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Chevron Australia loses Full Federal Court appeal – it's all about the evidence of what independent parties would have done

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The Full Federal Court has given the Commissioner of Taxation another significant win in its ongoing battle with Chevron Australia in relation to the transfer prices it used on certain cross-border related party loans with all three judges finding for the Commissioner. A copy of the judgement is available here.

The decision in *Chevron Australia Holdings Pty Ltd (CAHPL) v Commissioner of Taxation [2017] FCAFC 62*, delivered on Friday 21 April 2017, has implications not only for taxpayers with cross-border related party financial dealings but also taxpayers with other broader cross-border related party dealings.

The case concerns the transfer pricing implications of an intercompany loan agreement between CAHPL and its US subsidiary Chevron Texaco Funding Corporation (CFC) and whether the interest paid by CAHPL to CFC exceeded an arm's length price for the borrowing.

At first instance *(Chevron Australia Holdings Pty Ltd (No.4) v Commissioner of Taxation [2015] FCA 1092)*, the Federal Court had found that Chevron Australia had not discharged the onus of proof that the amended assessments raised by the Commissioner under *Division 13 of Part III ITAA 1936* and *Subdivision 815-A ITAA 1997* were excessive.

Key matters addressed by the Full Federal Court included the following:

Division 13

- The 'property' acquired by CHAPL:

  The Full Federal Court agreed with the judge at first instance that the property acquired by CAHPL "was the rights or benefits granted or conferred under the Credit Facility, including the sums lent". The absence of security being provided by CAHPL to CFC under the Credit Facility was more aptly to be seen as part of the consideration given by CAHPL.

- The 'consideration' given by CHAPL

  Consideration 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.

- The meaning of 'arm's length consideration':

  In determining arm's length consideration in the context of this case, the matter should be approached from the perspective of 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. 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 it 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.

- The hypothetical construct (ie an agreement between independent parties dealing at arm's length)

  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. 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.

Subdivision 815-A

- Held that Subdivision 815-A did not impose an arbitrary or incontestable tax and therefore was not constitutionally invalid.

Other matters

The Full Federal Court spent little time dealing with a range of other matters raised in the appeal including some that are currently very topical in transfer pricing disputes with the ATO at the present time, for example:

- Whether the proper currency of the loan between CFAFC and CFC was Australian dollars or United States dollars – the Full Federal Court accepted the findings of the judge in relation to the evidence presented at first instance.

KPMG observations:

The Full Federal Court in Chevron took a different approach to that taken by the Full Federal Court in SNF in relation to the characteristics of the hypothetical independent parties. The implications of this approach are potentially significant for taxpayers as the Division 13 hypothetical construct would enable features of the taxpayer in the context of the MNE group of which it forms part to be taken into account.

Acting inconsistently – or being perceived to act inconsistently – with internal company policies (for example to borrow externally at the lowest rate possible, to provide a parental guarantee for external borrowings by subsidiaries) is likely to be problematic from a transfer pricing perspective.

Next steps

It is not yet known if Chevron Australia will file a Special Leave Application with the High Court of Australia, however, in this litigation, such an eventuality would not be a surprise.

A more detailed brief will follow shortly.

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