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Australia's most significant transfer pricing decision

Glencore's victory against the Australian Taxation Office

On 6 November 2020, a unanimous decision was released by the Full Federal Court of Australia (the Court) in favour of the taxpayer in a significant transfer pricing appeal[1] involving $241 million amended income tax assessment.[2] The initial court decision handed down two years ago.

16 December 2020

Case background

The dispute between Glencore and the Commissioner surfaced as the latter suspected a breach in transfer pricing rules in relation to the purchase of copper concentrate by Swiss-based Glencore International AG (GIAG) from its Australian subsidiary, Cobar Management Pty Ltd (CMPL) over the 2007-2009 period. CMPL owned and operated the Cobar mine in NSW and since 1999 had sold all its production to GIAG. GIAG had the capability to perform downstream activities by way of reselling copper concentrate to third party smelters across the Asia Pacific region.

The transfer price of the copper concentrate was based on the London Metal Exchange (LME) price for refined copper, less certain discounts for Treatment Costs and Refining Costs (TCRC). As a result of contractual changes in 2007, the TCRC deduction was made at a flat rate of 23% (previously based on a published TCRC benchmark and reset annually), an approach known in the industry as 'Price Sharing'. Since 2004, GIAG was also allowed to select flexible quotational periods for the LME benchmarking purposes.

The Commissioner's position was that independent parties acting at arm's length would not have entered into the 2007 amended arrangements.

Key decisions

Limitations to the power to reconstruct the terms of the transaction

The Commissioner focused on whether independent parties would have agreed to similar arrangements under comparable situations and whether CMPL (as the seller) would have agreed to the change of terms that might adversely impact profitability.

Nevertheless, the Court decided that the taxpayer had sufficiently proved that the amended pricing mechanism was arm's length (apart from the basis of calculation of freight charges in 2009). Notably, the Court confirmed that there is no power or authority to substitute different terms of a contract where those terms do not define the price. This effectively implies that the 'reconstruction' provision under Australia's transfer pricing laws should only be considered in very narrow circumstances.

Arm's length price can be more than one

The Commissioner's and the taxpayer's experts disagreed over the pricing with which independent parties would be more likely to agree and the Court accepted aspects of both sides. The use of price sharing terms in contracts was supported by other contracts in the market. Effectively, the taxpayer does not have to prove its pricing is more likely than that put by the Commissioner. The taxpayer just has to present sufficient evidence that its pricing position falls within a range of 'commercially acceptable arm's length outcomes'.

The Court acknowledged that care must be taken "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." In order to establish the arm's length price, a degree of flexibility and pragmatism is required.

[1] *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187

[2] Based on the applicable transfer pricing laws – Division 13 of Part III of the *Income Tax Assessment Act 1936*, and Subdivision 815-A of the *Income Tax Assessment Act 1997*.

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Losses do not mean the transfer price is not arm's length

The Commissioner challenged the amended contract on the basis that the taxpayer was "highly likely to be worse off" as opposed to staying under the prior contract. However, the Court held that prior contracts are not determinative of whether the arrangement in dispute was arm's length. 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". The Court found it reasonable to factor risk handling into the price determination. Given the extremely volatile copper concentrate market at that time, the trade-off between certainty and profitability was viewed as reflective of commercial prudence.

Key takeaways

The Glencore case is useful in lending guidance to interpreting complex transfer pricing rules. While the judgments under the case are untested in the new Subdivision 815-B environment, we believe the case has several key features that may help taxpayers defend their transfer pricing positions:

- Finding evidence that the same or similar pricing mechanism is adopted by independent parties in the market
- Ensuring the pricing is commercially prudent and consistent with the economic and market circumstances at the time of the arrangement
- Maintaining transfer pricing documentation on a contemporaneous basis. This not only evidences good corporate governance, but also mitigates the risk of hindsight challenge from the tax authorities. This is particularly important when a change in pricing methodology takes place.

Get in touch

Reach out to ShineWing Australia's global transfer pricing and international tax experts to discuss how these changes may present an opportunity for your business. To learn more about the case or transfer pricing in further detail contact one of our experts below.

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