THE TAX INSTITUTE

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Dear Ms Kelly and Mr Gulati,

Decision Impact Statement - *Commissioner of Taxation v Glencore Investment Pty Ltd*

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office (**ATO**) in relation to the Decision Impact Statement - *Commissioner of Taxation v Glencore Investment Pty Ltd* (**DIS**).

The decision in *Commissioner of Taxation v Glencore Investment Pty Ltd* (***Glencore***) is of interest to taxpayers because it provides practical guidance on the approach to, and categories of, evidence they must produce to show that a transaction was on arm's length terms for the purposes of transfer pricing. Compliance with the arm's length requirement for transfer pricing purposes is a factually difficult area of the law and requires a significant investment of resources by taxpayers to ensure that they can satisfy the relevant evidentiary standards.

The Tax Institute is of the view that the *Glencore* case provides opportunities for the ATO to provide greater clarity on these matter in the DIS. We consider that advice or guidance by the ATO that clarifies or reduces this evidentiary burden can significantly reduce taxpayer compliance costs. It will also ensure taxpayers provide only relevant information to the ATO, thereby potentially reducing administrative resources required by the ATO to examine arm's length transactions for these purposes.

Our detailed response is contained in **Appendix A**.

We would be pleased to continue to work with the ATO on any amendments to the DIS.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more about The Tax Institute.

If you would like to discuss any of the above, please contact Associate Tax Counsel, Abhishek Shekhawat, on 02 8223 0013.

Yours faithfully,

Peter Godber

President

APPENDIX A

Proof of taxpayer's intentions

The Tax Institute is of the view that the DIS should more clearly articulate the particulars of the relevant onus taxpayers are required to prove when contending that the consideration in a particular transaction was on arm's length terms for the purposes of transfer pricing. Specifically, further clarity should be provided around potential requirements of ensuring that the relevant transaction was the most profitable available.

At paragraph [182], Middleton and Steward JJ (the majority) in *Glencore* stated:

> *'… It also follows that there is likely to be more than one price which is an arm's length price. In that respect, a taxpayer is under no obligation to choose a pricing methodology which pursues profitability in Australia at the expense of prudence. There is no obligation to "maximise" profitability at the expense of all else.'*

We consider that their Honours' comments should be reflected in the DIS to give taxpayers certainty and comfort on this point. That is, when more than one pricing option is available, taxpayers are not required to demonstrate why they chose a particular pricing methodology that does not maximise their profits compared to another. Their Honours' comments indicate that it is sufficient that a third party would have considered that pricing methodology and that factors other than profitability may need to be considered. This clarification would better allow taxpayers to allocate their limited resources towards key issues, namely, gathering evidence to demonstrate that independent parties dealing at an arm's length would also have entered into the arrangement in question.

It would be helpful to taxpayers if the DIS could also confirm the approach to be taken when gathering evidence to demonstrate this commercial rationale described above. The majority held at paragraph [186]:

> *'Finally, in applying the foregoing a degree of flexibility and pragmatism is required. Whilst the onus remains on the taxpayer to discharge its onus of proof of demonstrating excessiveness in the amended assessments, one should not apply Div. 13, or indeed Subdiv. 815-A, narrowly. Predicting how independent parties dealing at arm's length with each other would price a wholly controlled transaction is a difficult and complex issue. That is especially so when one integer which here directly affects the consideration payable is the formation of a commercial judgment about risk taking. The Court should acknowledge, and take into account, the practical difficulties faced by both the taxpayer and the Commissioner in finding evidence that grounds what is sufficiently reliable, or which demonstrates that something is insufficiently reliable. The answer is not always to be found in overly lengthy and complex expert reports. Common sense is required.'*

Specifically noting evidentiary difficulties and the need for a common sense approach could minimise compliance costs for the taxpayer, while reflecting the importance of the commercial rationale in determining whether a transaction was on arm's length terms.

Acceptable evidence

We also consider that the DIS should provide additional detail as to the types of evidence the courts have considered to be acceptable to demonstrate that a transaction was on arm's length terms. As noted by the majority in *Glencore*, the question of arm's length pricing for transfer pricing purposes is a factually difficult question for taxpayers and the Commissioner. As a result, transfer pricing compliance can be exceptionally costly for all involved. Providing advice on the permissibility and reliance on certain types of evidence can assist towards reducing these compliance and administration costs.

The use of expert evidence and reference points

The DIS expresses the Commissioner's view that sole reliance on expert evidence and reference points are insufficient to demonstrate that independent parties at an arm's length would have entered into the same arrangements. However, we consider that further clarity is required on the circumstances in which expert evidence and reference points would demonstrate an arm's length dealing. The DIS could also provide advice on the appropriate level of detail or other particulars that can be used to sufficiently demonstrate an arm's length dealing.

In practice, it is not uncommon for there to be no comparable uncontrolled prices (**CUPs**) to support the commerciality of the transaction. In the absence of appropriate CUPs, taxpayers are generally only able to rely on expert evidence, comparable reference points and market reports (among other sources), to evidence that independent parties dealing at an arm's length would also have entered into the same arrangement on comparable terms.

The majority in *Glencore* endorsed the use of such industry data as a sufficient basis for determining the range of acceptable profit-sharing rates in circumstances where no CUPs are available, including the copper mining industry. Their Honours noted at paragraph [203] that:

> *'In the circumstances, picking a mid-point in the Brook Hunt data was sound. It was a sufficiently reliable choice and accorded with common sense. In that respect, the Court must take care not to make the task of compliance with Australia's transfer pricing laws an impossible burden when a revenue authority may, years after the controlled transaction was struck, find someone, somewhere, to disagree with a taxpayer's attempt to pay or receive arm's length consideration.'*

Their Honours also provided an analysis of how comparable reference points can be used to determine the reasonableness of an arm's length value. It was held at paragraph [193] that:

> *'The contracts were valid "reference points" both for the purpose of considering the type of pricing formula chosen by C.M.P.L. and G.I.A.G. under the C.M.P.L.-G.I.A.G. agreement, and also, in a more general sense, both the rate of price sharing and the detail of the quotational period optionality which was selected. The contracts were a sounding board. They confirmed the joint opinion of the experts that there was nothing in the pricing formula adopted from February 2007 that did not also exist in contracts between independent market participants. They also demonstrated that price sharing of 23% was not out of the market. Because of the differences identified by the Commissioner, the contracts cannot be determinative of the application of Div. 13 or Subdiv. 815-A to the facts here. However, the matters identified above demonstrate that the contracts were relevant and admissible pursuant to ss. 55 and 56 of the Evidence Act 1995 (Cth.), notwithstanding the differences identified by the Commissioner. Although one is directed by s 815-20 of the 1997 Act to have regard to the Transfer Pricing Guidelines for the purposes of Subdiv. 815-A, the relevant standard for admissibility prescribed by ss. 55 and 56 remains the same under that Subdivision.'*

This indicates that market reports may be used as a sound basis for arriving at a range of acceptable prices for independent parties transacting at arm's length. Notably, the details of the reports and contracts, and how they align with market expectations, can provide the foundations for determining if there was or was not an arm's length dealing under a common sense approach. Their Honours' findings also indicate that reference points from contracts, although not directly comparable, may be taken together with expert evidence to establish that independent parties dealing at arm's length would also have entered into the same arrangement at issue.

Although the DIS indicates that the Commissioner considers the totality of the evidence, it would be helpful to articulate the evidentiary value of different types of information to which taxpayers may have access. This would reduce the level of uncertainty and compliance costs for taxpayers as it would provide greater awareness of the information which the Commissioner considers acceptable in these situations.

Evidence about the specific taxpayer's risk appetite

We also consider that the DIS should expressly state that taxpayers are not required to produce evidence about their particular risk appetite.

In *Glencore*, the majority held at paragraph [191] that:

> *'…because risk and the pricing formula were inextricably bound up with each other, it was open for either party to lead evidence about how independent enterprises dealing wholly independently with one another might be expected to have assessed the issue or issues of risk as at February 2007. 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.*

Although evidence was presented about the taxpayer's risk appetite in *Glencore*, it was not vital to establishing that the terms and conditions of the transaction at issue were at an arm's length. Stating this in the DIS will help to ensure that taxpayers only provide relevant evidence to the Commissioner, again potentially reducing compliance and administrative resources.

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 11,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.