the affairs of both companies and their relationship in respect of the on-lending of the funds raised by CFC by Chevron Treasury, in particular, by Mr Krattebol, such direction being in accordance with the best interests of the Chevron group, and in particular to bring about the most efficient corporate capital structure and the best after tax result for the Chevron group.

83 That condition or these conditions operated between CAHPL and CFC in their financial relations and was or were manifested in the Credit Facility. The inquiry then for the purposes of s 815-15(1)(c) is what "amount of profits" might have been expected to accrue, but did not by reason of the conditions.

84 The understanding of the nature of that causal inquiry is assisted by the discussion in the OECD 1995 Guidelines (the Guidelines). Paragraph 6 of the Preface to the Guidelines sets out the general approach:

> In order to apply the separate entity approach to intra-group transactions, individual group members must be taxed on the basis that they act at arm's length in their dealings with each other. However, the relationship among members of an MNE group may permit the group members to establish special conditions in their intra-group relations that differ from those that would have been established had the group members been acting as independent enterprises operating in open markets. To ensure the correct application of the separate entity approach, OECD Member countries have adopted the arm's length principle, under which the effect of special conditions on the levels of profit should be eliminated.

85 The arm's length principle is set out in Art 9 of the OECD Model Tax Convention on Income and Capital.

86 The Guidelines discuss the arm's length principle in Ch 1. In the discussion of Art 9, the Guidelines state at [B.1.6]:

> By seeking to adjust profits by reference to the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances, the arm's length principle follows the approach of treating the members of an MNE group as operating as separate entities rather than as inseparable parts of a single unified business. Because the separate entity approach treats the members of an MNE group as if they were independent entities, attention is focused on the nature of the dealings between those members.

87 The Guidelines in Section B, in dealing with the statement of the arm's length principle, discuss at [B.1.10] the practical difficulty in applying the arm's length principle that may arise from the fact that associated enterprises may engage in transactions that independent enterprises would not engage in. For instance, an independent entity may not be willing to sell or licence some valuable intellectual property or know-how. Some of the discussion is illuminating:

> [T]he owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, the intangible owner may be prepared to offer terms to associated enterprises that are less restrictive because the use of the intangible can be more closely monitored. There is no risk to the overall group's profit from a transaction of this kind between members of an MNE group. An independent enterprise in such circumstances might exploit the intangible itself or license it to another independent enterprise for a limited period of time (or possibly under an arrangement to adjust the royalty).

88 Section C of the Guidelines concerns guidance for applying the arm's length principle. The section begins (at [C.1.15]) with a discussion of comparability as follows:

> Application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent enterprises. In order for such comparisons to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. In determining the degree of comparability, including what adjustments are necessary to establish it, an understanding of how unrelated companies evaluate potential transactions is required. Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter into the transaction if they see no alternative that is clearly more attractive.

89 The Guidelines in a section beginning at [C.1.36] discuss the recognition of the actual transaction undertaken. The whole of [C.1.36] – [C.1.38], though long, should be set out:

A tax administration's examination of a controlled transaction **ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them**, using the methods applied by the taxpayer insofar as these are consistent with the methods described in Chapters II and III. In other exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.

However, there are two particular circumstances in which it may, exceptionally, be both appropriate and legitimate for a tax administration to consider disregarding the structure adopted by a taxpayer in entering into a controlled transaction. The first circumstance arises where the economic substance of the transaction differs from its form. In such a case the tax administration may disregard the parties' characterisation of the transaction and re-characterise it in accordance with its substance. An example of this circumstance would be an investment in which an associated enterprise in the form of an interest-bearing debt when, at arm's length, having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way. In this case it might be appropriate for a tax administration to characterise the investment in accordance with its economic substance with the result that the loan may be treated as a subscription of capital. **The second circumstance arises where, while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price.** An example of this circumstance would be a sale under a long-term contract, for a lump sum payment, of unlimited entitlement to the intellectual property rights arising as a result of future research for the term of the contract (as previously indicated in paragraph 1.10). While in this case it may be proper to respect the transaction as a transfer of commercial property, it would nevertheless be appropriate for a tax administration to conform the terms of that transfer in its entirety (and not simply by reference to pricing) to those that might reasonably have been expected had the transfer of property been the subject of a transaction involving independent enterprises. Thus, in the case described above it might be appropriate for the tax administration, for example, to adjust the conditions of the agreement in a commercially rational manner as a continuing research agreement.

In both sets of circumstances described above, **the character of the transaction may derive from the relationship between the parties rather than be determined by normal commercial conditions and may have been structured by the taxpayer to avoid or minimise tax. In such cases, the totality of its terms would be the result of a condition that would not have been made if the parties had been engaged in arm's length dealings. Article 9 would thus allow an adjustment of conditions to reflect those which the parties would have attained had the transaction been structured in accordance with the economic and commercial reality of parties dealing at arm's length.**

(Emphasis added.)

90 The above discussion illuminates that the causal test in s 815-15(1)(c) based on Art 9 is a flexible comparative analysis that gives weight, but not irredeemable inflexibility, to the form

of the transaction actually entered between the associated enterprises. A degree of flexibility is required especially if the structure and detail of the transaction has been formulated by reference to the group relationship and a "tax-effective" outcome (even if, as here, one that is not said to be illegitimate). The form of that transaction may, to a degree, be altered if it is necessary to do so to permit the transaction to be analysed through the lens of mutually independent parties.

91 There is nothing in the Guidelines that requires other than the independent status of the enterprises **from each other** in the transaction. Thus, to paraphrase the last sentence of [C.1.38], Art 9 (and so s 815-15(1)(c)) would allow an adjustment of conditions to reflect the conditions which the parties would have attained had the transaction been structured in accordance with commercial reality with the parties to the transaction dealing at arm's length.

92 The conditions operating between CAHPL and CFC if they were independent of each other would not include the direction by Chevron Treasury of the officers of both for the benefit of the group as a whole. The conditions between mutually independent CFC and CAHPL could, however, include CAHPL situated within the Chevron group and CAHPL being subject to the direction of Chevron for the benefit of the Chevron group.

93 In such circumstances, were CAHPL seeking to borrow for five years on an unsecured basis with no financial or operational covenants from an independent lender, in order to act rationally and commercially and conformably with the interests of the Chevron group to obtain external funding at the lowest possible cost consistently with any relevant operational considerations, it would do so with Chevron providing a parent company guarantee, if such were available.

94 In the light of the evidence as to Chevron's policy concerning external funding and its willingness to provide a guarantee to achieve that end the above is the natural and commercially rational comparative analysis when one removes the controlled conditions operating between CAHPL and CFC and replaces them with the condition of mutual independence.

95 In the circumstances there would have been a borrowing cost conformable with Chevron's AA rating, which, on the evidence, would have been significantly below 9%.

96 One then must assess whether an amount of profits has not accrued thereby. The borrowing cost of CAHPL would have been less than it was under the Credit Facility; thus CAHPL's

deductions against operating revenue would have been less, and operating profit conformably greater. There would, however, have been a reduced inflow of (non-assessable) dividends. If one looks to the whole income year and compares the profits of CAHPL in the two scenarios one may not see a difference in amount of profits, although the two amounts would be differently formulated. In the actual transaction the profits are made up of lower (assessable) operating profit and higher (non-assessable) dividend income from CFC. In the hypothesised transaction the same level of profits are made up of higher (assessable) operating profit and lower (non-assessable) dividend income from CFC. There is, however, no mandate or requirement to look at the profit position of CAHPL only at year end. In point of fact, an amount of operating profit would have accrued with lower interest deductions; and turning to s 815-15(1)(d) had **that** amount of profits so accrued the amount of its taxable income would have been greater than its actual amount.

97 The appellant must therefore have failed to show the assessments based on it to be excessive.

I certify that the preceding ninety-seven (97) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Chief Justice Allsop.

Associate:

Dated: 21 April 2017

REASONS FOR JUDGMENT

PERRAM J:

98 I have had the advantage of reading in draft the reasons and orders proposed by Pagone J with which I agree.

I certify that the preceding one (1) numbered paragraph is a true copy of the Reasons for Judgment herein of the Honourable Justice Perram.

Associate:

Dated: 21 April 2017

REASONS FOR JUDGMENT

PAGONE J:

99 Chevron Australia Holdings Pty Ltd ("CAHPL") challenges assessments made by the Commissioner pursuant to Division 13 of the *Income Tax Assessment Act 1936* (Cth) ("the 1936 Act") in five income tax years from 2004 to 2008 (inclusive), and those made by the Commissioner pursuant to Division 815 of the *Income Tax Assessment Act 1997* (Cth) ("the 1997 Act") in three of those five years, namely for the 2006 to 2008 years (inclusive). The assessments relate to interest paid by CAHPL to Chevron Texaco Funding Corporation ("CFC") under an agreement between them dated 6 June 2003 styled "Credit Facility Agreement". Each of the assessments in question was in substance made upon the basis that the interest paid by CAHPL, an Australian company, to its United States subsidiary, CFC, was greater than it would have been under an arm's length dealing between independent parties.

100 The purpose of the Credit Facility Agreement between parent and subsidiary was to effect an internal refinancing of an Australian currency debt of Chevron Australia Pty Ltd ("Chevron Australia") and to fund CAHPL's acquisition of Texaco Australia Pty Ltd ("TAPL"). CAHPL was established as the Australian holding company of the Chevron Group of Companies following the merger between Chevron Corporation ("CVX"), its ultimate United States parent company, and Texaco Inc. CFC was established in the group as a United States subsidiary of CAHPL for CFC to lend funds to its Australian parent at about 9% interest from money raised by CFC from the issue of commercial paper in the United States at a rate of about 1.2%. In June 2002 the shares in Chevron Australia and TAPL were transferred to CAHPL and were found by the learned trial judge to represent over 99.8% of the value of CAHPL. The TAPL shares were acquired by CAHPL for a consideration found by his Honour to be at fair value of AUD$1.529 billion from a temporary interest free loan from the transferor, namely Getty Mining International Inc ("Getty"). Chevron Australia had owed CAHPL AUD$1.9 billion before the transfer of its shares by Getty to CAHPL on a loan from Chevron Capital Corporation ("CCC") following a return of capital to its then shareholder. The learned trial judge accepted that on 6 June 2003 CAHPL drew the Australian dollar equivalent of US$1.45 billion under the Credit Facility Agreement and that on 26 August 2003 CAHPL drew the Australian dollar equivalent of US$1 billion under the Credit Facility Agreement.

101 In each of the income years in question CAHPL claimed tax deductions in Australia for the interest it paid to CFC, and returned as income the dividends it received from CFC as non-assessable non-exempt income pursuant to s 23AJ of the 1936 Act. The Commissioner described in written submissions the evidence accepted by the learned trial judge as being to the effect that the internal funding arrangements put in place resulted in CAHPL increasing its untaxed dividends from CFC as CAHPL's interest payments to CFC increased whilst CFC would make significant profits from borrowing at 1.2% and on-lending at 9% which would not be taxed either in the United States or in Australia. The economic effects of the internal financing structure put in place, in other words, included CAHPL's Australian taxable income being reduced by the deductions it claimed for the interest payments it made to its United States subsidiary and the receipt by CAHPL of non-taxable income from dividends CFC was able to declare to CAHPL from the interest CFC had derived from CAHPL.

102 The Commissioner's assessments were not made under the anti-avoidance provisions in Part IVA of the 1936 Act but in reliance upon transfer pricing provisions on the basis that the consideration paid by CAHPL to CFC for property acquired from CFC (namely, from the loan), exceeded the arm's length consideration that might reasonably have been expected in an agreement between independent parties acting at arm's length. Anti-avoidance provisions are directed to cancel tax benefits otherwise obtained by the regular application of revenue laws where obtaining the tax benefit was the dominant purpose of the scheme by which the tax benefit was obtained. Transfer pricing provisions, in contrast, give effect to a fiscal policy that the domestic revenue base is not to be eroded by the cost of cross-border acquisitions between related parties upon consideration which exceeds the arm's length price expected to be incurred between independent parties dealing with each other at arm's length in respect of the acquisition. That fiscal policy departs from the usual principle which is applicable to the taxation of a domestic transaction that "it is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent": *Ronpibon Tin NL and Tongkah Compound NL v Federal Commissioner of Taxation* (1949) 78 CLR 47 at 60; *Cecil Bros Pty Ltd v Federal Commissioner of Taxation* (1964) 111 CLR 430.

103 On 20 May 2010 the Commissioner issued amended assessments to CAHPL for each of the five years of income from 2004 to 2008 upon determinations dated 30 April 2010 under Division 13 of the 1936 Act. On 26 October 2012 the Commissioner issued amended assessments to CAHPL for the 2006 to 2008 tax years based upon determinations under

Division 815 of the 1997 Act. CAHPL challenged the determinations upon which the assessments were made. The Division 13 assessments were challenged on the basis that the person who made them lacked authority to do so. The determinations made under Division 815 were challenged on the basis that the relevant provisions in the legislation were beyond the parliament's constitutional power and also on the basis that the determination under Division 815 could not effectively have been made because of the existence of the earlier determinations which had been made under Division 13.

104 The Division 13 determinations dated 30 April 2010 had been 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. The Commissioner conceded that Mr Roberts did not have the authority to make the Division 13 determinations, but contended that the fact of his lack of authority did not discharge the taxpayer's burden of proving the assessments to be excessive. His Honour correctly upheld the amended assessments which the Commissioner had issued on 20 May 2010 based upon the determination which had been made by Mr Roberts notwithstanding his lack of authority.

105 A taxpayer's burden of proving that an assessment is excessive is not discharged by showing that in some respect the Commissioner erred: see *Commissioner of Taxation v Dalco* (1990) 168 CLR 614*; Gashi v Federal Commissioner of Taxation* (2013) 209 FCR 301; *Rigoli v Federal Commissioner of Taxation* (2014) 96 ATR 19*; Rigoli v Federal Commissioner of Taxation* [2016] FCAFC 38. Section 175 of the 1936 Act protects the validity of an assessment from challenge by reason that a provision has not been complied with. Section 175 of the 1936 Act provides:

> **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.

Section 177(1) of the 1936 Act excluded also from challenge the due making of an assessment in these proceedings upon the production of a document contemplated by that provision. Section 177(1) provided:

> **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 Part 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.

Section 177(1) had been substituted between the time of the oral hearing at first instance and the time of the determination of the appeal by s 350-10 in Schedule 1 to the *Taxation Administration Act 1953* (Cth) ("the Administration Act") but its provisions were to the same effect as s 177(1) of the 1936 Act. Section 350-10(1) to Schedule 1 of the Administration Act provides:

350–10 Evidence

Conclusive evidence

(1) The following table has effect:

Conclusive evidence		
Item	**Column 1** **The production of …**	**Column 2** **is conclusive evidence that …**
1	(a) a *Gazette* containing a notice purporting to be issued by the Commissioner for the purposes of a *taxation law; or (b) a document that: (i) is under the hand of the Commissioner, a *Second Commissioner, a *Deputy Commissioner or a delegate of the Commissioner; and (ii) purports to be a copy of, or extract from, a document issued by the Commissioner, a Second Commissioner, a Deputy Commissioner or a delegate of the Commissioner for the purposes of a taxation law;	the notice or document was so issued.
2	a notice of assessment of an *assessable amount	(a) the assessment was properly made; and (b) except in proceedings under Part IVC of this Act on a review or appeal relating to the assessment—the amounts and particulars of the assessment are correct.

Section 350-10 enacted in a rewritten form the provisions previously found in s 177(1) and is not to be taken to be different just because different forms of words are used: see 1997 Act, s 1-3(2). Where s 177(1) had previously excluded from challenge in Part IVC proceedings "the due making of the assessment", s 350-10 subsequently excludes from challenge in Part IVC proceedings whether "the assessment was properly made".

106 A significant issue, however, unexpectedly arose during the hearing of the appeal about whether either s 177(1) of the 1936 Act or s 350-10 of the Administration Act applied. The issue arose because s 177(1) of the 1936 Act had been in force at the time of hearing of the proceeding at first instance but had been repealed by the time of the oral hearing of the appeal, however, s 350-10 of the Administration Act had not yet become operative and was not to come into force until 1 April 2017. In the circumstances CAHPL sought, and on 14 March 2017 was granted, leave to rely upon the absence of s 177(1) or s 350-10 at the time of hearing of the appeal to challenge the assessments made in reliance upon the Division 13 determinations. It was not possible for the Court, however, to determine the appeal before 1 April 2017 when s 350-10 came into effect and accordingly the decision is to be made on the basis that s 350-10 is part of the law to be applied to decide the rights of the parties on the appeal: see *Victorian Stevedoring & General Contracting Company Pty Ltd v Dignan Informant* (1931) 46 CLR 73, 107; *Western Australia v Ward* (2002) 213 CLR 1, 87 [70], 261-2 [612]-[613].

107 The assessments issued by the Commissioner on 20 May 2010 depend upon the making of determinations under Division 13 of the 1936 Act. On 30 April 2010 Mr Roberts made determinations in the following form:

> **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 paragraph 136AD(3)(a) of the Act, Chevron Holdings Pty Ltd has acquired property under an international agreement;
>
> 2. am satisfied for the purposes of paragraph 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 paragraph 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 paragraph 136AD(3)(d) of the Act, that subsection 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 30th 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

It was submitted for CAHPL that these determinations did not support the assessments made because they were not valid determinations. In *WR Carpenter Holdings Pty Ltd v Federal Commissioner of Taxation* (2006) 63 ATR 577 Lindgren J had said at [144] that "the fact itself of the making of [a] determination goes to the substantive liability to tax" which was open to be challenged by a taxpayer in Part IVC proceedings. The trial judge in the present appeal concluded, however, that determinations had been made albeit by a person lacking authority to have done so, but that the lack of authority did not make them a nullity and was insufficient to establish the assessments to be excessive.

108 His Honour was correct in concluding that Mr Roberts' lack of authority to make the determinations did not establish the assessments to be excessive. Provisions such as s 175, together with the former s 177(1) of the 1936 Act and s 350-10 of the Administration Act, assume procedural invalidity in the making of an assessment but prevent a challenge upon that basis. The combined objective of those provisions is to ensure that a taxpayer may challenge the correctness of "the amounts and particulars of the assessments" but not the procedural errors of the Commissioner. It is the substance of the amount of an assessment which a taxpayer may challenge rather than whether the Commissioner erred in the administrative process by which the assessments were made. Determinations under Division 13 were made in this case, albeit that they were made by a person lacking authority to make them. That absence of authority was a non-compliance by the Commissioner with a provision of the 1936 Act which by reason of s 175 of the Act does not affect the validity of the assessment, and was excluded from review in Part IVC proceedings as falling within the

"due making" of the assessment (within the meaning of s 177(1) of the 1936 Act) and within whether the assessment "was properly made" (within the meaning of s 350-10 of Schedule 1 to the Administration Act). Mr Roberts' lack of authority was similar to the defect considered by *George v Federal Commissioner of Taxation* (1952) 86 CLR 183 of an assessment being made by the Commissioner after the wrong officer had formed a view required to be formed before issuing an assessment under s 167 of the Act. In *George* it was said at 206 that s 177 excluded from challenge "the question whether the right officer ha[d] applied his mind to the question whether" the taxpayer's returns were satisfactory in an assessment made under s 167 which had authorised the making of an assessment if the Commissioner was not satisfied with the taxpayer's return.

109 The object of the provisions found in ss 175, 177, and now s 350-10, is to remove the Commissioner's procedural irregularity from challenge in Part IVC proceedings and to ensure that the taxpayer's challenge to an assessment is directed to those substantive integers upon which liability depends. A taxpayer is entitled to establish the absence of facts the existence of which may be necessary for the substantive liability to arise under an assessment. Thus, for example, the taxpayer in *McAndrew v Federal Commissioner of Taxation* (1956) 98 CLR 263 was able to challenge the excessiveness of an assessment by establishing that the conditions required by s 170(2) had not been fulfilled. The conditions in s 170(2) upon which the assessment depended in *McAndrew* were not procedural. The assessing power authorised by s 170 in *McAndrew's* case depended upon the existence of objective facts about which the Commissioner needed to be satisfied. The issue sought to be challenged was not whether the Commissioner was satisfied, or had erred in some internal process by which the Commissioner had become satisfied, but whether there were in existence the objective facts upon which the power depended irrespective of the Commissioner. The taxpayer was able to challenge in *McAndrew* the objective facts upon which the Commissioner's state of satisfaction depended in contrast to whether the Commissioner's state of satisfaction had regularly been reached.

110 In *WR Carpenter Holdings Pty Ltd v Commissioner of Taxation (Cth)* (2007) 161 FCR 1 the Full Court explained the difference between matters going to the substantive liability of a taxpayer, which are able to be challenged by a taxpayer in Part IVC proceedings, and matters of procedural invalidity which are protected from challenge. The Full Court said at [43]:

> Before we turn to examine some of the authorities, we would make the general observation that, in our view, the answers to the questions posed by this appeal lie in

> the analysis of the language of Div 13 in the light of s 177(1) itself rather than an intermediate classification of provisions as turning on the Commissioner's state of mind or otherwise. This is not to suggest that a distinction of the kind drawn by his Honour below between "state of mind" cases and "determination" cases is neither valid nor appropriate, but arguably it does not fully explain why s 177(1) does not prevent examination of the due formation by the Commissioner of his state of mind or satisfaction, whereas it does prevent examination of the due making by the Commissioner of his determination. In our view, the explanation is to be found in the fact that the first goes to substantive liability whereas the second is merely procedural. Where Parliament intended that the criteria for liability should include the due formation by the Commissioner of his state of mind, opinion or judgment, either in lieu of objective criteria, or as an addition to incomplete objective criteria, s 177(1) has never denied the ability of a taxpayer to examine the due formation of that state of mind on judicial review grounds. But where 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.

In the present case the validity of the determinations made by Mr Roberts is a matter going to the procedure which CAHPL is not able to challenge in Part IVC proceedings but CAHPL may challenge the basis of the determination upon which the assessment depends: see also *Commissioner of Taxation v Dalco* (1990) 168 CLR 614 at 622; *Federal Commissioner of Taxation v AusNet Transmission Group Pty Ltd* (2015) 231 FCR 59 at [23]-[24], [32]-[33],[67]-[68], [152]-[154].

111 It may be convenient to consider next the substantive question concerning the application of Division 13 for the five years in dispute. The determinations made by Mr Roberts on 30 April 2010 relied upon s 136AD(3) of the 1936 Act which provided:

> (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.

The meaning of s 136AD(3) depends in part upon the definitions found in s 136AA which provided:

> (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.

In general terms it may be said that Division 13 applies to substitute an arm's length price for the consideration given in respect of property acquired by a taxpayer in a non-arm's length dealing under an international agreement. Its provisions are not made to depend upon considerations of tax avoidance but, as mentioned, reflect a fiscal policy that parties who are not dealing at arm's length with each other in relation to an acquisition under an international agreement should be treated for domestic taxing purposes as if the consideration in respect of the acquisition equalled the arm's length consideration that might reasonably be expected to have been given or agreed to be given as consideration if the property had been acquired under an agreement between parties who were independent and were dealing at arm's length with each other in relation to the acquisition. Division 13 does not strike down all non-arm's length dealings and it has no effect unless the consideration given in a non-arm's length dealing in a cross-border agreement is greater than that which might reasonably be expected to have been given or agreed to be given under an agreement between independent parties dealing at arm's length with each other in respect of the acquisition. The provision cannot apply, in other words, to a wholly domestic non-arm's length dealing within a group of companies or to a cross-border transaction which does not have the fiscal effect caused by greater consideration being given than might reasonably be expected to be given in an arm's length dealing between independent parties. Nor does Division 13 necessarily apply to

non-arm's length transactions between arm's length parties. That is because the objective of Division 13 is directed to international acquisitions which have the effect of reducing the tax payable in Australia by non-arm's length dealings between non-arm's length parties.

112 The construction of Division 13 is not without difficulty despite what might appear to be its deceptive simplicity. The object to be achieved by Division 13 seems clear enough in general terms but its application requires application of its actual terms rather than what might have been an unexpressed intention. An important step in that application is the correct identification of the property that was acquired by a taxpayer. The correct identification of the property is necessary because it serves as the reference point (a) by which to identify the consideration actually given or agreed to be given by the taxpayer and (b) by which to identify the consideration that may reasonably be expected to have been given or agreed to be given if the property had been acquired in the hypothetical agreement posed by s 136AA(3).

113 The first condition to the application of s 136AD(3) in the present case required consideration of whether CAHPL acquired property under an international agreement. There was no dispute about the Credit Facility Agreement being an international agreement within the meaning of ss 136AD(3)(a) and 136AA, but there was disagreement about the correct identification of the property acquired. The Commissioner emphasised the acquisition of money by CAHPL when advanced by CFC. CAHPL, in contrast, emphasised the acquisition of an unsecured facility pursuant to the terms of the Credit Facility Agreement. CAHPL's case was that Division 13 required the pricing of an unsecured loan like that which it obtained pursuant to the Credit Facility Agreement. The Commissioner, in contrast, contended that the application of Division 13 required an inquiry into what consideration might reasonably be expected to have been given or agreed to be given by CAHPL in an arm's length dealing for the acquisition of the amount of money obtained from CFC.

114 Section 136AD(3)(a) called for the identification in this case of the property that had been acquired "under" the Credit Facility Agreement. The trial judge found at [73] that the property acquired by CAHPL under the international agreement "was the rights or benefits granted or conferred under that Credit Facility, including the sums lent". What CAHPL acquired under the Credit Facility Agreement must include, as his Honour found, all of the rights and benefits granted or conferred under the agreement including, but not limited to, the amounts received by way of loan: see also *McGain v Commissioner of Taxation* (1965) 112 CLR 523, 528; *Macquarie Finance Ltd v Federal Commissioner of Taxation* (2004) 57 ATR

115, [47]; *Federal Commissioner of Taxation v Radilo Enterprises Pty Ltd* (1997) 72 FCR 300 at 313.

115 A fundamental point of difference between CAHPL and the Commissioner turned on whether the unsecured nature of the loan between CAHPL and CFC was to be regarded as a benefit, right, privilege or facility (and therefore part of the definition of the property acquired) or was only to be taken into account in determining the consideration (and therefore relevant in comparing the consideration given by CAHPL with the hypothetical consideration that might reasonably be expected to be given or agreed to be given in respect of the acquisition under an agreement between independent parties dealing at arm's length with each other in relation to the acquisition). The difference between the submissions arose in part from the breadth of, and interrelationship between, the definitions of "property", "acquire", and "services" in s 136AA. The definitions of those words are intended to have wide application. Property is defined to include services, and services is defined broadly to include any rights, benefits, privilege or facilities under an agreement for or in relation to the lending of money, and the ability to use funds without security, guarantee or charge may be spoken about loosely as a right, privilege, benefit or facility, but the absence of security, guarantee or other charge is more aptly seen as part of the consideration or price paid for the right, privilege, benefit or facility rather than as a right, privilege, benefit or facility itself. The relevant rights, benefits, privileges or facilities provided, or to be provided, to CAHPL under the Credit Facility Agreement in relation to the lending of money was the use of the funds advanced by way of loan and not the consideration paid or given for the use of the funds by way of loan.

116 The Credit Facility Agreement conferred no rights upon CAHPL until CFC, in its absolute discretion, made advances. Section 3.1 of the Credit Facility Agreement provided that CFC thereby agreed in "its sole discretion to make advances from time to time to CAHPL in the aggregate equivalent in Australian dollars to US$2.5 billion". Section 3.2 provided that CFC had no commitment to make any advances and was correspondingly not entitled to any commitment fee in respect of the agreement. By s 3.3, however, CAHPL promised to pay on the maturity date the principal of each advance made to it, and to pay to CFC any interest on the unpaid principal amount of each advance made to it for the period commencing on the date of such advance and continuing until the maturity date for such advance at the applicable interest rate for such advance. "Advance" was defined by s 1.1 to mean "each lending" to CAHPL pursuant to s 3.1 and 4.1 of the agreement. "Maturity date" was defined with respect to each advance to mean 30 June 2008 (although that date was subsequently extended) and

the applicable interest rate was defined to mean "a rate equal to one-month AUD-LIBOR-BBA as determined with respect to each interest period plus 4.14% per annum". Section 4.1 provided for the giving of notice by CAHPL to CFC of each request for an advance.

117 CAHPL gave its subsidiary no security for the loan but the absence of security for what CAHPL got is not something that was "acquired" by CAHPL "under" the Credit Facility Agreement. It is true that the terms upon which CAHPL obtained the loan did not require CAHPL to give security but to say that is to make a statement about what CAHPL gave or agreed to give for the loan rather than about the property it acquired. The consideration given by CAHPL for the rights, benefits, privileges or facilities to use the funds it acquired under the Credit Facility Agreement is not to be confused with the consideration it gave. The lack of security was an absence in the consideration it was required to give for the funds it received rather than part of what it obtained and his Honour was correct to identify the property as he did.

118 The next two tasks to be undertaken for the application of Division 13 required, first, the identification of the consideration actually given or agreed to have been given by CAHPL in respect of the loan of US$2.5 billion and secondly, the identification of the consideration that might reasonably be expected to have been given or agreed to be given in respect of the acquisition of a loan of US$2.5 billion if that loan had been acquired under an agreement between independent parties dealing at arm's length with each other in relation to the acquisition.

119 The comparison required to be undertaken by s 136AD(3) is of the consideration for the property actually acquired with the arm's length consideration (as defined) of a hypothetical agreement. His Honour correctly explained at [76] that this required the hypothetical agreement for acquisition to be depersonalised "so as to make it, hypothetically, between independent parties dealing at arm's length, but not so as to alter the property acquired". Care must be taken in that task not to lose sight of the objective of Division 13, and of the assumption upon which its application is based, namely that there is something able to be compared. The basal assumption of transfer pricing provisions is that non-arm's length parties have selected a non-arm's length consideration for the acquisition of property which had a higher arm's length consideration than if the dealing had been between them as independent parties dealing at arm's length. That may proceed from a view of a paradigm case of transfer pricing arrangements in which there are identifiable arm's length dealings for

property of the type whose arm's length consideration is to be determined. The model upon which s 136AD(3) is based presupposes, in other words, that there exists a comparable agreement able to be compared with the actual agreement under which the consideration for the comparable agreement was not affected (a) by the parties not being independent from each other and (b) by not having dealt with each other at arm's length in respect of the acquisition. The hypothetical agreement contemplated by the definition of arm's length consideration in s 136AA(3)(d) does not compel one of the parties necessarily to be the taxpayer (see *Federal Commissioner of Taxation v SNF (Australia) Pty Ltd* (2011) 193 FCR 149, [9], [97]-[102]).

120 CAHPL's case was that the statutory direction that the arm's length consideration be compared with its actual consideration required its loan to be priced. In other words that what had to be priced was a loan without security or covenants to be given by a commercial lender to a borrower such as CAHPL. CAHPL accepted what had been said in *SNF* at [99] about excluding the particular attributes of the actual parties in determining the arm's length consideration, but submitted that in the case of a loan "the characteristics of the borrower will affect the pricing of the loan" and, therefore, that it was "impossible to exclude all the attributes of the borrowing party in question".

121 Section 136AD(3), unlike s 136AD(4), presupposes, and can only operate, where it is possible and practical to ascertain an arm's length consideration for the supply or acquisition in question. Accordingly, s 136AD(3) may not apply to some non-arm's length supplies or acquisitions. It is, of course, neither necessary nor desirable to express a concluded view about the matter, but it may be helpful to note that it is not difficult to imagine property (such as, perhaps, a license to use certain intellectual property rights, internally generated know how or central management corporate services or finance) to which s 136AD(3) might not, but to which s 136AD(4) might, apply. The significance in the difference between the operation of s 136AD(3) and s 136AD(4), however, lies in the role in the former of the assumption that there is an arm's length consideration objectively able to be ascertained for the acquisition of the property in question. Central to the application of s 136AD(3) is, therefore, the factual ascertainment of an arm's length consideration by reference to the standard of reasonable expectation upon a hypothesis of an agreement made between them as independent parties dealing at arm's length.

122 CAHPL did not contend that there was no arm's length consideration upon which s 136AD(3) could operate. Its case was, rather, that the arm's length consideration was that which, or less than that which, it gave or agreed to give by way of consideration for the loan it obtained from CFC without security or covenants in light of its credit worthiness from the perspective of a commercial lender looking at a hypothetical borrower with CAHPL's characteristics. That case was submitted to require pricing the loan it obtained on those terms and upon the hypothesis of CAHPL's credit worthiness.

123 In that regard CAHPL relied upon the expert reports of Mr Gross and Mr Martin who gave evidence about the evaluation process undertaken by commercial lenders in assessing credit and in pricing loans. Mr Gross had been the head of Global Investment Banking at the Bank of America between 1998 and 2002, the group managing director of Huron Consulting Group, Chicago, between 2003 and 2006, and a partner at Sandhurst Capital Partners focusing on consulting and advising private equity and hedge funds between 2006 and the time of giving evidence. Mr Martin was the Chief Executive Officer of Anawan Cliffs Capital Management and Advisory LLC with over 20 years' experience in the global leveraged finance industry. From April 2010 to January 2013 he had served as the co-head of Global Leveraged and Acquisition Finance at Morgan Stanley & Co in New York.

124 Much of the evidence of Mr Gross and Mr Martin was to the effect that a loan such as that obtained by CAHPL would not have been available to a hypothetical company with CAHPL's credit worthiness as a standalone company. The evidence found by his Honour was that the borrowing by CAHPL would not have been sustainable if obtained from an independent party. Both Mr Gross and Mr Martin determined CAHPL's credit worthiness from a commercial lender's perspective by looking at CAHPL's characteristics and at the average credit spreads for a category of debt known as institutional term loan B for borrowers with a corresponding level of credit worthiness to that which they had each determined for CAHPL. Mr Gross concluded that in his experience "most term loans extended to B+ rated borrowers [were] secured" and that the typical loan facility arrangements had "tight loan covenants". Mr Martin rated CAHPL as a weak BB borrower and discounted the prospect that a bank would participate in lending to a company with the credit worthiness of CAHPL. As a standalone company, severed from the financial strength of its ultimate parent and corporate group, CAHPL could not secure a loan for an amount equivalent to $US2.5 billion at the rate obtained by its subsidiary with the backing of the ultimate parent.

125 The burden of this evidence was directed to a construction of the definition of arm's length consideration as requiring a hypothetical agreement between "independent parties". CAHPL focused upon the words "independent parties dealing at arm's length" in the definition as requiring a comparison between the actual agreement between the parties in question with a hypothetical agreement between other independent parties rather than a comparison between the actual agreement with what the parties might reasonably be expected to have given as consideration if their hypothetical agreement had not lacked independence and had been at arm's length. On CAHPL's construction it was submitted that the application of s 136AD(3) required pricing a hypothetical loan which a hypothetical CAHPL could obtain from a hypothetical independent party on the assumption that the hypothetical CAHPL had the attributes of the actual CAHPL but was otherwise independent. However, to apply s 136AD(3) in that way, would be unrealistic and contrary to its purpose.

126 There is, as his Honour observed at [501], some difficulty in the application of the hypothesis required by s 136AD. Section 136AD(3) requires, and depends upon, the ascertainment of an arm's length consideration. The arm's length consideration to be ascertained for the purposes of s 136AD(3) is to be determined by reference to the two criteria found in s 136AA(3)(d); namely, (a) that the arm's length consideration meets the objective standard of being that which might reasonably be expected in relation to the acquisition, and (b) that the standard of reasonable expectation be determined upon the hypothetical basis that the property had been acquired under an agreement in which the parties were independent and were dealing at arm's length with each other in relation to the acquisition. The focus of the inquiry called for by these provisions is an alternative agreement from the one actually entered into where the alternative agreement was made by the parties upon the assumptions that they were independent and dealing at arm's length. In that regard it may be useful to note in passing that the nexus between the consideration and the acquisition is expressed by reference to the words "in respect of" rather than the word "for" and that the agreement in the hypothetical is described by reference to the indefinite article "an", indicating that the hypothetical in the comparison may be different from the actual agreement with which it is to be compared. The provisions do not require the construction of an abstract hypothetical agreement between abstract independent parties. The hypothesis in the definition of arm's length dealing is of an agreement which was not affected by the lack of independence and the lack of arm's length dealing. The task of ascertaining the arm's length consideration is, therefore, fundamentally

a factual inquiry into what might reasonably be expected if the actual agreement had been unaffected by the lack of independence and the lack of arm's length dealing.

127 The standard of reasonable expectation found in the words "might reasonably be expected" in s 136AA(3)(d) calls for a prediction based upon evidence. In *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359 the High Court said at 385:

> A reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.

The prediction contemplated by Division 13, like that contemplated by s 177C of the 1936 Act, involves an evaluative prediction of events and transactions that did not take place but the prediction must be based upon evidence and, where appropriate, upon admissible, probative and reliable expert opinion: see *Federal Commissioner of Taxation v Futuris Corporation Ltd* (2012) 205 FCR 274 at [79]-[81]; see also *Peabody v Commissioner of Taxation* (1993) 40 FCR 531, [39] (Hill J).

128 The need to posit a hypothetical acquisition under an agreement for the purpose of evaluating it by reference to the standard of reasonable expectation requires a consideration of the evidence to determine a reliably comparable agreement to that which was actually entered into. That, as his Honour said at [499] required the hypothetical to remain close to the actual loan. The function of the hypothesis is to identify a reliable substitute consideration for the actual consideration which was given or agreed to be given, and the reliability of the substitute consideration depends upon the hypothetical agreement being sufficiently like the actual agreement. Thus, as his Honour held, the purchaser in this case need not be a hypothetical standalone company (see [79]) and was to be an oil and gas exploration and production subsidiary (see [80]). The characteristics of the purchaser must be such as meaningfully to inform an inquiry into whether the consideration actually given under the agreement exceeded the arm's length consideration under the hypothetical agreement; or, to use the words of the learned trial judge at [80], in the hypothesis the independent parties are to have the characteristics relevant to the pricing of the loan "to enable the hypothesis to work". The actual characteristics of the taxpayer must, therefore, ordinarily serve as the basis in the comparable agreement. That does not mean that all of the taxpayer's characteristics are necessarily to be taken into account. The decision in *SNF* is an illustration of a feature of the taxpayer (namely that of having a history of incurring losses) being held not to be relevant to

determining the arm's length price of an arm's length acquisition. In some cases the consideration that might reasonably be expected to be given in an agreement in which the parties were independent and dealing at arm's length may be found in comparable dealings in an open market. What may readily be ascertained as the consideration in an open market for the property in question may supply the answer to the question but in each case the inquiry called for is a factual inquiry into the consideration that might reasonably be expected to be given in an agreement which did not lack independence between the parties and in which they dealt with each other at arm's length.

129 The policy assumption in the provisions to which the inquiry is directed is that the actual taxpayer in question would have given less consideration for what it obtained but for the lack of independence and the lack of arm's length dealing. In each case the focus of inquiry must be to identify a reliable comparable agreement to the actual agreement by the actual taxpayer for the legislative assumption to have meaningful operation. The provisions of Division 13 are intended to operate in the context of real world alternative reasonable expectations of agreements between parties and not in artificial constructs. The comparable agreement may, therefore, usually assume an acquisition by the taxpayer of the property actually acquired under an agreement having the characteristics of the agreement as entered into but otherwise hypothesised to be between them as independent parties dealing with each other at arm's length in relation to that acquisition. The purchaser (or in this case the borrower) may therefore, as his Honour considered at [79], be a company like CAHPL which is a member of a group, but where the consideration in respect of the acquisition identified in the hypothetical agreement is not distorted by the lack of independence between the parties or by a lack of arm's length dealings in relation to the acquisition.

130 The prediction of what might reasonably be expected is not to be undertaken upon the hypothesis submitted on behalf of CAHPL that it was not a member of the Chevron group or, in the language sometimes used in this context, as if it were an orphan. To do so would distort the application of Division 13 and fundamentally undermine its purpose of substituting as a comparable a real world arm's length consideration that consideration which could predictably have been agreed between them on the hypothesis that they had been independent and dealing at arm's length. The ultimate object of the task required by Division 13 is to ensure that what is deemed as the consideration by s 136AD(3) is the reliably predicted amount which CAHPL might reasonably be expected to give or to have given by way of consideration rather than a hypothetical consideration without reliable foundation in the facts

or reality of the circumstances of the taxpayer in question. That, if it be relevant, is consistent with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations: see I [1.20], [1.27] and [1.31].

131 In this case the property to be considered in the hypothetical agreement was a loan of US$2.5 billion for a term of years. What CAHPL obtained were the rights, benefits, privileges and facilities of a loan of US$2.5 billion in accordance with the Credit Facility Agreement for a number of years for a consideration which did not require it to give security. His Honour found at [87] that an independent borrower like CAHPL dealing at arm's length would have given security and operational and financial covenants to acquire the loan obtained by CAHPL. At [87] his Honour said:

> 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.

There is no reason to depart from that conclusion. It is not to the point that CAHPL, if it were a standalone company, had a risk rating on a scale approximately equal to BB+ loans. It can be accepted, as was submitted for CAHPL, that its credit profile was critical to the pricing of loans available in the market in question but the credit profile of the "hypothetical CAHPL" is not the inquiry required by s 136AD(3). The inquiry was not to determine the price of a loan which CAHPL obtained from CFC, nor to price a loan like that loan which CAHPL (with its credit worthiness) might have been able to obtain, as an independent arm's length party to such a loan, but to make a prediction about what might reasonably be expected to be given or agreed to be given under a hypothetical agreement if the parties had been independent and were dealing at arm's length in relation to the acquisition.

132 The evidence before, and found by, his Honour amply supported his Honour's prediction of the reasonable expectation of a borrowing by CAHPL being supported by security. Its subsidiary, CFC, had borrowed on the market by issuing its commercial paper with a guarantee from its ultimate American parent. It was Chevron policy that CVX in California ultimately decided all matters concerning internal restructures including the extent to which subsidiaries were financed by debt or equity. The policies of Chevron were that no external financing could take place unless Treasury or CVX, or another department of CVX, approved of the borrowing. An objective of the group was to obtain the lowest cost of funding to the

group for external borrowing. Ms Taherian accepted in cross-examination that the plan included that money would be raised at an interest rate that was close to US LIBOR and then lent to CAHPL at a higher rate of interest. Ms Taherian had been employed by CVX and its subsidiaries in the United States between 1996 and 2010 as director of international financing in the Treasury group although she had been a relatively junior employee from 2001 to 2005.

133 An alternative submission made by CAHPL, however, does have some force. The alternative submission was that the hypothetical acquisition would need to assume that CAHPL had paid a fee to its parent for the provision of security on the hypothetical loan. CFC actually raised funds in this case through a commercial paper program with the benefit of a guarantee from its ultimate United States parent which had a AA credit rating. CAHPL did not enjoy that credit rating and could not have borrowed US$2.5 billion on comparable terms to its parent without a guarantee supported by its parent. CFC did not pay a fee to the ultimate United States parent for the benefit of the guarantee but there is force in the proposition that a cross-border guarantee by the United States parent for the benefit of its Australian subsidiary to raise funds in the United States market with the benefit of a guarantee from the United States parent might have attracted a fee from CAHPL to CVX. The OECD guidelines contemplate that a cross-border guarantee by a parent to a subsidiary may require the payment of an arm's length guarantee fee. The payment of such a fee might not be part of the consideration payable by CAHPL to the lender but the meaning given to "arm's length consideration" in s 136AA(3)(d) is not confined to the consideration moving only between the parties to the transaction. What may constitute "consideration" for the hypothetical in s 136AD(3) (as defined by s 136AA(3)(d)) is not to be construed narrowly and includes that given by the acquiring party so as to move the agreement whether that be in money or in money's worth: *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143 at 152; *Chief Commissioner of State Revenue v Dick Smith Electronics Holdings Pty Ltd* (2005) 221 CLR 496 at [71]-[72]; *Commissioner of State Revenue (Vic) v Lend Lease Development Pty Ltd* (2014) 254 CLR 142 at [43], [49]-[51]. The definition is broad enough to encompass all consideration relevantly given by the party receiving the property in respect of the acquisition whether paid to the transferor of the property or to a third party such as, in this case, hypothetically to the parent company upon the hypothesis of the payment of a fee. In this case, however, there was insufficient evidence on the case as conducted to warrant the conclusion that a fee might reasonably have been expected to have been paid by CAHPL as part of the consideration that CAHPL might give in respect of the hypothetical loan.

134 It is unnecessary to deal in much detail in this case with the difference between the parties concerning the proper currency of the hypothetical agreement to be compared with the actual agreement. CAHPL submitted that the hypothetical agreement was to be denominated in Australian currency as provided by the Credit Facility Agreement and, incidentally, as the Commissioner had assessed. The evidence, however, was capable of supporting a different reasonable expectation because the funds lent by CFC to CAHPL were wholly sourced from the issue of commercial paper in the United States denominated in United States dollars. Furthermore, all of the funds raised by CFC by the issue of commercial paper were applied in the United States for the United States needs of the Chevron group: the loan between CFC and CAHPL was only an internal transaction. His Honour at [583] accepted, however, that the terms of the hypothetical agreement might have been expected to be in Australian currency. In that regard his Honour accepted CAHPL's submission that its borrowings in Australian currency would avoid or limit foreign currency gains and losses. His Honour had also said at [302], as was clearly the case, that the actual loan was in Australian dollars: see also [102], [105], [106], [113], [115] and [116]. There is no reason to depart from those findings and from his Honour's conclusion that the hypothetical agreement might reasonably have been expected to be in Australian currency.

135 A separate challenge to the assessments in relation to the 2006 to 2008 years which was considered by his Honour was to the effect that any determination which had been made under Division 13 of the 1936 Act ceased to be operative once the 2002 amended assessments were made under Division 815-A of the 1997 Act for those years. The subsequent assessments which had been made by the Commissioner in reliance upon Division 815-A of the 1997 Act were also challenged both on technical grounds and also on the basis of constitutional invalidity. It may be desirable to consider the impact on the assessments based on Division 13 of the assessments made in reliance upon subdivision 815 after first considering its terms and the challenge to the constitutional validity of its provisions.

136 The amended assessments issued by the Commissioner on 26 October 2012 in respect of each of the 2006 to 2008 tax years relied upon determinations made under s 815-30 of the 1997 Act. Division 815-A was enacted in 2012 by Act Number 115 of 2012 but was made to apply retrospectively to income years starting on or after 1 July 2004. It was subsequently replaced by subdivision 815-B to 815-D for income years commencing on or after 29 June 2013.

137 Section 815-10 permitted the Commissioner in the years in question to make a determination mentioned in subsection 815-30(1) for the purpose of negating a "transfer pricing benefit" within the meaning of s 815-15. On 24 October 2012 the Commissioner made determinations under s 815-30 for each of the three years of income ended 31 December 2005 to 31 December 2007, being the 2006 to 2008 income tax years (inclusive). The determinations for each year were in the same form as that for the year ended 31 December 2005, namely:

> **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).

The determinations in this form were to the effect of a determination under s 815-30(1)(a) of an amount by which the taxable income of CAHPL was increased and a further determination under s 815-30(2)(b) attributing the increase of the previous determination to a decrease in the interest deductions available to CAHPL in the relevant year of income.

138 The power of the Commissioner to make the determinations in s 815-30 was for the purpose of negating a transfer pricing benefit obtained by an entity. Section 815-15(1) relevantly set out the conditions to determine whether CAHPL had obtained a transfer pricing benefit. Section 815-15(1) provided:

> **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
>
> (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).

For present purposes there was no dispute that CAHPL was an Australian resident coming within the first requirement in s 815-15(1) but the parties disputed whether the conditions in (b) and (c) were satisfied with the consequential effect for the condition in s 815-15(1)(d).

139 Division 815 was enacted in 2012 but was made to apply retrospectively to income years starting on or after 1 July 2004. The Explanatory Memorandum accompanying the Bill in 2012 expressed the view that the retrospective enactment was justified, at least in part, by giving effect to what was said to be a long held view of the ATO which had been brought into doubt by the decision of *SNF*. CAHPL challenged the constitutional validity of Division 815 in its retrospective application.

140 CAHPL accepted that the Commonwealth parliament had power to enact tax legislation with some retrospective effect: see also *R v Kidman* (1915) 20 CLR 425; *Polyukhovich v Commonwealth* (1991) 172 CLR 501. It was contended, however, that the enactment of Division 815-A with retrospective effect was beyond the constitutional power of the Commonwealth because it imposed an arbitrary and incontestable tax. In its written submissions, and also in the notice of a constitutional matter given under s 78B of the *Judiciary Act 1903* (Cth), it was submitted that:

> The requirement that a tax not be arbitrary goes to both its criteria of application (which must satisfy the dual requirement of being ascertainable and sufficiently general in nature) and the manner of application of those criteria. Further, in terms of contestability, the question of present concern is not the availability of the judicial power of the Commonwealth to determine the dispute. This submission is not concerned with the spectre of the Legislature deciding its own competence (see *MacCormick* at 639-640) or with encroachment upon Chapter III. Contestability is employed in the sense of a taxpayer knowing the criteria for liability in the tax year in question.

CAHPL relied also upon an observation made extra judicially by Gordon J in "The Commonwealth's Taxing Power and Its Limits – Are We There Yet?" (2013) 36 *Melbourne University Law Review* 1037 where her Honour said at 1061-2:

> If the Commonwealth's position is the taxpayer should order their affairs subject to the Commonwealth's overriding right to subsequently enact retrospective legislation at a time and of a kind of its choosing, then it will inevitably face scrutiny. And if that's not the stated position of the Commonwealth, but the practical outcome of it, in passing retrospective legislation, the resulting legislation will inevitably face scrutiny.

The particular vice relied upon by CAHPL was that the retrospective effect of Division 815 was such that in the years in question it was not aware, and could not have been aware, of the criteria that would many years later become those for liability under Division 815 in the earlier years. In the 2007 to 2008 years the taxpayers did not know, and could not know, that they would come to be taxed in those years by reference to the criteria of the legislation enacted in 2012. It was also submitted that the criteria of liability were not ascertainable because whether or not an entity got a transfer pricing benefit within the meaning of s 815-15(1) was to be determined by reference to the documents covered by s 815-20 (to the extent relevant) which included the OECD guidelines. That was so because s 815-20 required considering the effect of subdivision 815 by reference to, amongst other documents, the OECD Model Tax Convention on Income and Capital and the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

141 It has long been accepted in Australia that the parliament may legislate to validate retrospectively the imposition of taxation before the passage of supporting legislation: see *The Colonial Sugar Refining Co Ltd v Irving* [1903] St R Qd 261, 76; *Suntory (Aust) Pty Ltd v Federal Commissioner of Taxation* (2009) 177 FCR 140. The ability of the parliament to enact laws with retrospective effect has been affirmed in the context of tax legislation: see *Mutual Pools & Staff Pty Ltd v Commonwealth* (1994) 179 CLR 155, 167-8, 209, 217-218.

142 In *MacCormick v Federal Commissioner of Taxation* (1984) 158 CLR 622 and *Deputy Commissioner of Taxation v Truhold Benefit Pty Ltd* (1985) 158 CLR 678 the High Court upheld the constitutional validity of prospective assessments based upon an existing liability arising from past events. The fact that the taxpayer upon whom the liability arose in *MacCormick* was not able to challenge an earlier liability was not found to make the tax either arbitrary or incontestable. The majority said at 639-642:

> The exactions in question answer the usual description of a tax. They are

compulsory. They are to raise money for governmental purposes. They do not constitute payment for services rendered: see *Matthews v. Chicory Marketing Board (Vict.)*, per Latham C.J.; *Leake v. Commissioner of State Taxation*, per Dwyer J. They are not penalties since the liability to pay the exactions does not arise from any failure to discharge antecedent obligations on the part of the persons upon whom the exactions fall: see *R. v. Barger* (57), per Isaacs J. They are not arbitrary. Liability is imposed by reference to criteria which are sufficiently general in their application and which mark out the objects and subject-matter of the tax: see *Federal Commissioner of Taxation v. Hipsleys Ltd* (58).

A further submission was made by the plaintiffs that recoupment tax under the relevant legislation is an incontestable tax and for this reason is beyond the power of the Parliament. Recognition is to be found in the cases of the doctrine that the incontestability of a tax may go to its validity. The principle which lies behind the doctrine is a more general one of elementary constitutional law. It is simply that the legislature cannot determine conclusively for itself its power to enact legislation by putting beyond examination compliance with the constitutional limits upon that power. As was pointed out in *Deputy Commissioner of Taxation v. Hankin* (59), the point is "that which was so much discussed in *Australian Communist Party v. The Commonwealth* (60), and which is sometimes expressed by saying that 'a stream cannot rise higher than its source'." In the latter case, Fullagar J. put the matter clearly when he said (61):

> "The validity of a law or of an administrative act done under a law cannot be made to depend on the opinion of the law-maker, or the person who is to do the act, that the law or the consequence of the act is within the constitutional power upon which the law in question itself depends for its validity. A power to make laws with respect to lighthouses does not authorize the making of a law with respect to anything which is, in the opinion of the law-maker, a lighthouse. A power to make a proclamation carrying legal consequences with respect to a lighthouse is one thing: a power to make a similar proclamation with respect to anything which in the opinion of the Governor-General is a lighthouse is another thing."

In other words, where, as is ordinarily the case under the Commonwealth Constitution, the validity of the law depends upon its characterization as a law with respect to a particular subject matter by reference to the criteria which the law itself fixes for its operation, the law cannot be so characterized if, in effect, it goes on to provide that it will have that operation regardless of whether those criteria are, in truth, satisfied.

The particular doctrine in relation to taxation was expressed by Dixon C.J. in *Deputy Federal Commissioner of Taxation v.Brown* (62), in these terms:

> "Although there is no judicial decision to that effect, it has, I think, been generally assumed that under the Constitution liability for tax cannot be imposed upon the subject without leaving open to him some judicial process by which he may show that in truth he was not taxable or not taxable in the sum assessed, that is to say that an administrative assessment could not be made absolutely conclusive upon him if no recourse to the judicial power were allowed."

See also per Williams J (63).

For an impost to satisfy the description of a tax it must be possible to differentiate it from an arbitrary exaction and this can only be done by reference to the criteria by which liability to pay the tax is imposed. Not only must it be possible to point to the

criteria themselves, but it must be possible to show that the way in which they are applied does not involve the imposition of liability in an arbitrary or capricious manner. In *Giris Pty. Ltd. v. Federal Commissioner of Taxation* (64) Kitto J. pointed out that the expression "incontestable tax" in the sense in which it is used in *Hankin and Brown* "refers to a tax provided for by a law which, while making the taxpayer's liability depend upon specified criteria, purports to deny him all right to resist an assessment by proving in the courts that the criteria of liability were not satisfied in his case". The purported tax is thereby converted to an impost which is made payable regardless of whether the circumstances of the case satisfy the criteria relied upon for characterization of the impost as a tax and for characterization of the law which imposes it as a law with respect to taxation. Such an incontestable impost is not a tax in the constitutional sense and a law imposing such an impost is not a law with respect to taxation within s. 51 (ii). It is in this sense that an incontestable tax is invalid.

However, the liability which the legislation imposes to pay recoupment tax is not incontestable in this sense. One of the criteria of liability for recoupment tax is a pre-existing, unpaid liability on the part of a target company to pay company tax. The fact that a person not liable to pay company tax but liable to pay a different tax in the form of recoupment tax has a limited right or no right at all to contest the liability of the relevant target company for company tax is not to the point. It is the existence of the overdue company tax which is one of the criteria of liability for recoupment tax and that existence is established once an assessment of company tax is made and any objection has been finalized for the period for objecting has expired and the tax remains unpaid at the relevant time. Liability to pay recoupment tax does not arise until these events have occurred and it arises only upon the assessment of those persons to whom the legislation applies. The assessment of those persons is open to the ordinary processes of review and appeal. This is because the 1982 Assessment Act incorporates the relevant parts of the *Income Tax Assessment Act* relating to the assessment and collection of tax, including review and appeal.

It would not be to the point if no right to contest the liability of a target company to pay company tax were given to those persons liable to pay recoupment tax upon the basis of the overdue company tax. The limited rights given to those persons to contest the liability of the company are, from the point of view of legality, gratuitous. If in a particular case the provisions have the effect that a person liable to pay the recoupment tax is unable to contest the liability of the target company, and the assessment of that liability was in fact incorrect, the result will be plainly unjust, but it will not mean that the recoupment tax is incontestable. Of course, it was not argued, nor could it be argued, that company tax is itself an incontestable tax. Liability to pay that tax arises upon the assessment of a company pursuant to the provisions of the *Income Tax Assessment Act* and in relation to that assessment the ordinary processes of review and appeal are open. Once those processes are complete or the time for taking them has expired, the existence of the company tax may be proved by recourse to s. 177(1) of the *Income Tax Assessment Act* which provides that production of a notice of assessment shall be conclusive evidence of the due making of the assessment and that the amount and all the particulars of the assessment are correct. That section does not, of course, apply in proceedings on appeal against the assessment of the company tax. The existence of that section does not make company tax incontestable nor was it suggested that it does.

(Footnotes omitted.)

In *Truhold* the majority observed at 686 that a tax is nonetheless a tax even though it may operate harshly upon those affected or upon those who might not have been in existence at the time of the transaction and who were made liable to pay recoupment tax.

143 The majority in *Roy Morgan Research v Federal Commissioner of Taxation* (2011) 244 CLR 97 endorsed what had been said in *MacCormick* and, at 111 [39], referred to what had been said in *Deputy Federal Commissioner of Taxation v Brown* (1958) 100 CLR 32 by Dixon CJ at 40, and explained that for an impost to satisfy the description of a tax "it must be possible to differentiate it from an arbitrary exaction" which "could only be done by reference to the criteria by which liability to pay the tax is imposed". In *MacCormick* it was said that it must not only be possible to point to the criteria themselves, but also to show that the way in which they are applied does not involve the imposition of liability in an arbitrary or capricious manner. In *Roy Morgan* the majority explained that these passages, sourced from what had been said in *Brown*, established that compliance with the Constitution required that liability for tax not be imposed without leaving open to the taxpayer some judicial process by which the taxpayer may show that in truth the tax was exigible or not exigible in the sum assessed: see 111, [39].

144 Division 815-A does not impose an arbitrary or incontestable tax in the sense contemplated by the authorities. It can be accepted for present purposes, as was submitted by CAHPL, that in the years in which CAHPL has been assessed under Division 815-A it could not have been aware of the criteria of liability in respect of those years which came only to be imposed by the subsequent enactment, with retrospective application, of Division 815-A. That circumstance, however, is inherent in the nature of retrospective legislation except, perhaps, in a practical sense of legislation purportedly validating acts taken in anticipation of legislation announced to be enacted. That a person may not be aware at an earlier point in time what the criteria of liability may subsequently be made to apply to that earlier point in time does not make the legislation arbitrary or incontestable in the sense considered in *Brown*, *MacCormick*, and *Roy Morgan*. The absence of an awareness as at the end of the year of liability of the criteria that would subsequently be adopted for the liability was relevantly present on the facts in *MacCormick* in which the liability of the taxpayers for recoupment tax was based upon the existence of unpaid tax from a previous year.

145 The criteria of liability under Division 815 is found in s 815-15(1) (quoted above) which sets out four criteria to determine whether an entity gets a transfer pricing benefit for the purposes

of the application of Division 815. The first requires a factual determination about whether the entity is an Australian resident. The second involves the construction of an international instrument to determine whether the requirements of the associated enterprise article for the application of that article to the entity have been met. In this case that required consideration of Article 9 of 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) ATS 16 Article 9 (entered into force 31 October 1983) ("United States Convention"): see s 815-20(5). In that context s 815-20 draws attention to certain documents for the purpose of interpretation of a provision of the international tax agreement in question to the extent that the documents are relevant. Section 815-20(1) applies an objective standard by reference to which regard is to be had to the documents referred to in s 815-20(2) with recourse to those documents only if relevant. Section 815-20 provided:

> 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.
>
> […]

The direction in s 820-20(1) to consider the documents referred in s 820-20(2) does not modify or alter the operative provisions in s 815-15 but is a direction given in aid of interpretation of the operative provision. That direction is for the purpose of interpretation, and applies only to the extent relevant, and does not render uncertain the criterion by which Division 815-15 is to apply. Section 815-20 would be severable if its effect were otherwise. The third requirement in s 815-15(1) depends upon a factual inquiry to determine (a) the amount of profits which have accrued and a prediction about what might have been expected to accrue but for the conditions mentioned in the relevant article applicable to the entity.

146 It was next submitted for CAHPL that assessments could not be made under Division 815 where there existed determinations under Division 13. The issue as raised before the trial judge of the relationship between Division 13 of the 1936 Act and Division 815 of the 1997 Act was described by his Honour at [29] that CAHPL's case had been that the Division 13 assessments ceased to be operative once the 2012 amended assessments had been made under Division 815. His Honour rejected that submission and accepted at [588] that the Commissioner could defend the assessments on an alternative basis. CAHPL challenged this conclusion on appeal and submitted that it was based upon an erroneous identification of what was said to be "the true inquiry; namely, whether as a matter of statutory construction, a Subdivision 815-A determination can be made where an assessment to give effect to a determination under Division 13 against the same taxpayer in the same year and in precisely the same amount has been made".

147 CAHPL's submission at first instance, as correctly recorded by his Honour at [586], and as maintained on appeal, was that there could be no "transfer pricing benefit" within the meaning of s 815-15 of the 1997 Act because 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". The reference in this provision to "this Act" included a reference both to the 1936 Act and to the 1997 Act as well as to the relevant provisions of the Administration Act. The argument for CAHPL was, therefore, that the deeming effect of s 136AD(3) excluded the possibility of any amount being included by subsequent inclusion of a transfer pricing benefit under Division 815.

148 It is true that the Commissioner made inconsistent determinations and gave effect to them by amended assessments but there was before the Court only one liability upon an assessment as amended. The appeals by CAHPL to this Court under s 14ZZ(1)(a)(ii) of the Administration

Act was of the Commissioner's objection decision made under s 14ZY on CAHPL's objection. The objection was made under s 175A of the 1936 Act which gave CAHPL an entitlement to object against an assessment in the manner set out in Part IVC of the Administration Act. In *Commissioner of Taxation (Cth) v S Hoffnung & Co Limited* (1928) 42 CLR 39 Isaacs J explained at 54 that the separate processes of assessment and amendment of an assessment did not produce two assessments saying:

> An "alteration or addition" is not something extraneous to a standing assessment. When an alteration or addition is made the assessment henceforth exists as *altered* or *added* to, and not as previously existing plus independent alteration or addition.
>
> [see also Commissioner of Taxation v Stokes (1996) 72 FCR 160 at 169].

The issue for determination in the objection decision before the Court was whether the assessment was excessive and the Commissioner was able to defend the liability imposed by the assessment upon alternative bases which may be inconsistent: see *Commissioner of Taxation v Australia and New Zealand Savings Bank Limited* (1994) 181 CLR 466; *Cadbury-Fry-Pascall* (1944) 70 CLR 362; see also *Hepples v Federal Commissioner of Taxation* (1992) 173 CLR 492. It is not uncommon to find different provisions being simultaneously operative to impose liability. Section 815-40 itself recognised this in providing against the possibility of double taxation and by contemplating the simultaneous operation of s 136AB of the 1936 Act and Division 815 of the 1997 Act. Neither provision is excluded from concurrent operation to supporting one liability imposed by an assessment.

149 CAHPL pointed to s 14ZZR in support of the submission that the assessments based upon Division 815 could not be made because they had been made at the time when s 14ZZR continued to give effect to the assessments which had been made based upon the Division 13 determinations. Section 14ZZR does not, however, have the effect of preventing the Commissioner from relying upon determinations in the alternative as he has done in this proceeding. Section 14ZZR provided:

> The fact that an appeal is pending in relation to a taxation decision does not in the meantime interfere with, or affect, the decision and any tax, additional tax or other amount may be recovered as if no appeal were pending.

Section 14ZZR preserves the Commissioner's ability to recover tax or additional tax pending an appeal by providing that the pending of an appeal under Part IVC of the Administration Act "does not in the meantime interfere with, or affect, the decision" from which the taxpayer may have objected and lodged an appeal. The efficacy of an assessment pending an appeal,

however, does not prevent the existence of an alternative basis upon which the decision may be defended by the Commissioner in the appeal by alternative determinations.

150 The need to consider the substantive application of Division 815 arises, as his Honour observed at [526], only in the alternative however it may be desirable to consider the issues raised in the appeal in deference to the arguments and his Honour's reasons. The explanatory memorandum accompanying the amendments effected by Division 815 explained that the measures were introduced following the decision in *SNF* in which it was considered, amongst other matters, that the Commissioner could not directly apply the provisions of the relevant treaty as an alternative basis for transfer pricing adjustments without domestic Australian legislation. Paragraph 1.15 of the explanatory memorandum explained that the amendments contained in Division 815 were intended to ensure that treaty transfer pricing rules might apply by operation of Division 815, alternatively to the operation of Division 13, if the law did not permit that as it stood.

151 The legislative mechanism to impose liability under Division 815, as set out above, depended in this case upon CAHPL getting a "transfer pricing benefit" within the meaning of s 815-15(1). The first requirement was satisfied by CAHPL being an Australian resident. The second requirement depended upon whether the requirements in the "associated enterprises article" for the application of that article to CAHPL had been met. Section 815-15(5) supplied the meaning of "associated enterprise article" which, in the present case, was Article 9 of 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* ("the United States Convention") which entered into force on 31 October 1983. Article 9(1) of the United States Convention provided:

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.

The requirements in Article 9(1) which needed to be met for its application in the present case directed attention to the relationship and conditions existing between two enterprises in their commercial or financial relations to determine whether "conditions operate[d]" between them 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". Section 815-15(1)(b) will be satisfied if those conditions are met.

152 The learned trial judge found that there were conditions operating between CAHPL and another enterprise which operated between them 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. At [582] his Honour said:

> 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.

It was submitted on appeal for CAHPL that his Honour erred in the identification of the conditions operating between CAHPL and CFC in their commercial or financial relations. It was submitted that his Honour erred in construing the conditions requirement of s 815-15 by rejecting CAHPL's distinction between "commercial and financial relations" and the "conditions" operating in respect of those relations, and that his Honour erred by not excluding common ownership as a condition operating between CAHPL and CFC in their commercial and financial relations.

153 The interpretation to be given to Article 9(1) in its application in s 815-15(1)(b) must be in accordance with the rules of interpretation applicable to a treaty provision: see *Thiel v Federal Commissioner of Taxation* (1990) 171 CLR 338. Article 9(1) was described in *SNF* at 109 as attempting "to address at a high level of generality the problems thrown up by transfer pricing by providing for pricing as if the transaction had been between independent parties". The purpose of Article 9(1), as explained in *SNF*, and its function through the operation of s 815-15(1)(b), is to identify those conditions existing between enterprises in two countries affecting their financial or commercial relations. The identification of those conditions permits a broad and wide ranging inquiry into the relations existing between the enterprises concerned. There is not excluded from that inquiry the relationship existing between the parties such as parent or subsidiary. The factual inquiry of the conditions operating between the enterprises which needs to be undertaken is unconfined by the terms of Article 9(1), or by the terms of s 815-15(1)(b), by any circumstance other than that there be identified those conditions which bear relevantly and probatively upon whether they operate between the relevant 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". His Honour was, therefore, permitted to take into consideration, as conditions, the relations between CAHPL and CFC, and of other members of the Chevron group, notwithstanding that they were also identified as preconditions in (a) and (b) in Article 9(1). Article 9(1) identified two preconditions to its application but it did exclude the preconditions, or any of the matters relevant to those preconditions, from being relevant also to an inquiry into whether the matters within those preconditions (namely the relations existing between the relevant enterprises) were part of the conditions operating in

the way contemplated by Article 9(1). In broad terms the structure of Article 9(1) may be seen in part to call for an inquiry into whether the circumstances in (a) and (b) give rise to the conditions "operating" which differ from those which might be expected to "operate" between independent parties. The relations existing between the enterprises are apt to be conditions that potentially operate upon the dealings between, and which bear upon, the inquiry into whether there are conditions operative of the kind contemplated. The matters identified by his Honour at [582] may fairly be said to be conditions which existed between CAHPL and CFC which operated between them which differed from those that might be expected to operate between independent parties dealing wholly independently with one another in respect of the loan.

154 The third condition in s 815-15(1)(c) was that an amount of profits had not accrued which might have been expected to accrue to CAHPL but for the conditions mentioned in the Article. His Honour found that this condition was satisfied; that is, that an amount of profits did not accrue to CAHPL that might have been expected to accrue to CAHPL but for the conditions mentioned in Article 9(1). At [614] his Honour said:

> Having rejected the applicant's submissions, primarily submissions as to the proper construction of Art 9 and of Subdiv 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 Div 13 of the ITAA 1936.USD

CAHPL submitted that his Honour erred in this conclusion in part by reason of the construction of s 815-15 considered and rejected above. CAHPL also submitted, however, that his Honour erred in concluding that the profits requirement in s 815-15(1)(b) was satisfied by denying the necessity for a causative relationship between the conditions and the non-accrual of profits, and by not taking into account the fact that CAHPL received dividends from distributions made by CFC.

155 Section 815-15(1)(c) contemplated a relationship between the non-accrual of profits and the conditions mentioned in Article 9 by reference to a "but for" test. The determination of factual causation by reference to a "but for" test has been said to require the determination of

whether something was "a necessary condition" of the "occurrence": see *Wallace v Kam* (2013) 250 CLR 375 at 383, [16]; *Strong v Woolworths Limited* (2012) 246 CLR 182 at 191, [20]; *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506 at 515-6. In this case the inquiry about the existence of such a causative relationship (in that sense) required an evaluative judgement about whether the conditions mentioned in Article 9(1) were necessary conditions for the non-accrual of profits which might have been expected to accrue. The function of the condition in s 815-15(1)(c) is to determine those profits which had been excluded from assessability and is the legislative equivalent of the words found in Article 9(1), namely, that profit "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". Article 9 goes on to provide that the contracting state, in this case Australia, may provide for the inclusion, and for taxation of the domestic enterprise, on those profits which had not accrued by reason of the conditions found to be operating between the enterprises that had differed from those that might be expected to operate between independent enterprises dealing wholly independently with one another.

156 The evaluative judgment required by Article 9 required comparing the conditions which operated between CAHPL and CFC with those expected to operate between "independent enterprises" but that did not require his Honour to compare CAHPL and CFC with a wholly standalone company. The purpose of the comparison is to determine whether profits have not accrued for tax in a jurisdiction which "might have been expected to accrue" but for the condition found to operate. His Honour was correct to reject CAHPL's contention that an "independent" company within Article 9 was a company which stood alone with no corporate affiliations. At [604] his Honour said:

> 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.

The comparison which Article 9 required to be undertaken is akin to that contemplated by Division 13. The object was to determine whether conditions actually prevailing between the relevant enterprises differed from those which might be expected to operate if they had been independent and had been dealing wholly independently with each other. The hypothetical in that exercise is undertaken for the purpose of determining whether the dealing which actually occurred might have been expected to occur on different terms. That will generally require that the parties in the hypothetical will generally have the characteristics and attributes of the actual enterprises in question. The comparison required by Article 9 is expected to be undertaken in a practical business setting of potential transactions able to be entered into and which are to be used as a basis for a reliable hypothesis upon probative material. Ultimately the question was that of determining whether profits might have been expected to accrue to CAHPL if the transaction it entered into with CFC had been entered into where the conditions which operated between CAHPL and CFC did not operate, that is, where CAHPL and CFC had been dealing with each other wholly independently. The hypothetical thus required hypothesising circumstances in a dealing between an enterprise like CAHPL and an enterprise like CFC where, however, the conditions operating between them were between independent enterprises dealing wholly independently with each other. That is not to say that Division 815A, or Article 9(1), strikes down intracompany dealings which are not at arm's length, because neither Division 815A nor Article 9(1) operates unless the relevant transaction causes (in the relevant sense) the non-accrual of an amount of profits in a contracting state in which it would have accrued if the transaction had been at arm's length between independent parties. The fiscal policy which Division 815 and Article 9 express is not directed to intracompany non-arm's length dealings but only to those intracompany non-arm's length dealings which have a fiscal effect of reducing the tax that would otherwise have been expected to accrue in a contracting state. His Honour was correct to assume on the evidence that what might be expected to operate between independent enterprises dealing wholly independently with each other was a loan by CAHPL with security provided by its parent at a lower interest rate.

157 CAHPL next submitted that s 815-15(c) had not been satisfied because there was no amount of profits which had not accrued. In that regard CAHPL drew attention to the fact that it had received dividends from CFC albeit that they were non-assessable non-exempt income under s 23AJ of the 1936 Act. It was also submitted by CAHPL that the Commissioner may erroneously have considered the word profits in Article 9(1) to mean taxable income rather

than to have been used in a more generic sense. Section 3(2) of the *International Tax Agreements Act 1953* (Cth) provides:

> 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.

This provision applies also to the United States Convention but it does not result in the conclusion that the word "profits" appearing in s 815-15(1)(c) or in Article 9 is to be read so as to confine the inquiry required by s 815-15(1)(c) or Article 9.

158 His Honour was correct at [611]-[614] to reject CAHPL's submission that there had been no profits which had not accrued within the meaning of s 815-15(1)(c) or Article 9(1). Section 815-15(1)(c) postulates that a consequence of the presence of the conditions in Article 9 was that "an amount of profits" which might have been expected to accrue did not accrue. The word "profits" in the provision and in Article 9 is used in a more generic sense than "taxable income". The focus of the provision is the tax effect of a dealing not the overall income of a taxpayer. The specific focus in s 815-15(1)(c) is whether "an amount" of profits had not accrued, just as the focus of Article 9(1) is whether "any profits" had not accrued. There is no basis in the text of the provisions or in the policy they express to equate the profits referred to with the taxable income of the taxpayer. The fact that CAHPL received dividend income may be relevant in evaluating what might be expected to accrue in the particular facts in question but it does not result in the conclusion that there was no amount of profits which did not accrue by reason of the conditions mentioned in Article 9 for the purposes of s 815-15(1)(c). The condition was satisfied by reason of an amount of profits not accruing but for the conditions mentioned in Article 9.

159 The appeal should be dismissed.

I certify that the preceding sixty-one (61) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Pagone.

Associate:

Dated: 21 April 2017