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Transfer pricing: The Glencore appeal. To hedge or not to hedge? That is the question

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Jim Killaly, B Juris, LLB, PSM
Former ATO Deputy Commissioner (Large Business and International)
TTPI Honorary Visiting Fellow,
Crawford School of Public Policy, The Australian National University

Abstract

The Full Federal Court decision in the *Glencore Case* raises very important questions in relation to core concepts underlying Australia's previous and current transfer pricing rules. The case involves the pricing structure that an Australian mining company used for the copper concentrate it sold to its Swiss parent, the largest global trader in copper concentrate. Broadly speaking, the price for copper concentrate is worked out by deducting selecting a copper reference price from a listed metals exchange, like the London Metals Exchange, and deducting an allowance for treatment and copper refining costs (TCRCs). This was the main issue in the case. There were two options realistically available to the taxpayer: the use of market benchmarks that took account of both the prices set by the major mills and those set by the spot market; and, another method known as price sharing where the TCRCs are set at a fixed percentage of the copper reference price, which had the effect of protecting the seller from the risk that copper prices and TCRCs may trend in different directions. In February 2007 when the taxpayer switched to a price sharing formula that set the TCRC rate at 23% of the copper reference price, the benchmark rate set by the Japanese mills was much lower, and the TCRC rate established for the purposes of the mining company's budget, which was approved by its parent around August to September 2006, was 6.5% of the copper reference price. The Appeal Court accepted the taxpayer's argument that the 23% was an arm's length rate because there were contracts between independent parties that used price sharing, and 23% was the midpoint of the rates in those cases, and because the taxpayer's expert witness testified that for such a high cost mine price sharing was "a conservative and reasonable approach to minimising risk". The Court did not consider how independent parties dealing at arm's length (or wholly independently) with each other would have gone about deciding whether or not to hedge the risk, or the comparative benefits of market benchmark pricing relative to price sharing. A question therefore arises as to whether the Appeal Court correctly applied the statutory tests, a matter that would benefit from a High Court review.

Keywords: Australia's transfer pricing rules, the arm's length principle, the formulation of the arm's length hypothetical, determining arm's length comparability, the burden of proof in transfer pricing cases

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Tax and Transfer Policy Institute

Crawford School of Public Policy

College of Asia and the Pacific

+61 2 6125 9318

tax.policy@anu.edu.au

The Australian National University

Canberra ACT 0200 Australia

www.anu.edu.au

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Background

On 6 November 2020 the Full Federal Court handed down its decision in the *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187, dismissing the Commissioner's appeals in respect of the income years ended 31 December 2007 to 2009[1] in all but one aspect, the transportation charges for the 2009 year. The decision appealed against was reported as *Glencore Investments Pty Ltd v Commissioner of Taxation* [2019] FCA 1432 (the *Glencore Case*) and was the subject of detailed analysis in *The Glencore Case: Transfer pricing and the world of possibilities,* ANU Crawford School of Public Policy, Tax and Transfer Policy Institute Working Paper 8/2020, July 2020.

The context in which the transfer pricing dispute arose can be succinctly stated. Since 1999 an Australian mining company, Cobar Management Pty Ltd (CMPL), was selling copper concentrate to its Swiss parent, Glencore International AG (GIAG), under a life of mine offtake agreement with slight variations to the pricing clauses from time to time. However, the pricing formula for that output was fundamentally changed in February 2007. In broad terms, prior to that time the pricing was based on market benchmarks using a method that provided options for selecting the copper reference price from market prices for copper grade A quoted on the London Metals Exchange averaged over defined periods of time[2], and the use of a combination of the benchmark prices set by major smelters for the treatment and copper refining costs (TCRCs) together with spot prices for TCRCs. The price for the copper concentrate was derived by deducting the TCRCs from the selected copper reference price and making any appropriate adjustments for the copper content in the concentrate relative to the benchmark standard that the copper concentrate would have a copper metal content of 30%.

The February 2007 agreement replaced the market benchmark system with a wider range of options for selecting the copper reference price and stipulated that the TCRCs were to be calculated at 23% of the selected copper reference price, a pricing structure referred to in the market as "price sharing", and that the new formula was to operate for three years whereas the previous market benchmark agreement required annual renegotiation.

The Commissioner challenged the changes made in February 2007, arguing that in reliance on the arm's length principle as encapsulated in Australia's transfer pricing rules the taxpayer should have retained the pre-existing pricing structure, and he increased the taxpayer's taxable income for the 2007, 2008 and 2009 income years on the basis that the prices for copper concentrate derived from the use of the February 2007 pricing formula were less than arm's length prices. The taxpayer successfully challenged this[3] and the Commissioner subsequently appealed that judgment, again relying on the transfer pricing rules in Division 13 of the *Income Tax Assessment Act 1936* (*ITAA36*) and Subdivision 815-A of the *Income Tax Assessment Act 1997* (*ITAA97*). Sections 815-10 and 815-15 of the *ITAA97* incorporate by reference the transfer pricing rules in Article 9 of the Swiss Agreement[4]. The

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[1] Substituted accounting periods that the Commissioner had approved in lieu of the years of income ended 30 June 2008 to 2010.
[2] [2019] FCA 1432 at [3].
[3] *Glencore Investments Pty Ltd v Commissioner of Taxation* [2019] FCA 1432.
[4] *Agreement between Australia and Switzerland for the Avoidance of Double Taxation with Respect to Taxes on Income and Protocol* [1981] ATS 5 (the "Swiss Agreement").

Commissioner also argued that the taxpayer had not satisfied the evidentiary burden it bore under section 14ZZO of the *Taxation Administration Act 1953*, relative to the requirements of those transfer pricing rules, of showing that the amended assessments were excessive.

The two-fold purpose of this analysis is to explore the rationale used to support the appeal decisions in comparison to the statutory tests in Division 13 and Subdivision 815-A; and how the requirements of those provisions shape the evidentiary burden placed on the taxpayer by section 14ZZO. The analysis raises the question of whether the Court may have applied a different test to the tests stipulated in Division 13 and Subdivision 815-A and suggests that the weight of the evidence, read in its proper context, may not support a view that the taxpayer has discharged the requisite burden of proof.

While the appeal decision clarifies to some extent the ability to examine clauses of a contract that have a bearing on the price a taxpayer receives for property it supplies to an offshore associate to determine if they are arm's length or not, it also raises important issues in relation to the nature and application of the arm's length test as encapsulated in Division 13 *ITAA36* and Subdivision 815-A *ITAA97*, and in relation to the operation of section 14ZZO. These issues would benefit from guidance from the High Court. While Division 13 *ITAA36* and Subdivision 815-A *ITAA97* have been superseded by Subdivision 815-B, C and D *ITAA97*, the new provisions are based on the same concept of benchmarking actual dealings against what independent parties dealing at arm's length (or wholly independently) with each other would have done. The appeal decision is also significant from the perspective of protecting Australia's tax base from non-arm's length transfers of risks between related parties. It is also important in ensuring taxpayers and tax administrators are operating from commonly understood principles when verifying compliance with Australia's transfer pricing rules.

The arm's length test in Division 13 and Subdivision 815-A

There are common threads running through the arm's length test as separately encapsulated in Division 13 (in this case the most relevant parts being subsections 136AD(1) and 136AA(3)(c)) and Subdivision 815-A (and particularly Article 9 of the Swiss Agreement which is incorporated by reference). This can be seen in the structure and language of the relevant provisions.

Section 136AD(1) provides:

> **136AD Arm's length consideration deemed to be received or given**
>
> (1) Where:
>
> (a) a taxpayer has supplied 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 supply;

(c) consideration was received or receivable by the taxpayer in respect of the supply but ***the amount of that consideration was less than the arm's length consideration in respect of the supply***; and

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

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 supply shall be deemed to be the consideration received or receivable*** by the taxpayer in respect of the supply.

Subsection 136AA(3)(c) provides:

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

…

(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***.

Article 9 of the Swiss Agreement provides:

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***.

[Emphasis added.]

The application of the arm's length principle as articulated in Division 13 and Subdivision 815-A, which incorporates by reference the language of the Associated Enterprises Article in the Swiss Agreement, requires a comparison, depending on whether one is applying Division 13 or Subdivision 815-A, of the actual consideration or conditions in the commercial or financial relations, as the case may be, with ***the consideration that might reasonably be expected to have been received*** or ***the conditions that might reasonably be expected to operate*** in dealings between independent parties dealing at arm's length (or wholly independently) with each other.[5]

Neither subsection 136AD(1) nor Article 9 of the Swiss Agreement include a purpose test. This was deliberate policy. One of the factors supporting that policy was that a commercial purpose being pursued by a taxpayer or the group should not bar a tax administration from adjusting the consideration or the profit in cases where, on an objective evaluation, independent parties dealing wholly independently (or at arm's length) with each other would have agreed on a higher amount of consideration[6] or different conditions in their commercial or financial relations that would have resulted in a higher amount of profit for the taxpayer and an accordingly higher amount of taxable income[7]. In his Second Reading Speech on the Bill, the then Treasurer described the policy scope of Division 13 as follows:

> … it is important to recognise that an arrangement to shift profits out of Australia may be entered into for a complex mixture of tax and other reasons.
>
> However, ... the fact that tax saving is not a key purpose of the particular arrangement or transaction is no reason why we, as a nation, should not be in a position to counteract any loss of the Australian revenue inherent in it.
>
> The main requirements for the application of the revised provisions are that a taxpayer has supplied, or acquired property or services under an 'international agreement', one or more of the parties to which were not dealing at arm's length with each other, and that the supply or acquisition was at prices other than those that might have been expected in a transaction between independent parties dealing independently – that is, at arm's length.[8]

It follows from the language, structure and policy underlying subsection 136AD(1) that the existence of a commercially rational purpose behind the setting of the amount of the consideration is not, in itself, a bar to the application of that provision. It follows that the existence of a risk management purpose is not in itself sufficient to demonstrate that Division 13 has no application. Its application depends on the outcome of the comparison between the actual consideration and the arm's length consideration as defined by subsection 136AA(3)(c). Similarly, the application of Article 9 of the Swiss Agreement – and hence Subdivision 815-A - turns on an objective determination of the arm's length conditions that would operate in the commercial or financial relations and the comparison of those conditions with the actual conditions that operated between the related parties.

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[5] See *The Glencore Case: Transfer pricing and the world of possibilities* at page 64 where it is also noted at footnote 277 that *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 includes observations in relation to this necessary comparison as part of applying Division 13: see at [15] to [17] per Allsop CJ and [118] and [119] per Pagone J, with whom Allsop CJ and Perram J agreed; and in relation to Subdivision 815-A see paragraph [88] per Allsop CJ and at [156] per Pagone J, with whom Allsop CJ and Perram agreed. See also paragraph 1.15 of the 1995 OECD Guidelines.
[6] Subsection 136AD(1).
[7] See Article 9 of the Swiss Agreement, incorporated into Subdivision 815-A by subsection 815-10 in reliance on the definition of "associated enterprises article" in section 995-1, and the definition of "transfer pricing benefit" in section 815-15.
[8] Cth, Parliamentary Debates, HR, 24 March 1982, 1367-8.

In relation to Article 9 of the Swiss Agreement, the OECD expresses a similar view in paragraphs 1.2 to 1.5 of its *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations,* issued in 1995 and as updated in 1999 (the 1995 OECD Guidelines), the guidelines relevant to the years of income in dispute in the *Glencore Case*. Paragraph 1.4 expressly makes the point that factors other than tax considerations may distort the conditions of commercial and financial relations established between associated enterprises. A range of examples is shown which clearly make commercial sense but would run foul of Article 9 if independent parties dealing wholly independently with each other would not have adopted and acted on that rationale. It can similarly be concluded therefore, having regard to the language, structure and its underlying policy, that the application of Article 9 of the Swiss Agreement does not turn on whether or not there is a commercially rational purpose, or whether or not there is a tax avoidance purpose evident in the setting of the conditions that operate between the associated enterprises in their commercial or financial relations, but on the comparison of the actual conditions with the arm's length conditions and whether taxable profits were lower as a result of the operation of non-arm's length conditions.

In any event, as the facts of the *Glencore Case* show, there may be more than one commercial rationale, each supporting a different course of action. This was acknowledged by Middleton and Steward JJ in their majority judgment. In considering the evidence given by Mr Ingelbinck, an expert witness for the Commissioner, they said:

> What then is one to do with Mr Ingelbinck's opinion? In our view, his opinion that the parties should have adopted benchmark TCRCs appears to us to represent another possible position that arm's length parties might reasonably be expected to have adopted. But the existence of this possibility does not negate our finding that price sharing using a 23% rate was *also* an arm's length outcome. It was, nonetheless, not an outcome Mr Ingelbinck favoured. In our view, this is a case where reasonable minds have reasonably differed within a range of commercially acceptable arm's length outcomes…[9]

This line of reasoning implies that the statutory arm's length principle as separately expressed in Division 13 and Subdivision 815-A operate in a particular way, as does the principle of comparability that underpins it, and it also carries implications for the burden of proof that is imposed on a taxpayer by the operation of section 14ZZO as shaped by those statutory transfer pricing provisions.

Bearing in mind that the formation of the arm's length hypothetical requires a determination of what comparable independent parties dealing at arm's length (or wholly independently) with each other would do in comparable circumstances, the real question to be addressed is what would such parties do when faced with the choice of remaining with a pricing structure based on market benchmarks or switching to a "price sharing" formula in order to hedge CMPL against inverse movements in the price of copper and TCRCs. In other words, regard has to be had to the integrity of the decisionmaking process, regardless of whether the decision is made centrally by the group and imposed on a subsidiary, but especially where, as here, it has been found, and not contested, that the parties were not dealing at arm's length with each other in relation to the supply of copper concentrate[10]. It is by considering how independent parties dealing at arm's length would approach the decisionmaking that a

[9] [2020] FCAFC 187 at [213].
[10] *Glencore Investments Pty Ltd v Commissioner of Taxation* [2019] FCA 1432 at [171].

relevant and reliable arm's length hypothetical can be developed. It is not an answer to the question of what such independent parties would do to say that the actual conditions comprising the pricing structure of a "price sharing" agreement are similar to those that can be seen in dealings between independent parties dealing wholly independently with each other. The difficulty is that such an approach ***assumes*** that the adoption of the price sharing formula is the arm's length hypothetical for the purposes of Division 13 and Subdivision 815-A merely from the existence of such agreements in the market and the acceptance of the taxpayer's risk management rationale, before the necessary comparability analysis is done to ascertain the arm's length hypothetical on an objective basis having regard to all the factors affecting comparability. To do so is to substitute a different test to the one specified by Division 13 and Subdivision 815-A. It is pertinent to note that the OECD has observed that:

> Independent enterprises when evaluating the terms of a potential transaction, will compare the transaction to other options realistically available to them, and they will only enter the transaction if they see no alternative that is clearly more attractive…independent enterprises would generally take into account any economically relevant differences between the options realistically available to them (such as differences in the level of risk or other comparability factors discussed below) when valuing those options.[11]

The approach taken by the Full Federal Court in the *Glencore Case* ignores this inherent characteristic of the commercially rational behaviour that typifies the way independent parties dealing wholly independently with each other make decisions that protect and advance their separate economic interests. The point is that there is no evidence that the taxpayer undertook such an evaluation of the economically relevant differences between a market benchmark pricing framework and a price sharing pricing framework, or that the Court sought to undertake such an analysis in forming the arm's length hypothetical.

There is nothing in the wording of sections 136AD(1), 136AA(3)(c) and Article 9 of the Swiss Agreement[12], or in the articulation of the arm's length hypothetical by the Full Federal Court in the *Chevron Case*, or in the 1995 OECD Guidelines, that supports a narrowing of the search for pricing options that were realistically available to a seller of copper concentrate in dealings between independent parties dealing at arm's length with each other in the open market.

It seems uncontroversial to say that the language, structure and purpose of Division 13 and Subdivision 815-A are each based on the *objective* ascertainment of an arm's length hypothetical as a benchmark against which the actual consideration received or the actual conditions that operate are compared, depending on which provisions are being applied. The operation of those provisions is not based on whether the multinational group wanted to hedge the risk in relation to inverse movements of copper prices and TCRCs. It turns on whether in the circumstances of the *Glencore Case* it can be objectively concluded that an independent party that was jointly conducting an integrated mining, marketing and trading business with an independent party would, in comparable circumstances, have agreed to adopt the price sharing formula used by CMPL and GIAG - or would have chosen to remain with the pre-existing market benchmark pricing arrangement.

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[11] Paragraph 1.15 of the 1995 OECD Guidelines.

[12] Article 9 of the Swiss Agreement is incorporated into Subdivision 815-A by reference through the combined operation of sections 815-10 and 815-15.

The reasoning adopted by the Full Federal Court in the *Chevron Case* sheds some light on what is involved in developing the arm's length hypothetical. As Allsop CJ said, bearing in mind that the *Chevron Case* involved an acquisition of property for a consideration that exceeded the arm's length consideration:

> 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.[13]

Justice Pagone put it in the following way:

> 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.[14] [Emphasis added.]
>
> …***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

[13] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [46].
[14] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [126].

> 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.[15] [Emphasis added.]

The concept of comparability is implicit in the statutory requirement to ascertain the conditions that might be expected to operate in the commercial or financial relations between independent parties dealing wholly independently with one another. The factors relevant to determining arm's length comparability include the economic circumstances, including economic and market forecasts, despite the inevitable uncertainties with such exercises, because independent parties dealing at arm's length would have regard to the commercial context in which their dealings are occurring. There were significant uncertainties and risks attached to each of the courses of action that the Full Court saw as possible positions that arm's length parties might reasonably be expected to have adopted. Each possible course of action has economically relevant differences. The question is how would independent parties dealing at arm's length (or wholly independently) with each other have weighed up those uncertainties, risks and economically relevant differences in choosing a course of action. There is no evidence that the taxpayer did this; there is evidence that the Commissioner and his expert witness, Mr Ingelbinck, did. This presents a basis for arguing that the taxpayer did not apply the correct test in its analysis the operation of Division 13 and Subdivision 815-A.

The comparability factors also include the business strategies being pursued. It is therefore relevant to the development of the arm's length hypothetical to have regard to the fact that CMPL was jointly conducting an integrated mining, marketing and trading business with GIAG. This business strategy is a relevant comparability factor. As her Honour said at first instance:

> In the present case, the relevant mine producer for the purposes of the hypothetical agreement is a mine producer with all the characteristics of CMPL, which include, as earlier stated, that it had no need for a logistics or marketing division because it sold the whole of its production for the life of the mine to a buyer with GIAG's characteristics, namely a trader with a substantial marketing team which purchased the whole of the mine's production for the life of the mine.[16]

The arm's length hypothetical would therefore be informed by considerations of how independent joint venturers would deal with each other and how such an integrated business sold copper concentrate to independent buyers in the open market. However, the taxpayer did not lead any evidence on these matters.

It could be argued that by determining the case by reference to whether similar terms to those adopted by the taxpayer in pricing its supplies of copper concentrate appear in contracts between independent parties dealing at arm's length biases the analysis "by a rigid constriction of the arm's length hypothesis in a shape and form controlled by the [multinational group]"[17] and undermines the sensible operation of Division 13 and Subdivision 815-A according to their terms and purposes. While "commercial prudence" can be seen to be a relevant aspect of arm's length behaviour, it seems clear that it is not the determinative test stipulated by Division 13 or Subdivision 815-A[18] because dealings that offend those provisions can often, if not generally, be seen to be commercially prudent, a

[15] [2017] FCAFC 62 at [129].
[16] See *Glencore Investments Pty Ltd v Commissioner of Taxation* [2019] FCA 1432 at [181].
[17] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [55] per Allsop CJ.
[18] [2020] FCAFC 187 at [138].

reality that led to the policy encapsulated in those provisions being drafted in terms that did not include a purpose test.

Middleton and Steward JJ expressly considered their role as appeal judges in a transfer pricing case in relation to the evidence and the submissions put in that regard by the Commissioner and the taxpayer.[19] Their Honours cited *Jadwan Pty Ltd v Rae and Partners (A Firm)* [2020] FCAFC 62; (2020) 378 ALR 193 which in turn cited the following passage from *Fox v Percy* (2003) 214 CLR 118 at 126-127 [25]:

> Within the constraints marked out by the nature of the appellate process, the appellate court is obliged to conduct a real review of the trial and, in cases where the trial was conducted before a judge sitting alone, of that judge's reasons. Appellate courts are not excused from the task of "weighing conflicting evidence and drawing [their] own inferences and conclusions, though [they] should always bear in mind that [they have] neither seen or heard the witnesses, and should make due allowance in this respect" [Dearman v Dearman (1908) 7 CLR 549 at 564, citing *The Glannibanta* (1876) 1 PD 283 at 287]. In *Warren v Coombes* [(1979) 142 CLR 531 at 551], the majority of this Court reiterated the rule that:
>
> > [I]n general an appellate court is in as good a position as the trial judge to decide on the proper inference to be drawn from facts which are undisputed or which, having been disputed, are established by the findings of the trial judge. In deciding what is the proper inference to be drawn, the appellate court will give respect and weight to the conclusion of the trial judge but, having reached its own conclusion, will not shrink from giving effect to it.
>
> The Full Court in *Jadwan* then said the following at 312 [414]:
>
> > What is set out in the above passage is subject to other principles of appellate review to which we have referred, including the requirement that an appellant show error in the primary judge's decision, and the acknowledgement in the authorities of the circumstances in which the appellate court will not be in as good a position as the trial judge to decide on the proper inferences to be drawn. The weight to be given to the findings of the trial judge will vary according to the type of issue in question, and the nature and the extent of the advantage enjoyed by the trial judge. But if error is shown, a court of appeal may then be required to make its own findings of fact and to formulate its own reasoning based upon those findings if it is in a position to do so: *Robinson Helicopter* at [43]; and see also, *Waterways Authority v Fitzgibbon* [2005] HCA 57; (2005) 221 ALR 402 at [134] – [135] (Hayne J).

Middleton and Steward JJ then concluded:

> The principles expressed in the foregoing passage are, in our view, applicable to this appeal. In particular, the reference to the "position" of the trial judge referred to in the foregoing passage includes the advantage enjoyed here by the learned primary judge who had the opportunity to consider, and reflect upon, the entirety of the evidence as

[19] [2020] FCAFC 187 at [142] to [150].

> a whole. It follows that the task of this Court is to undertake a "real review" of the evidence, but to do so with a degree of restraint and deference when considering the findings of the learned primary judge. That is all the more so where, as here, those findings followed the review and consideration of a rather large volume of evidence.

The *Glencore Case* involves questions of law and fact. It required the primary judge and the Appeal Court to construe the provisions of Division 13 and Subdivision 815-A and to weigh up all of the admissible evidence against that construction of the relevant statutory provisions. A similar task was undertaken by the High Court in *Hope v The Council of the City of Bathurst* [1980] HCA 16; 144 CLR 1; 80 ATC 4386. The leading judgment was delivered by Mason J, as he then was, with whom Gibbs, Stephen, Murphy and Aickin JJ agreed. He said:

> Many authorities can be found to sustain the proposition that the question whether facts fully found fall within the provisions of a statutory enactment properly construed is a question of law.[20]

Mason J then pointed out the special considerations that apply where a statute uses words according to their common understanding and the question is whether the facts as found fall within these words. He cites the judgment of Kitto J in *NSW Associated Blue Metal Quarries Ltd v FC of T* (1956) 94 CLR 509 and draws out four steps in the required reasoning process:

(i) To decide as a matter of law whether the Act uses the expression(s) in any other sense than that which they have in ordinary speech.
(ii) If this is decided in the negative, the "common understanding of the words has…to be determined" as "a question of fact". The clear implication is that if the words do not bear the sense they have in ordinary speech the determination of their meaning is a question of law;
(iii) To decide whether the material before the Court reasonably admits of different conclusions as to whether a party's circumstances fall within the ordinary meaning of the words as so determined; and this is a question of law; and
(iv) If different conclusions are reasonably possible, it is necessary to decide which is the correct conclusion; and that is a question of fact.[21]

Key questions of law that arise in the *Glencore Case* relate to how the arm's length hypothetical, which forms the basis for the comparisons with the actual consideration and the actual conditions required by Division 13 and Subdivision 815-A respectively, is to be formed; and, whether the hypothetical encompasses the decision as to whether or not to hedge the risk of inverse movements in the price of copper and TCRCs.

The taxpayer has presented its case on the basis that the decision to hedge this risk is part of the relevant arm's length hypothetical because, on the basis of the expert evidence it presented, it made commercial sense to hedge that risk and that, on the basis of the documentary evidence presented, independent parties dealing at arm's length with each other had used similar price sharing agreements.

[20] 80 ATC 4386 at 4389.
[21] 80 ATC 4386 at 4389–4390.

Middleton and Steward JJ, in considering whether the contracts tendered in evidence by the taxpayer were comparable to the CMPL – GIAG agreement, made the following observations:

> In our view, many of the differences identified by the Commissioner are relatively important. They diminish the probative value of the contracts said to be comparable. But they do not negate that value entirely. The contracts were valid "reference points" both for the purpose of considering the type of pricing formula chosen by CMPL and GIAG under the CMPL – GIAG 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 exist in the 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 demonstrate that the contracts were relevant and admissible pursuant to ss 55 and 56 of the *Evidence Act 1995* (Clth), notwithstanding the differences identified by the Commissioner. Although one is directed by s815-20 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.[22]

Then, in considering the expert opinions given by Mr Ingelbinck and Mr Wilson for the Commissioner and the taxpayer respectively, Middleton and Steward JJ stated:

> …in our view it was permissible for Mr Wilson to give evidence about how a commercially rational miner operating a high cost mine might make choices about managing risk as at February 2007. His evidence was in this respect not speculation, as the Commissioner contended, but an admissible opinion. It was also permissible for Mr Wilson to hypothesise, as at February 2007, a more conservative miner who might be prepared to trade earnings for certainty given the extreme volatility in the copper prices in 2006, and given the potential exposure arising from the use of benchmark TCRCs which might in the future, as they had in the past, move in the opposite direction to the copper price. Mr Ingelbinck agreed that the owner of a high cost mine might tend to be more cautious. We do not think the hypothetical miner's membership of a hypothetical multinational group affects the validity of Mr Wilson's opinion. In our view, the relevance, if any, of being a member of a group of companies would be a matter for an expert to consider, but this aspect of the hypothetical did not seem to matter to either Mr Wilson or Mr Ingelbinck.[23]

Then at [197] Middleton and Steward conclude:

> In short, and in simple terms, in our view, for the reasons given by Mr Wilson, giving up forecast earnings to secure a more prudent or conservative outcome on risk was a result that arm's length parties might be expected to have wanted in early 2007. Our conclusion is strongly fortified by the fact that, even with the changes made to the

[22] [2020] FCAFC 187 at [193].
[23] [2020] FCAFC 187 at [195].

> CMPL – GIAG agreement in February 2007, based on the forecasts at the time, CMPL was still going to be earning profits described as "healthy". Of course, we accept that other independent parties could have chosen different terms as at February 2007 to price the CSA mine's copper concentrate.

As discussed above, Middleton and Steward JJ reached the following conclusion on the competing evidence given by Mr Ingelbinck:

> his opinion that the parties should have adopted benchmark TCRCs appears to us to represent another possible position that arm's length parties might reasonably be expected to have adopted. But the existence of this possibility does not negate our finding that price sharing using a 23% rate was *also* an arm's length outcome. It was, nonetheless, not an outcome Mr Ingelbinck favoured. In our view, this is a case where reasonable minds have reasonably differed within a range of commercially acceptable arm's length outcomes…[24]

The reasoning adopted by Middleton and Steward JJ raises the question as to whether the arm's length hypothetical for the purposes of Division 13 and Subdivision 815-A has been properly formulated. The decision as to whether or not to hedge the risk of inverse movements in copper prices and TCRCs is critical to the analysis of what independent parties dealing at arm's length (or wholly independently) with each other would do in terms of establishing a foundation for the calculation of the consideration payable for the copper concentrate (relevant to the application of Division 13); or in terms of establishing the conditions that would operate in their commercial or financial relations (which is relevant to the operation of Subdivision 815-A and Article 9 of the Swiss Agreement). The reasoning does not reflect the fact that the fundamental choice between a market benchmark pricing formula and price sharing is central to the formulation of the arm's length hypothetical because that choice is central to answering the question of what arm's length parties dealing at arm's length (or wholly independently) with each other would do in comparable market and business circumstances. Arguably, for this reason the conclusion reached by the majority is open to challenge on a question of law.

Since the question of whether an independent seller of copper concentrate would or would not hedge the risk of inverse movements between the copper price and TCRCs appears to be a legitimate question given the language, structure and purpose of both Division 13 and Subdivision 815-A, it is necessary to consider how independent parties dealing at arm's length would make that choice. This leads to a need to consider the evidence supporting the selection of the market benchmark pricing formula relative to the evidence supporting the choice of price sharing, due regard being had to the statutory purpose of each set of provisions. This does not appear to be how the taxpayer or Middleton and Steward JJ approached the case.

To reach the conclusion that market benchmark pricing and price sharing were each possible positions that arm's length parties dealing at arm's length could reach is a necessary step, but incomplete in terms of the analysis needed to ascertain the legislative objective of determining what independent parties dealing at arm's length (or wholly independently) with each other would do. That final step requires a consideration of what such parties would take

[24] [2020] FCAFC 187 at [213].

into account in making a choice between these two courses of action, due consideration being given to the full range of comparability factors.

There are good grounds for arguing that the *Glencore Case* is not one where the choices open to the taxpayer are analogous to cases where there is a range of arm's length prices. Ranges of arm's length prices are determined once all the comparability analysis has been completed. Generally, one would expect that, to be truly comparable, the price range would have to be fairly narrow. One sees in the copper concentrate market that the selection of the copper reference price is based on monthly averages of copper prices on an exchange like the London Metals Exchange and the options for selecting pricing periods is limited. Selecting one of those copper reference "prices" can be seen to be analogous to an arm's length range. However, the analogy with an arm's length range of prices is difficult to make when the market benchmark pricing and price sharing are so fundamentally different and can, as in the *Glencore Case*, have major impacts on pricing.

Thawley J delivered a separate judgment explaining his reasoning in terms of the application of Division 13 and Subdivision 815-A.[25] His Honour formed the view that it was permissible to depart from the terms of the actual transaction that affect consideration payable[26], or, in relation to Subdivision 815-A, differ from arm's length conditions (whether or not they define price)[27]. However, he believed there a limitation on the extent to which any departure from actual terms is permitted under Division 13 and Subdivision 815-A. His Honour expressed this limitation by reference to whether the terms of the international agreement were ones which might reasonably be expected between independent parties, in the position of CMPL and GIAG, dealing with each other at arm's length, and whether the consideration for the supply of the copper concentrate under "an agreement" with those terms was within an arm's length range.[28]

His Honour does not base his judgment on the risk mitigation rationale presented by the taxpayer and its expert witness Mr Wilson, which was endorsed by the majority as a rationale for concluding that price sharing using 23% allowance for TCRCs was an arm's length outcome. His Honour relied on the High Court decision in *W R Carpenter Holdings Pty Ltd v Commissioner of Taxation* (2008) 237 CLR 198 at [38] (the *Carpenter* Case) for the view that Division 13 does not require an investigation or consideration of purpose or motive. While Division 13 and Subdivision 815-A (operating in conjunction with Article 9 of the Swiss Agreement) do not make the existence of any motive or purpose a precondition for the operation of those sets of provisions, this does not mean that purpose or motive are always irrelevant, just that they are not determinative. The implications of the *Carpenter Case* were discussed extensively in *The Glencore Case: Transfer pricing and the world of possibilities* at pages 55-56, 67-70 and 106-107. This was largely in relation to the significance of a tax avoidance purpose. However, for the reasons set out above, it can equally be argued that the existence of a business or commercial rationale for choosing a particular pricing formula (or amount of consideration or particular conditions to operate in the commercial or financial relations between the associated parties) is not determinative of the operation of Division 13 or Subdivision 815-A respectively, even though it may be a relevant factor in assessing comparability.

[25] [2020] FCAFC 187 at [240].
[26] [2020] FCAFC 187 at [245] and [278] in relation to Division 13 and [292] to [295] in relation to Subdivision 815-A.
[27] [2020] FCAFC 187 at [297] and [298].
[28] [2020] FCAFC 187 at [270], [271] and [295].

The difficulty presented by the analysis adopted by Thawley J is that it begs the question of whether or not an independent seller of copper concentrate would agree to sell its output on the basis of the pricing in the February 2007 agreement or stick with the pre-existing market benchmark pricing; it begs the question, for example, of whether in arm's length dealings the seller would hedge or not hedge the risk of inverse movements between copper prices and TCRCs, a choice that will have a significant causal impact on the consideration received and the profit derived.

As discussed above, there are sound reasons for arguing that the formulation of the arm's length hypothetical required by Division 13 and Subdivision 815-A necessarily involves a determination of the choice that a party dealing at arm's length (or wholly independently) with an independent buyer would make between these two pricing options in comparable circumstances. In this regard, as argued in *The Glencore Case: Transfer pricing and the world of possibilities*[29], the rationales offered by the taxpayer for the switch from market benchmark pricing to the price sharing and other changes made by the February 2007 agreement are not soundly based. Accordingly, it would follow that it could not be reasonably expected that they would be adopted by a seller dealing with an independent buyer on an arm's length basis, at least not without other compelling evidence. Quite apart from these apparent shortcomings in rationale, it seems particularly difficult to argue that a seller dealing at arm's length with an independent buyer, with whom it is jointly conducting an integrated mining, marketing and trading business, would have agreed to price sharing with that party in respect of the 2007 income year on the terms set out in the February 2007 agreement when the Japanese mills benchmark TCRC for that year was already known to be US 15.4 cents per pound[30], well below the 23%, even though spot TCRCs remained a risk in relation to one half of its production. The 2007 Budget for CMPL, endorsed by GIAG around August or September 2006[31], budgeted TCRCs for 2007, 2008 and 2009 at 6.5%, 9.6% and 9.4% respectively. This was the budgeted total TCRC, which included the combination of market benchmark and spot rates.[32] It seems reasonable to conclude on this basis that CMPL was more likely than not to be significantly worse off financially as a result of the 23% TCRC rate in the February 2007 agreement.

Did the taxpayer satisfy the burden of proof imposed by section 14ZZO?

Section 14ZZO places the burden of proving that the contested assessments are excessive on the taxpayer. However, it seems uncontentious that the elements needing to be proved are determined by the relevant provisions of Division 13 and Subdivision 815-A. It is therefore up to the taxpayer to show what the correct arm's length hypothetical is; and, in the facts and circumstances of the *Glencore Case*, that the correct hypothetical was the adoption of the price sharing agreement of February 2007 and not the continuance of the pre-existing market benchmark pricing structure. Arguably, the taxpayer has failed to meet this requirement because it has not considered the economic impacts of the different choices and explained

[29] ANU Crawford School of Public Policy, Tax and Transfer Policy Institute Working Paper 8/2020, July 2020 at pages 81 to 97.

[30] [2020] FCAFC 187 at [19] paragraphs (g).

[31] *Glencore Investments Pty Ltd v Commissioner of Taxation* [2019] FCA 1432 at [133].

[32] The data on TCRCs available by February 2007 is analysed at page 30 of *The Glencore Case: Transfer pricing and the world of possibilities*, together with references to the relevant parts of the judgment of Davies J at first instance.

why a seller dealing at arm's length with an independent buyer would have chosen the terms of the February 2007 agreement in comparable circumstances.

Were the taxpayer able to prove that the selection of the February 2007 agreement pricing structure was the arm's length choice and that its terms were consistent with what a seller would have adopted in arm's length dealings with an independent buyer in comparable circumstances it would have met the burden of proof imposed by section 14ZZO in its operation in conjunction with Division 13 and Subdivision 815-A.

There is extensive discussion in the appeal decision of the evidence regarding examples of price sharing agreements and the insightful observations by the majority that such an exercise is "a necessary but nonetheless unsatisfactory task".[33] Middleton and Steward JJ make the final observation that:

> …an industry expert may validly give an opinion, based on her or his experience and expertise, about whether a clause in a contract specifying the consideration payable, is one which independent parties dealing with each other at arm's length, might or might not be expected to adopt. She or he may rely on other contracts in the market place entered into by independent parties, as a reference point, sounding board or as other similar support in forming that view.[34]

They go on to state:

> The onus on a taxpayer is to show that an assessment issued to it is excessive. No part of that onus necessarily requires a taxpayer to lead evidence to negate positive claims put up by the Commissioner in defence of an assessment: *Allied Pastoral Holdings Pty Ltd v Federal Commissioner of Taxation* [1983] 1 NSWLR1 at 10-11. Here, it was sufficient for the taxpayer to discharge its onus of proof by relying on the expert opinion of Mr Wilson and by demonstrating that Mr Ingelbrinck's opinion was not to be preferred.[35]

The *Allied Pastoral Holdings Case* concerned the application of the former sections 25(1) and 26(a) of the *Income Tax Assessment Act 1936*. The debate in relation to the onus of proof was about whether the taxpayer needed to call all material witnesses or tender all material documents to support its evidence that it did not have the relevant profitmaking purpose to trigger the assessment provisions. The facts distinguish it from those in the *Glencore Case* because Division 13 and Subdivision 815-A do not contain a purpose test as a precondition to their operation. Nevertheless, a core issue in the *Allied Pastoral Holdings Case* was whether the evidence of a witness as to purpose needed corroboration before it could be accepted. Hunt J found:

> …It is, of course, important in many cases in determining whether or not the evidence of the taxpayer should be accepted to consider whether it is corroborated…it is not obligatory for a taxpayer, before he can discharge his burden of proof, to call all the material witnesses and to produce all the material documents which support his evidence…It is certainly wiser for the taxpayer to do so in most cases to ensure that his own evidence is accepted, but even where he does not do so the tribunal of fact

[33] [2020] FCAFC 187 at [100].
[34] [2020] FCAFC 187 at [103].
[35] [2020] FCAFC 187 at [230].

> may nevertheless be sufficiently impressed with the taxpayer as a witness that his evidence is accepted without such corroboration or without the whole of such corroboration. If his evidence as to his purpose is accepted, then he has discharged his onus of proof whatever corroborative evidence he has or has not called.[36]
>
> The taxpayer bears no onus to negate each of the objective facts in the evidence which may be consistent with the purpose of profitmaking by sale. Those facts must, as I have said, be considered by the tribunal of fact when determining whether or not to accept the taxpayer's evidence that dominant purpose in acquiring the property was not one of profit-making by sale. But once that evidence of the taxpayer's purpose is accepted, the other objective facts in the evidence are irrelevant and they must be discarded; the taxpayer has discharged his onus and the reference or appeal must be allowed. There is no legal obligation upon the taxpayer to produce other evidence to corroborate his evidence before it can be accepted.[37]

The context in the *Allied Pastoral Holdings Case*, where there is a key witness giving evidence as to whether or not there was a profit-making purpose, is different from that in the *Glencore Case* where the Commissioner and the taxpayer are each leading expert evidence as to what the arm's length hypothetical should be. In the *Glencore Case* the experts are in agreement on a range of matters and in conflict on others. The statutory requirements, and hence the burden of proof, are also materially different between the two cases. In the *Allied Pastoral Holdings Case* the issue to be proved is whether or not the taxpayer had a particular profit-making purpose; in the *Glencore Case* the question is whether a seller dealing at arm's length with an independent buyer would have chosen one pricing structure or another, an issue that turns on the consideration of the whole of the admissible evidence in relation to the matters that the statutory elements that Division 13 and Subdivision 815-A require to be proved: in particular what the arm's length hypothesis is that forms the foundation for the comparison required by each set of provisions. It seems inescapable that in such a case the taxpayer has to show that the selection of the pricing structure in the February 2007 would be preferred to the pre-existing market benchmark pricing structure. The taxpayer has not done this. It has shown that the terms in the February 2007 agreement are similar to those appearing in dealings between independent parties on the open market and can be used as a sounding board or a reference point, rather than as comparables.

The taxpayer also led expert evidence through Mr Wilson, and challenged aspects of the evidence provided by the Commissioner's expert witness, Mr Ingelbinck. The Commissioner also challenged aspects of Mr Wilson's evidence but, despite concessions made by Mr Wilson in cross-examination, Middleton and Steward JJ did not think that Mr Wilson's opinion should be rejected on that account.[38]

At [204] the majority discusses the fact that, on a scenario that was put to him, Mr Wilson agreed that the taxpayer would be worse off. The majority pointed to the findings of the primary judge that "there was nothing in the contemporaneous documents which identified any uncertainty for the mine in relation to its capacity to continue mining in 2007 to 2008 or 2009 or to suggest that CMPL considered that there was any real risk that its level of production would not continue throughout those years." They pointed out that these findings were not challenged on appeal. Even though the majority found fault with the line of cross-

[36] 83 ATC 4015 at 4021.
[37] 83 ATC 4015 at 4022.
[38] [2020] FCAFC 187 at [204].

examination, the fact remains that her Honour's findings undermine the taxpayer's argument that uncertainty about costs was a key factor supporting the choice of price sharing.

At [209] the majority raises concerns regarding the comments Mr Wilson made in cross-examination that CMPL would be worse off financially with a price sharing rate of 23%. While it was not established how much worse off CMPL would be because it was not possible to forecast the spot TCRC rate that was intended to be the base for negotiation of TCRCs applied to 50% of the Base Tonnage of 100,000 wet metric tonnes (that is, 50,000 wet metric tonnes)[39], it was clear that the 23% rate was well above the 6.5% budgeted rate for the 2007 income year and the 9.6% and 9.4% rates budgeted for the 2008 and 2009 income years respectively, those budgeted rates reflecting the combined market benchmark and spot rates that were the basis of the TCRC calculation when the 2007 Budget was approved by GIAG around August or September 2006.[40] The Budget is a critical part of the management system that is key to managing and measuring performance and its development drew on the combined expertise of the mine management and GIAG, the largest trader of copper concentrate. On that basis, it is hard to see how the taxpayer and its parent would not realise that it was highly likely that CMPL would be financially materially worse off as a result of the 23% TCRC in the February 2007 agreement. Faced with the same contemporaneous analysis it seems more likely than not that a seller evaluating the pricing terms of a similar offtake agreement with an independent buyer would come to the conclusion that the proposed changes from a market benchmark pricing structure would not be acceptable.

It was generally accepted by the parties to the *Glencore Case* and their experts that forecasts were subject to risks and elements of judgment based on experience and market knowledge and market position were involved. It is noted that, while Mr Wilson was aware of the risks he stuck to his forecasts.[41]

The fact that a 23% TCRC rate was forecast to leave CMPL profitable, as mentioned at [138] of the majority judgment is irrelevant to the operation and purpose of Division 13 or Subdivision 815-A, which are focussed on ensuring that taxpayers are liable to tax on the *correct* amount of assessable (and hence taxable) income. The volatility in the TCRC market pointed to by Mr Wilson has to be seen in the context of CMPL's own budget forecasts, that had the benefit of input from GIAG, the largest trader of copper concentrate, and Mr Wilson's continued confidence in his forecasts developed for Brook Hunt.

While Mr Ingelbinck was challenged on his evidence in relation to quotational period optionality, his expert opinion evidence in relation to the relative attractiveness of a market benchmark pricing structure over price sharing was unshaken. This is important given his long experience as a trader in copper concentrate. His ability to deal with hypotheticals put to him in cross-examination show balance and discernment. Unlike Mr Wilson, Mr Ingelbinck's expert opinion evidence considers both the market benchmark and price sharing pricing structures and helps address the question of whether a seller dealing with an independent party on an arm's length (or wholly independent) basis would have included a risk mitigation element in its pricing structure. Mr Wilson's evidence was confined to articulating a commercial rationale for the adoption of price sharing.

[39] [2020] FCAFC 187 at [19] paragraphs (d)(iv) to (viii).
[40] [2020] FCAFC 187 at [19] paragraph (d)(j) and *Glencore Investments Pty Ltd v Commissioner of Taxation* [2019] FCA 1432 at [133].
[41] [2020] FCAFC 187 at [137].

Thawley J summarised his analysis of the question of whether the taxpayer[42] satisfied its onus of proof in relation to Division 13 in the following way:

> In the present case, Glencore Investment Pty Ltd (GIPL) discharged its onus of establishing that the consideration received by CMPL was one which might reasonably be expected to have been received as consideration on the assumption that the supply of copper concentrate under the international agreement had been made under an agreement between independent parties dealing at arm's length with each other in relation to the supply. GIPL discharged its onus by showing that:
>
> (1) First, the terms of the "international agreement" were ones which might reasonably be expected between independent parties, in the position of CMPL and GIAG, dealing with each other at arm's length; and
> (2) Secondly, the consideration for the supply of copper concentrate under "an agreement" with those terms was within an arm's length range.[43]

Recalling the earlier discussion regarding the formulation of the arm's length hypothetical, his Honour's approach begs the question of whether or not an independent seller of copper concentrate would agree to sell its output on the basis of the pricing in the February 2007 agreement or stick with the pre-existing market benchmark pricing; it begs the question, for example, of whether in arm's length dealings the seller would hedge or not hedge the risk of inverse movements between copper prices and TCRCs, a choice that will have a significant causal impact on the consideration received and the profit derived. His Honour has clearly interpreted the arm's length hypothetical in Division 13 as not requiring the choice between the pre-existing market benchmark pricing structure and the 23% price sharing pricing structure to be evaluated in terms of their relative economic merits in a way that a seller dealing with an independent buyer on an arm's length basis would do. Arguably, this raises a question as to whether the arm's length hypothetical has been correctly formulated and applied.

His Honour drew a distinction in his reasoning in relation to the application of Subdivision 815-A relative to the analysis adopted by Middleton and Steward JJ. In Thawley J's view the language of Subdivision 815-A does not contemplate or require a distinction between the terms of an actual agreement that define price (which Middleton and Steward JJ consider can be substituted) and those which do not (which their Honours consider cannot be substituted). In his view:

> (1) If the terms in the agreement which "define price" are arm's length terms, it would ordinarily be unlikely that those terms could be said to be "conditions" operating 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". In those circumstances, it is difficult to see how they could be rationally substituted.
> (2) If the agreement contains terms which do not define price, and which would not be found in the agreement if it had been between independent enterprises dealing wholly independently with one another, it is difficult to see why those terms could not be substituted under Subdiv 815-A. Such terms may well amount to

[42] The taxpayer is Glencore Investment Pty Ltd as the head company of a multiple entry consolidated ("MEC") group for Australian tax purposes, of which Cobar Management Pty Ltd ("CMPL") is a member.
[43] [2020] FCAFC 187 at [271].

> "conditions" operating "between 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". If such terms affect the consideration payable or receivable, or profits, it is difficult to see why they should not be "substituted".[44]

The first proposition is not comprehensive in terms of the scope of Subdivision 815-A. It focusses on the terms of an agreement and carries an inference that the transfer pricing problem in the particular type of case being contemplated arises from the terms of an agreement that "define price", as opposed to the selection of a particular type of agreement which has consequences for pricing. In the *Glencore Case* the terms of the agreement being challenged arise from the decision to supply copper concentrate under the terms of an agreement that arise because the agreement includes a risk mitigation element. The controversy in the *Glencore Case* can be seen as emanating from the choice of that particular type of agreement. It seems legitimate, in the course of considering *all* the elements bearing on comparability in the process of identifying the arm's length hypothetical under Subdivision 815-A, to explore whether a seller of copper concentrate, in its commercial and financial relations with an independent buyer with whom it is dealing wholly independently, would or would not encompass the risk mitigation element in the agreement having regard to the business, market and economic context. It seems an avoidance of the purpose of the arm's length test to *assume* it would do so without evaluating the relative economic merits of all the options realistically available and satisfying itself that the agreement with the risk mitigation element is the most attractive option. It is only by doing so that a taxpayer is reflecting the integrity of the arm's length test and the commercial rationalism that permeates the decisionmaking processes of independent parties dealing wholly independently with one another.

The second proposition seems to leave open the ability under Subdivision 815-A to challenge the inclusion of a risk mitigation element in an agreement if independent parties dealing wholly independently with one another would not have done so in comparable circumstances. This is the Commissioner's argument and it seems to have a lot, in terms of the conceptual basis and the evidence, to commend it.

Taking into account the fact that the taxpayer appears to have applied the wrong test in developing the arm's length hypothetical for the purposes of Division 13 and Subdivision 815-A, since it did not compare the relative economic merits of the different pricing structures realistically available in the market, and the weight of the contemporaneous evidence supporting the selection of a much lower TCRC, it is difficult to see how the taxpayer can be said to have satisfied its onus of proof under section 14ZZO as it applied in conjunction with Division 13 and Subdivision 815-A. The evidence in relation to TCRCs for the 2007 year of income in particular seems difficult to rebut.

[44] [2020] FCAFC 187 at [296] – [297].

Conclusion

Having regard to the High Court's analysis in *Hope v The Council of the City of Bathurst* [1980] HCA 16; 144 CLR 1; 80 ATC 4386, it does appear that there are important questions of law that arise from the *Glencore Case* appeal decision that would warrant the seeking of special leave to appeal to the High Court. The construction applied to the operation of Division 13 and Subdivision 815-A have significant implications for Subdivisions 815-B, C and D and the ability to protect Australia's tax base from risk-stripping techniques. The financial engineering available in modern financial markets presents a significant vulnerability in this regard. More generally, the administration of Australia's transfer pricing rules, by both tax administrators and multinational groups, would be enhanced by the clarification of how the arm's length hypothetical is developed and how comparability analysis is to be undertaken.