Commissioner of Taxation v Glencore Investment Pty Ltd -

Decision impact statement

Commissioner of Taxation v Glencore Investment Pty Ltd

Court citation(s):	[2019] FCA 1432; [2020] FCAFC 187; [2021] HCA Trans 098
Venue:	Federal Court of Australia Full Federal Court of Australia High Court of Australia (special leave application)
Venue reference no:	NSD 1679/2017; NSD 1900/2017; NSD 1956/2017 NSD 1636 of 2019; NSD 1637 of 2019; NSD 1639 of 2019 S223/2020 – S225/2020
Judge name(s):	Davies J Middleton, Steward and Thawley JJ Gordon J and Kiefel CJ (special leave application)
Judgment dates:	3 September 2019 6 November 2020 21 May 2021 (special leave decision)
Appeals on foot:	No
Decision outcome:	Mostly unfavourable to the Commissioner

Impacted advice

This decision has no impact on any related advice or guidance.

Précis

This Decision impact statement outlines the ATO's response to this case, which concerned the construction and application of the transfer pricing provisions contained in Division 13 of the *Income Tax Assessment Act 1936* (ITAA 1936) and Subdivision 815-A of the *Income Tax Assessment Act 1997* (ITAA 1997) to amendments made in February 2007 to the terms of a sale agreement between Cobar Management Pty Ltd (CMPL) and its ultimate Swiss parent, Glencore International AG (GIAG). CMPL is a wholly-owned Australian subsidiary of Glencore Investment Pty Ltd (GIPL) and operator of the CSA copper mine (CSA mine) located in Cobar, New South Wales. These amendments affected CMPL's profits from the sale to GIAG of all the copper concentrate produced at the CSA mine during the period from February 2007 to 31 December 2009 (2007 to 2009 years).

Brief summary of relevant facts

The CSA mine was acquired by the Glencore group in 1998 and has been operated and managed by CMPL since 1999.

GIAG purchased all the copper concentrate produced at the CSA mine from CMPL which it then traded, mostly to smelters. The purchases were made under a series of 'life of mine offtake agreements', the first of which was entered into between GIAG

and CMPL in mid-1999 and which had since been replaced and amended from time to time.

Up until February 2007, the offtake agreements had been structured as 'market-related' agreements. In February 2007, CMPL and GIAG amended their existing agreement to introduce a pricing method known in the copper concentrate industry as 'price sharing', which significantly altered the method of calculation of the price to be paid to CMPL for its copper concentrate.

Some of the amendments made in February 2007 included:

- the calculation of the treatment and copper refining charges (TCRCs), which reduced the price to be paid by GIAG to CMPL for the copper concentrate, was no longer to be determined by reference to the benchmark and spot market for TCRCs and was instead to be fixed at 23% of the copper reference price for three years, and
- GIAG was provided with increased optionality in selecting the 'quotational period' used to determine the average applicable copper price, which impacted the ultimate price to be paid by GIAG to CMPL for the copper concentrate. This included 'back-pricing', which permitted GIAG to select the period after knowing the price for at least one of the periods.

For the 2009 year only, by way of written addendum, GIAG and CMPL also set higher freight rates by reference to the cost of shipments to India rather than by reference to the cost of shipments to China, Japan and/or the Philippines (which were historically the more frequent destinations for almost all of the copper concentrate sold by CMPL to GIAG).

After an audit, the Commissioner issued amended assessments in May 2013 to GIPL, as the head company of a multiple entry tax consolidated group that included CMPL, for the 2007 to 2009 years. The amended assessments were issued on the basis of determinations made by the Commissioner pursuant to Division 13 of the ITAA 1936 and Subdivision 815-A of the ITAA 1997 to, inter alia, increase the consideration paid by GIAG to CMPL for the copper concentrate purchased by GIAG from CMPL for those income years. The increased consideration included the effect of substituting the 23% price sharing mechanism with a market-based TCRC calculation (akin to that previously used by the parties) and substituting the increased quotational period optionality afforded to GIAG with the use of a consistent quotational period annually.

GIPL objected to the amended assessments; those objections were subsequently disallowed by the Commissioner and the disallowed objection decisions were appealed by GIPL to the Federal Court.[1]

On 3 September 2019, Davies J handed down a wholly unfavourable decision against the Commissioner, who then appealed her Honour's decision to the Full Federal Court. On 6 November 2020, the Full Federal Court allowed the Commissioner's appeal in part, but only in respect of the freight matter for the 2009 year. On 21 May 2021, the High Court decided to not grant the Commissioner special leave to appeal against the balance of the Full Federal Court's decision.

[1] In the objection decision and the Federal Court appeal, the Commissioner argued an additional ground that the freight terms agreed to by CMPL and GIAG also did not reflect arm's length terms.

Issues decided by the Court

The judgment of the Federal Court at first instance[2]

The Commissioner's primary case, based on expert evidence, was that an entity with the relevant attributes and in the position of CMPL, supplying copper concentrate to an independent counterparty with which it was dealing wholly independently, would not have agreed to a three-year 23% price sharing mechanism, the increased quotational period optionality and the revised freight terms for the relevant period.

GIPL's case, also based on expert evidence, was that the relevant terms which the Commissioner took issue with were terms that existed in contracts for the sale of copper concentrate between independent parties in the same industry and with some of the same characteristics as CMPL and GIAG; and were therefore terms that might be expected to be found in an arm's length agreement that was absent of any relational bias.

In refuting the Commissioner's primary case, Davies J found at [314] that '… the Commissioner's approach impermissibly restructures the actual contract entered into by the parties into a contract of a different character', and at [317] that:

> … any restructuring of the actual agreement for the purposes of the comparative analysis is limited to the two exceptional cases outlined in the 1995 Guidelines, each being instances where the form of the transaction adopted by the parties "rather than be determined by normal commercial conditions ... may have been structured by the taxpayer to avoid or minimise tax".

Her Honour went on to conclude at [319–322] that as the present case did not fall within either of the exceptions referred to in the 1995 OECD Guidelines, there was no ability for the Commissioner to restructure the amendments made in February 2007 from a price sharing contract to a market-related contract for the purposes of determining the extent to which the non-arm's length dealing affected CMPL's profits.

In the alternative, her Honour found that GIPL had discharged its onus of proof and that she was satisfied on the evidence that the terms operating between CMPL and GIAG to calculate the price at which CMPL sold its copper concentrate to GIAG were ones which might reasonably have been expected between independent parties, in the position of CMPL and GIAG, dealing with each other at arm's length and the consideration received by CMPL was also one which might reasonably have been expected between such parties.

The judgment of the Full Federal Court on appeal

On appeal, the Full Federal Court ultimately decided against the Commissioner, except in respect of the freight matter for the 2009 year. Middleton and Steward JJ delivered a joint judgment and Thawley J delivered a separate judgment, but all three judges agreed on the ultimate outcome.

Restructuring

The Full Federal Court disagreed with, and overturned, Davies J's conclusion that the Commissioner was 'impermissibly restructuring the contract' and instead held that, under both Division 13 of the ITAA 1936 and Subdivision 815-A of the ITAA 1997, the Commissioner could substitute terms that resulted in a different formula or a different methodology to be utilised in order to ascertain the arm's length consideration.

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[2] *Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* [2019] FCA 1432.

Middleton and Steward JJ observed at [155–156] that those terms which 'define the price' could be substituted under Division 13 of the ITAA 1936 and Subdivision 815-A of the ITAA 1997 and also that, under Subdivision 815-A:

> In respect of the conditions in an agreement that only indirectly bear upon price, the extent to which the Commissioner can substitute different conditions if he considers that those conditions differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another is a question for another day.

Thawley J, however, disagreed with their Honours and observed at [267] and [296–298] that that there was no justification in limiting the terms or conditions that may be substituted under Division 13 of the ITAA 1936 and Subdivision 815-A of the ITAA 1997 to only those which directly 'define the price'.

In reaching their view, Middleton and Steward JJ also observed at [153] that the OECD Guidelines:

> … are only a guide as to how a revenue authority or a taxpayer might apply the "arm's length principle", or how an O.E.C.D. member country might enact the "arm's length principle" into domestic law. In that respect, the various statements of abstract principle that may be found in the Transfer Pricing Guidelines may be contrasted with the much greater discipline and rigour in drafting that is usually found in domestic legislation. Of course, Subdiv. 815-A obliges the Court to work out whether an entity has got a transfer pricing benefit consistently with these Guidelines, *but* only to the extent they are relevant.

Pricing

Nevertheless, the Full Federal Court went on to hold that GIPL had discharged its onus of proof by establishing on the evidence that the actual pricing terms that applied between CMPL and GIAG in the 2007 to 2009 years, other than in respect of the freight terms in 2009, were ones that might reasonably have been expected between independent parties, with some of the same relevant objective characteristics as CMPL and GIAG, dealing at arm's length.

In reaching their conclusion, Middleton and Steward JJ relied heavily on the taxpayer's expert evidence, provided by Mr Wilson. Their Honours accepted Mr Wilson's expert evidence that the relevant terms set in February 2007, which were in dispute, were commercially prudent for the parties to adopt, existed in the relevant industry between independent parties with some of the same relevant objective characteristics as CMPL and GIAG and ultimately were a matter of commercial judgment having regard to the particular risk appetite of a particular mine. Although no evidence was led about CMPL's particular risk appetite, their Honours concluded at [191] that:

> The failure by C.M.P.L. to lead evidence about its actual risk appetite or that of G.I.A.G. or the broader Glencore Group did not foreclose C.M.P.L.'s ability to lead expert evidence more generally about, and make submissions concerning, what independent enterprises might have done to address the issue of risk.

Thawley J separately concluded at [264], [271] and [295] that, on the facts as found by the primary judge, GIPL had established that the relevant terms were ones which might reasonably have been expected between independent parties in the position of CMPL and GIAG dealing at arm's length and that the consideration for the supply of the copper concentrate on those terms was also one which might reasonably have been expected between such parties.

Lastly, in respect of the freight matter for the 2009 year, the Full Federal Court decided this issue in the Commissioner's favour as it found that no evidence was led at all to establish why the freight rates adopted for this year were ones that might

reasonably have been expected between independent parties with the same relevant objective characteristics as CMPL and GIAG (including their shipping history), dealing at arm's length.

The High Court's reasons for not granting special leave to the Commissioner

The Commissioner applied for special leave to appeal from the High Court[3] on the basis that the Full Federal Court misconstrued the 'arm's length principle' applicable under Division 13 of the ITAA 1936 and Subdivision 815-A of the ITAA 1997, and that the taxpayer did not discharge its onus of proof because it failed to lead evidence of the dealing that was likely to have been entered into between CMPL and GIAG if they had dealt with each other at arm's length.

In refusing the Commissioner's application, Kiefel CJ stated:

> The Commissioner seeks to overturn findings of fact upheld by the Full Court below. In our view no question of principle sufficient to warrant a grant of special leave arises.

ATO view of decision

Appropriate degree of depersonalisation

The Commissioner does not accept that this case narrows the extent by which a comparable hypothesis is to be personalised, nor that it sets a standard for 'depersonalisation'. While Middleton and Steward JJ considered at [187] the appropriate degree of depersonalisation relevant to the application of Division 13 of the ITAA 1936 and Subdivision 815-A of the ITAA 1997 to the particular facts and circumstances, in doing so their Honours took into account relevant objective characteristics of the parties.[4]

Consistent with the High Court's reasons in rejecting the Commissioner's application for special leave to appeal, the Commissioner accepts that the endorsement by Middleton and Steward JJ at [170–175] of particular passages from the judgments of Allsop CJ and Pagone J in *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 (*Chevron*)[5] demonstrates that there is neither inconsistency in the application of the arm's length principle nor the tests to be applied in respect of Division 13 of the ITAA 1936 and Subdivision 815-A of the ITAA 1997 between the Full Federal Court's decision in this case and the Full Federal Court's decision in *Chevron*.

Rather, the outcomes in the two cases were reached after a consideration of all the evidence before the respective Courts in each instance.

Evidence

The Commissioner considers that it will always require a careful examination of the totality of evidence available to best establish the arm's length consideration or the

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[3] *The Commissioner of Taxation of the Commonwealth of Australia v Glencore Investment Pty Ltd* [2021] HCATrans 98.

[4] Note further their Honours' support at [170] of Allsop CJ's proposition from *Chevron* that '… the inquiry does not necessarily require the detachment of the taxpayer as one of the independent parties to the hypothetical transaction', and (at [175]) Pagone J's proposition from *Chevron* that '…the actual characteristics of the taxpayer must "serve as a basis" in the comparable agreement'.

[5] The endorsed passages at [170–175] regarding *Chevron* were [43–45] and [48] from the *Chevron* judgment of Allsop CJ, and [119] and [128] from the judgment of Pagone J. The Commissioner considers that the statements of principle contained in those passages from the respective judgments in *Chevron*, as well as the statements of principle contained in paragraphs [50–51], [65] and [91] from the judgment of Allsop CJ and paragraphs [129], [153] and [156] from the judgment of Pagone J, are to be applied to the totality of evidence available in any given case.

arm's length conditions that might reasonably have been expected to operate in any given case.

Depending on the particular case, the totality of evidence available might include evidence about all of the relevant objective circumstances of the actual parties in the actual market at the relevant time, relevant group policies, how the taxpayer and its group might have contemporaneously dealt with third parties for the same or similar transaction, the prevailing contemporaneous practices in the relevant industry, and what other independent entities in the same or similar contemporaneous circumstances as the taxpayer and the counterparty might reasonably have been expected to have done.

Also, where a taxpayer relies solely on the opinion of an expert as to what independent parties in the same industry might reasonably have been expected to have done, that may not be considered to be sufficient by the Commissioner to discharge their onus of proof depending on the totality of evidence available. Although such expert evidence was found to be relevant and ultimately accepted by Middleton and Steward JJ in this case, as their Honours observed at [180] and [191], evidence about the Glencore group's policies or its risk appetite might also have been relevant had it been before the Court.[6]

Similarly, if a taxpayer seeks to rely on agreements that exist in the broader industry between independent parties that are not comparable but may establish general 'reference points', it will not be accepted that such agreements alone are sufficient to establish arm's length conditions and arm's length consideration. As observed by Middleton and Steward JJ at [193], agreements that are not truly comparable '… cannot be determinative of the application of Div. 13 or Subdiv. 815-A to the facts…'. Again, the totality of evidence available, including any 'truly comparable' agreements[7], will need to be considered in establishing relevant arm's length conditions and arm's length consideration.

Reconstruction

The Commissioner agrees with the Full Federal Court's conclusion that he was not impermissibly restructuring or reconstructing the relevant contract in this case. Moreover, as observed by Thawley J, the Commissioner agrees that there is no justification in the statutory language to limit the terms and conditions that can be substituted under Division 13 of the ITAA 1936 and Subdivision 815-A of the ITAA 1997 to only those that 'define the price'.

Subdivision 815-B of the ITAA 1997

There are textual differences between the statutory tests in Subdivisions 815-A and 815-B of the ITAA 1997, which may bear upon how relevant the decisions in this case and *Chevron* are to how Subdivision 815-B is ultimately applied by a court.

In particular:

- section 815-125 of Subdivision 815-B defines 'arm's length conditions' with specific reference to independent parties dealing wholly independently with one another in 'comparable circumstances' and a non-exhaustive list of relevant factors to which regard must be had in identifying those comparable circumstances is provided, and
- section 815-130 of Subdivision 815-B sets out a 'basic rule' and 'exceptions' framework for how the arm's length conditions are to be

[6] Note by way of contrast that in *Chevron*, evidence about group policies and group behaviour was considered highly relevant by the Court to the task of establishing arm's length consideration and arm's length conditions.

[7] See [121–122] of *Commissioner of Taxation v SNF (Australia) Pty Ltd* [2011] FCAFC 74.

identified and in what circumstances the identification of the arm's length conditions is to be based on the 'actual commercial or financial relations'.

Implications for impacted advice or guidance

This decision has no implication on any related advice or guidance.

Comments

We invite you to advise us if you feel this decision has consequences we have not identified. Please forward your comments to the contact officers by the due date.

Date issued	28 September 2021	
Due date:	29 October 2021	
Contact officers:	Helen Kelly	Nitin Gulati
Email address:	helen.kelly@ato.gov.au	nitin.gulati@ato.gov.au
Phone:	(07) 3213 5482	(03) 9285 1661

Legislative references

Income Tax Assessment Act 1936
Div 13

Income Tax Assessment Act 1997
Subdiv 815-A
Subdiv 815-B
815-125
815-130

Case references

Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCAFC 62; 345 ALR 570; 251 FCR 40
Commissioner of Taxation v Glencore Investment Pty Ltd [2020] FCAFC 187; 384 ALR 252; 281 FCR 219
Commissioner of Taxation v SNF (Australia) Pty Ltd [2011] FCAFC 74; 193 FCR 149; 82 ATR 680
Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia [2019] FCA 1432; 272 FCR 30
The Commissioner of Taxation of the Commonwealth of Australia v Glencore Investment Pty Ltd [2021] HCA Trans 98