AUSTRALIAN TRANSFER PRICING ALERT

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ARM'S LENGTH PRICING WILL BE HARDER TO JUSTIFY FOLLOWING THE CHEVRON CASE

In a landmark transfer pricing case, the Federal Court has held in Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4) [2015] FCA 1092, that Chevron Australia did not prove the interest rate on a loan from a related foreign company was at arm's length.

The Judge found in favour of the Commissioner under both the old transfer pricing rules in Division 13 of Income Tax Assessment Act 1936 and the revised transfer pricing rules in Subdivision 815-A of Income Tax Assessment Act 1997.[1]

Chevron Australia is considering an appeal of the Federal Court judgement and therefore whilst the case may not be over, the key issues for taxpayers to consider include the following:

- Chevron Australia did not provide sufficient evidence to prove that the consideration on the intra-group financing arrangement was the arm's length consideration. Onus of proof is on the taxpayer and this case highlights that to the extent taxpayers cannot discharge this onus through evidence it will be difficult to defend its transfer pricing arrangements from ATO scrutiny. This emphasis on the quality of proper analysis and documentation applies to all international related party dealings, not only intra-group financing arrangements.
- Taxpayers should review their intra-group financing arrangements to consider whether any economic analysis performed, in relation to determining the appropriate interest rate applied to its intra-group financing arrangements, takes into consideration all appropriate factors, including the financial resources available to the borrower that an arm's length lender would regard as relevant to the pricing of the loan. For example, would an independent lender require security or financial covenants in advancing funds in the first place? If the answer is yes, the loan may need to be priced as if these were in place. And this could result in a lower interest rate.
- Transfer pricing can be complex and there is not always a clear answer. The quality of analysis and corroboration of that analysis can be critical to supporting an outcome. In the Chevron case, many experts could not agree what the interest rate should be.

[1] Subdivision 815-A applies to income years commencing on or after 1 July 2004 and ceases to apply to income years to which Subdivision 815-B applies, which generally starts for income years commencing 1 July 2013.

SPECIALISATION
Transfer pricing

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- In addition to tax and interest, penalties of approximately $45 million (i.e. 25 per cent of the scheme shortfall amount) were imposed as the judge found the dominant purpose of the refinancing arrangement was to enter into a scheme, for which the sole or dominant purpose was to derive a benefit from the scheme. In the Chevron case, another entity in the US borrowed funds at a low interest rate (due to a guarantee from Chevron Corp) and on-lent funds to Chevron Australia at a higher interest rate which generated a large profit for the lender.
- This decision is reported just two weeks after the OECD announced its final Base Erosion Profit Shifting (BEPS) package in which many countries around the world have endorsed a number of actions explicitly designed to tackle perceived tax avoidance by multinational groups.
- More broadly the case is likely to empower the ATO to continue its pursuit in reviewing the transfer pricing positions of multinationals and taxpayers will need to be prepared to support their case.

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