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TP Cases Beyond Singapore's Shores

Key Takeaways From Recent Cases

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KEY TAKEAWAYS

- Stay abreast of recent international TP cases.
- Document the commercial rationale at the point of amending intercompany agreements.
- Prior agreements are not determinative of whether future agreements are arm's length in nature.

As the number of transfer pricing (TP) audits and litigations around the world rises, it becomes increasingly important for taxpayers to keep abreast of TP developments and proactively manage their intercompany transactions. At a recent webinar by the Singapore Chartered Tax Professionals, Accredited Tax Advisor (Income Tax) Elis Tan, Executive Director, and Koh Yun Qi, Associate Director, BDO Singapore, highlighted the critical issues and takeaways from recent international TP cases.

Intercompany Financing Arrangement – Singapore Telecom Australia Investments Pty Ltd V Commissioner of Taxation [2021]

This case concerned amended assessments issued by the Australian Taxation Office (ATO) to Singapore Telecom Australia Investments Pty Ltd (STAI), an Australia resident company, to disallow interest deductions on loans made under a related-party financial arrangement.

In October 2001, Singapore Australia Investment Ltd (SAI), a Singapore resident company, acquired Cable & Wireless Optus Ltd (CWO), which operated the Optus telecommunications business in Australia. SAI subsequently sold the shares of Singtel Optus Pty Ltd (SOPL) (formerly CWO) to STAI.

As part of the deal consideration to acquire the SOPL shares, an A$5.2-billion loan note issuance agreement (LNIA) was issued. Subsequently, the LNIA was amended three times over the term of the loan agreement:

- **First Amendment (31 December 2002)** – Reduced the maximum maturity date by one day.
- **Second Amendment (31 March 2003)** – The accrual and payment of interest was changed (with retrospective effect from the issuance date) to become contingent on certain financial benchmarks, and the interest rate was increased to include a premium of 4.552% once the benchmarks were met.
- **Third Amendment (30 March 2009)** – Changed from a floating interest rate to a fixed interest rate by substituting the one-year Bank Bill Swap Rate (BBSW) for a fixed rate of 6.835%, resulting in a fixed overall rate of 13.258%.

On the basis that the amounts of interest payable by STAI exceeded the amounts that might be expected to have been paid if the parties had been dealing at arm's length, ATO denied approximately A$895 million of interest deductions claimed by STAI in the 2010 to 2013 income years.

KEY ISSUES AND THE COURT'S DECISIONS

The Court found that, having agreed to the original LNIA, independent parties in the positions of SAI and STAI would not have then agreed to make the changes contained in the Second and Third Amendments. Specifically, independent parties would not have agreed to introduce financial benchmarks and add a premium of 4.552% in the Second Amendment. If a circumstance arose where the financial benchmark is never met, interest would never be paid.

The Court also pointed out that independent parties would not have agreed to change from a floating interest rate to a fixed interest rate in the Third Amendment, which was made amid the Global Financial Crisis when floating rates were generally decreasing. There was also a lack of expert evidence that the fixed rate of 6.835% was an arm's length substitute for the one-year BBSW at the time the amendment was made.

Ultimately, the Court decided in favour of the Commissioner on the basis that STAI had failed to demonstrate that the ATO's assessments were excessive.

KEY TAKEAWAYS FOR COMPANIES

- Ensure that comprehensive commercial and economic evidence are kept to support the company's transfer prices.
- When amending intercompany agreements, document the commercial reality that drove the amendments at the point in time; such contemporaneous documentation could help shed light on the commercial rationale behind the amendments in the event that the tax authorities challenge the company's TP position in the future.
- Consult relevant business units within the group before embarking on new or amending transaction terms to ensure that the proposed terms are in line with business norms and ensure that there is robust TP analysis to defend the company's TP positions.

International Trading of Commodities – Commissioner of Taxation V Glencore Investment Pty Ltd [2020]

This case concerned amended assessments issued by the ATO to increase the consideration Glencore International AG (GIAG) paid Cobar Management Pty Ltd (CMPL) for its copper concentrate, on the basis that the consideration was not at an arm's length price.

Since 1999, CMPL, an Australia resident company, has managed and operated a mine in Australia, and sold all the copper concentrate it produced to its ultimate Swiss parent, GIAG. The sales agreement between CMPL and GIAG had traditionally been structured as "market-related" agreements. In this connection, the agreement between CMPL and GIAG evolved over the years; the February 2007 agreement has the following key differences compared to the original 1999 agreement:

- The calculation of the treatment and copper refining charges (TCRCs), which reduced the price to be paid by GIAG to CMPL for the copper concentrate, was no longer to be determined by reference to the benchmark and spot market for TCRCs and was instead to be fixed at 23% of the copper reference price for three years, under a "price-sharing" arrangement.
- GIAG was provided with increased optionality in selecting the quotational period used to determine the average applicable copper price, which impacted the ultimate price to be paid by GIAG to CMPL for the copper concentrate. This included "back-pricing", which permitted GIAG to select the period after knowing the price for at least one of the periods.

The ATO issued amended assessments for years 2007 to 2009 to Glencore Investment Pty Ltd (GIPL), as the head company of a multiple entry tax consolidated group that included CMPL, and increased the consideration paid by GIAG to CMPL for the copper concentrate for those income years based on the pricing mechanism previously used instead of per the February 2007 agreement.

KEY ISSUES AND THE COURT'S DECISIONS

The Commissioner's primary case, based on expert evidence, was that an entity with the relevant attributes and in the position of CMPL, supplying copper concentrate to an independent counterparty with which it was dealing wholly independently, would not have agreed to a three-year 23% price-sharing mechanism and the increased quotational period optionality.

On the other hand, GIPL's case, also based on expert evidence, was that the relevant terms which the Commissioner took issue with were terms that existed in contracts for the sale of copper concentrate between independent parties in the same industry and with some of the same characteristics as CMPL and GIAG, and were therefore terms that might be expected to be found in an arm's length agreement that was absent of any relational bias.

In conclusion, the Court found that GIPL had discharged its onus of proof. The Court was satisfied on the evidence that the terms operating between CMPL and GIAG to calculate the price at which CMPL sold its copper concentrate to GIAG were ones which might reasonably have been expected between independent parties, in the position of CMPL and GIAG, dealing with each other at arm's length, and the consideration received by CMPL was also one which might reasonably have been expected between such parties.

KEY TAKEAWAYS FOR COMPANIES

- Ensure that related-party agreements are commercially viable, and that the form matches the substance of the transaction.
- Prior agreements are not determinative of whether future agreements are arm's length in nature.
- Expert evidence by credible witnesses may be heavily relied upon by the Courts and goes a long way in defending the company's TP position.

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