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Cross border financing and practical implications going forward

Angelina Lagana, Jane Rolfe, Sean Madden & Joe Tranzillo

This article provides insights from the decision in ***Singapore Telecom Australia Investments Pty Ltd v Commissioner of Taxation [2021] FCA 1597*** *(SingTel case) to assist taxpayers in managing their cross border inter-company arrangements as well as highlighting the evidentiary considerations that taxpayers must take into account in order to discharge their onus of proof in transfer pricing cases.*

The implications outlined below could potentially impact all taxpayers with international related party dealings (not just loans), both retrospectively and prospectively.

Summary

The decision in *SingTel* was handed down by the Federal Court on 17 December 2021, with Justice Moshinsky finding in favour of the Commissioner of Taxation (**Commissioner**).[1] The case is only the second Australian transfer pricing case to address issues directly raised by cross border inter-company financing following the Full Federal Court's April 2017 decision in *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 (**Chevron**) which also found in favour of the Commissioner.

The *SingTel* decision is a further development of Australia's transfer pricing laws. The dispute primarily concerned the application of Subdivision 815-A of the *Income Tax Assessment Act 1997* (**Subdivision 815-A**) to cross-border related-party borrowings.[2] The application of the former Division 13 of Part III of the *Income Tax Assessment Act 1936* (**Division 13**) was only briefly considered.[3] While these provisions have since been replaced by Subdivision 815-B of the *Income Tax Assessment Act 1997* (**Subdivision 815-B**) for income years commencing on or after 29 June 2013, there no doubt remains a number of large audits and disputes on-foot in which the Commissioner seeks to apply these earlier provisions. Additionally, some of the concepts embedded in Subdivision 815-A and possibly also Division 13 could potentially inform how Subdivision 815-B might be interpreted by the courts.

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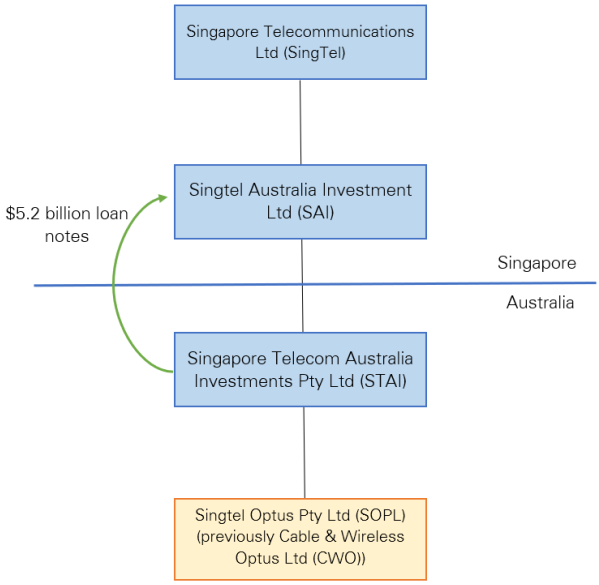
[1] *Singapore Telecom Australia Investments Pty Ltd v Commissioner of Taxation Transfer Pricing* [2021] FCA 1597.
[2] Paragraph [14].
[3] Paragraph [349].

Background

- In October 2001, SingTel Australia Investment Ltd (**SAI**), a Singapore tax resident, acquired SingTel Optus Pty Ltd (**Optus)**, which operated the Optus telecommunications business in Australia.

- In June 2002, Singapore Telecom Australia Investments Pty Ltd (**STAI**) acquired 100 percent of the issued capital in SingTel Optus Pty Ltd (**Optus**) for $14.2 billion from its immediate parent company, SSAI. The acquisition was funded by STAI through the issuance of ordinary shares and $5.2 billion of loan notes (**Loan Notes**) to SAI. This is illustrated in the diagram.



- The Loan Notes were denominated in AUD and were issued in June 2002 with a maturity date of no later than the tenth anniversary of the issue date, bearing interest at a floating rate of 1 year BBSW + 1.00 percent. The Loan Notes also provided for a withholding tax "gross-up". This meant that STAI was required to gross-up the interest payable under the Loan Notes so as to indemnify the noteholder for interest withholding tax payable at the rate of 10 percent.

- The Loan Notes were subject to the following three amendments:

  1. **First Amendment (31 December 2002)** – reduced the maximum maturity date by one day;

  2. **Second Amendment (31 March 2003)** – with retrospective effect from the issuance date, the accrual and payment of interest was changed to become contingent on certain benchmarks relating to Optus' financial performance, as well as a consequential increase to the interest rate to include a premium of 4.552 percent from the time the benchmarks were expected to be met; and

3. **Third Amendment (30 March 2009)** – changed from a floating interest rate to a fixed interest rate by substituting the 1 year BBSW rate for a fixed rate of 6.835 percent. As a consequence, the applicable interest rate became 13.2575 percent, comprising: (a) the interest rate (6.835 percent plus 1 percent) multiplied by 10/9; plus (b) the premium (4.552 percent).[4]

- The terms of the amended Loan Notes resulted in a total interest expense of $4.9 billion, which gave rise to deductions of the same amount.

- The Commissioner issued transfer pricing determinations to STAI under Subdivision 815-A and Division 13 denying approximately $895 million of the interest deductions claimed by STAI in the 2010 to 2013 income years, 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. The Commissioner issued amended assessments to give effect to the determinations and STAI objected to those Amended Assessments.

The parties' respective cases

As expressed by Justice Moshinsky, Subdivision 815-A first requires consideration of whether the conditions that operated between SAI and STAI in their commercial or financial relations differed from those which might be expected to operate between independent enterprises (**the Conditions Issue**).[5] Second, it requires consideration of whether the amounts of interest payable by STAI under the Loan Notes exceeded the amount payable had the "conditions which might be expected to operate" replaced the actual conditions that operated in respect of the Loan Notes (**the Profits Issue**).[6]

SingTel

SingTel argued that the actual structure of the Loan Notes (including the series of amendments) was not typically observed in the markets but was economically equivalent to a traditional debt capital market instrument with deferred and capitalised interest.[7]

A credit rating for STAI was determined by SingTel's credit rating expert witness, Dr. William J Chambers as ranging between BB and BBB over the period in which the Loan Note Issuance Agreement (**LNIA**) was outstanding. This rating included an uplift of 2-3 notches for parental affiliation with the broader SingTel group (which was rated A/A+ at the time).

On that basis, SingTel's debt capital markets expert Mr Charles Chigas determined that such an instrument (i.e. a 10 year loan note rated BB/BBB with deferral and capitalisation of interest) issued in the Debt Capital Markets (**DCM**) between arm's length parties might be expected to have a credit spread of 4.00 percent.[8] Chigas then compared that with his

[4] Paragraph [8].
[5] Paragraph [301].
[6] Paragraph [317].
[7] Paragraph [157] – [158].
[8] Paragraph [159].

calculation of the effective credit spread to maturity on the Loan Notes of 1.44 percent plus the withholding tax gross-up.

Chigas also put forward additional analysis that was based on the assumption of a parental guarantee provided by SingTel (to address arguments raised by the Commissioner), which demonstrated:

- A DCM transaction with a parent guarantee from SingTel, *with no guarantee fee* payable by STAI, would have had a credit spread of 205 to 215 bps.
- A DCM transaction with a parent guarantee from SingTel, *with a guarantee fee* payable by STAI, would have had a total credit spread of 300 to 360 bps.

As the total cost of the LNIA in each of the scenarios considered by Chigas were above the actual LNIA effective credit spread of 1.44 percent, it was concluded by Chigas that no profits were expected to accrue to STAI which did not so accrue due to non-arm's length dealings.[9]

Commissioner

The Commissioner put forward a number of alternative cases based on the expert evidence of Mr Weiss and Mr Johnson, experts in the fields of credit rating and DCM respectively.[10]

The credit rating for STAI as determined by Weiss ranged from A to A+ over the period in which the LNIA was outstanding. While the standalone rating of STAI was considered to be similar by both Weiss and Chambers, the level of implicit support applied by Weiss was much greater, such that the credit rating of STAI was aligned with that of the broader SingTel group.

Based on this rating, the Commissioner's DCM expert hypothesised that an arm's length financing structure would have involved STAI issuing a bridge loan for the first 9 months of the term (with interest payable at termination), which would then be refinanced by two loans with a term of 9 years and 3 months – one loan of $5.2 billion to refinance the principal amount and another loan of $1.5 billion to cover interest that would otherwise be deferred (including interest accrued under the bridge loan and interest expected to accrue and be deferred under the refinancing).[11]

Johnson also hypothesised that the loans would be 50 percent fixed and 50 percent floating, with no withholding tax gross-up.

The Commissioner's secondary case was based on the **No Amendment Model**. This model reflects the impact on the LNIA interest deductions if one assumes the original LNIA terms remain in place over the life of the financing and the Second and Third Amendments do not take place.

These calculations are based on the provisions and rates as provided under the original LNIA, with the exception that it is assumed interest is accrued and capitalised to principal

[9] Paragraph [263].
[10] Paragraph [166].
[11] Paragraph [165].

every 31 March. As explained by Mr Johnson in oral evidence, this calculation is "BBSW plus one per cent for the credit spread for the entire period". This model resulted in an excess interest expense of approximately $670 million (before the 10/9 gross-up) and approximately $745 million (after gross-up).[12]

The Commissioner's third alternative case was based on the **No Third Amendment Model**. This model reflects the impact on the LNIA interest deductions if one assumes the terms of the LNIA as amended by the Second Amendment remain in place after 31 March 2003, and the Third Amendment does not take place.

These calculations are based on the calculations and interest rates used by STAI in determining its interest rate deductions under the LNIA with the only exception being there is no conversion to a fixed rate in April 2009.[13]

It is unsurprising that this is yet another transfer pricing decision in which the parties sought to engage experts to support the positions taken. As explained in further detail below, the relevance of any expert evidence will depend on critical aspects such as the questions put to the experts, their expertise to opine on a particular question and of course, their credibility.

Federal Court decision

Justice Moshinsky decided in favour of the Commissioner, although it was on the basis of the Commissioner's secondary rather than primary case (i.e., the same interest rate as agreed by the parties in the original LNIA would have (or might be expected to have) applied throughout the whole life of the transaction).[14]

Although the case involved both Subdivision 815-A and Division 13, the focus of argument on both sides, and the findings of Justice Moshinsky, were delivered in respect of Subdivision 815-A.

Under the statutory test in Subdivision 815-A, the central issue was whether, but for the conditions that operated between SAI and STAI in their commercial or financial relations, an amount of profits might have been expected to accrue to STAI and, by reason of those conditions, the amount of profits has not so accrued.

This involves forming a reliable hypothesis based on probative material as to what independent parties in the positions of SAI and STAI might have been expected to have done.

Justice Moshinsky, at paragraph 156, summarised what he described as the key propositions relating to Subdivision 815-A which emerge from the Full Federal Court's decisions in *Chevron* and *Glencore*[15] as follows:

[12] Paragraph [292].
[13] Ibid.
[14] Paragraphs [345] and [355].
[15] *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187 (*Glencore*).

1. in relation to s 815-15(1)(b) and the reference to "conditions" in the associated enterprises article of double tax treaties, the identification of those conditions permits a broad and wide ranging inquiry into the relations existing between the enterprises concerned;
2. in relation to the causal test in s 815-15(1)(c), the test "is a flexible comparative analysis that gives weight, but not irredeemable inflexibility, to the form of the transaction actually entered into between the associated enterprises";
3. the form of the transaction "may, to a degree, be altered if it is necessary to do so to permit the transaction to be analysed through the lens of mutually independent parties";
4. the comparison required by s 815-15(1)(c) and the associated enterprises article "will generally require that the parties in the hypothetical will generally have the characteristics and attributes of the actual enterprises in question"; and
5. in relation to whether non-price terms of a transaction may be the subject of substitution in the exercise required by s 815-15(1)(c) and the associated enterprises article, the matter was left open by Middleton and Steward JJ in *Glencore*. Justice Moshinsky agreed with the observations of Thawley J that non-price terms may be substituted.

Applying the principles

For the purposes of the 'hypothetical' constructed under Subdivision 815-A, Justice Moshinsky found that a party in the position of STAI would be a member of a multinational corporate group like the SingTel group (consistently with the Full Federal Court's decisions in *Chevron* and *Glencore*).

Additionally, the hypothetical would be a transaction between a vendor and a purchaser of shares, where loan notes totalling $5.2 billion are issued by the purchaser as partial consideration for the acquisition of the shares.

The loan notes are assumed to be issued pursuant to a loan note agreement with a maximum term of 10 years (or 10 years less one day).

In applying the hypothetical to the facts and circumstances of the case, it was found by Justice Moshinsky that:

- Independent parties in the positions of STAI and SAI might have been expected to agree in June 2002 to issue loan notes with an interest rate of 1 year BBSW + 1.00 percent with interest deferral and capitalisation and a withholding tax gross-up, subject to a parent company guarantee from a company like SingTel of the obligations of the company in the position of STAI.[16]
- Furthermore, independent parties in the positions of SAI and STAI would not have agreed to make the changes contained in the Second Amendment. In particular, they

[16] Paragraph [322].

would not have agreed to introduce the benchmark terms and add the Premium of 4.552 percent.[17]

Justice Moshinsky found there was no apparent commercial rationale for the Second Amendment, as set out in paragraph 338 of the judgement:

There was a suggestion in STAI's submissions that the Second Amendment was needed to address SOPL's cashflow issues. However, the original LNIA already permitted STAI to defer and capitalise interest, and this has been incorporated into the hypothesis. Thus, cashflow issues affecting SOPL do not provide a commercial rationale for the Second Amendment. It seems more likely that, as submitted by the Commissioner, the aspect of the Second Amendment that stopped the accrual of interest (at least for a time) was directed at withholding tax issues. Further, there is no witness evidence as to the commercial rationale of the Second Amendment.

- Further, independent parties would not have agreed to make the changes in the Third Amendment. That is, they would not have agreed to change the component of the interest rate that was the 1 year BBSW to a fixed amount of 6.835 percent.[18]

Justice Moshinsky rejected the evidence put forward by SingTel that the amendment to the floating rate component of the interest rate under the LNIA was required to obtain certainty as to the funding costs under the LNIA going forward, as set out in paragraph 342 of the judgement:

In the absence of any commercial rationale, and in the absence of expert evidence that the figure of 6.835 percent was an arm's length substitute for the 1 year BBSW at the time of the Third Amendment (or the time the changes were substantively agreed), I consider a reliable hypothesis to be that independent parties in the positions of SAI and STAI would not have agreed to make the changes in the Third Amendment.

It follows that the original interest rate would have (or might be expected to have) continued through the whole life of the LNIA.

With respect to the approach taken by SingTel, Justice Moshinsky held that SingTel and Chigas' analysis departed too far from the actual transaction and the characteristics of the parties to that transaction and therefore, departed from the approach required under Subdivision 815-A.[19] The actual transaction involved a vendor and a purchaser of shares, and an issue of loan notes totalling approximately $5.2 billion by way of partial consideration for the acquisition of the shares. It did not involve a DCM bond issue.

Key issues

While it is yet to be confirmed if SingTel will appeal the decision of the Federal Court, Justice Moshinsky's judgment explores a number of issues that are likely to be relevant to

[17] Ibid.
[18] Op cit. 16.
[19] Paragraph [343].

other taxpayers with cross border related party financing or other transactions to which Subdivision 815-A or Division 13 may apply.

Amendments to agreements, practical implications and the importance of evidence

Justice Moshinsky found that having agreed to the original LNIA, a reliable hypothesis is that independent parties in the positions of SAI and STAI would not have then agreed to make the changes contained in the Second or Third Amendments.

Applying these findings to a more general transfer pricing analysis suggests that when considering any amendments to related party arrangements, taxpayers should ensure both that the amended terms and conditions are arm's length, but also that independent parties acting independently would agree to amend the existing arrangement. That is, considering the options realistically available to the parties (which would usually include continuing with business as usual), there must be contemporaneous evidence of the commercial rationale for amendments to the original arrangement.

This is consistent with the decision in *Glencore*[20] which found that, based on the evidence available in that case, a high-cost mine in the position of the taxpayer might reasonably be expected to vary its arrangements and enter into a price sharing agreement.

As with most transfer pricing issues, the best support for the arm's length nature of an amendment to an existing related party arrangement would be evidence that independent parties have entered into similar amendments in similar circumstances. Recognising that such evidence is not always readily available, other indicia of arm's length behaviour should be considered and applied to the relevant facts and circumstances, such as those outlined below:[21]

- an arm's length outcome is one that makes business sense in the circumstances of the particular taxpayer;
- an independent party dealing at arm's length would seek to protect its own economic interest;
- an independent party dealing at arm's length would compare the options realistically available and seek to maximise the overall value derived from its economic resources (noting however, the comments expressed in Glencore, that "*a taxpayer is under no obligation to choose a pricing methodology which pursues profitability in Australia at the expense of prudence" and "there is no obligation to "maximise" profitability at the expense of all else"*[22]);
- one option might be to not enter into a transaction because it does not make commercial sense for the particular taxpayer.

[20] Glencore at [153].
[21] TR 2011/1 paragraph [14], see also Chapter IX of the OECD Transfer Pricing Guidelines.
[22] *Glencore* at [182].

There is no doubt that contemporaneous evidence of the above will assist in supporting the position taken.

The decision is another reminder of the importance of supporting the arm's length nature of any amendment. The transfer pricing analysis should show why entering into the amendment makes commercial sense for the parties, having regard to what is in their best economic interests and the options realistically available to them.

Credit ratings

Another key issue to the dispute was the role of parental support and its impact on creditworthiness and the interest rate. There are two types of parental support:

1. **Implicit support** reflects the expectation that a parent company will support a subsidiary to meet its debt obligations. Hence, a subsidiary is afforded extra creditworthiness by virtue of being part a multinational group even if that support is not expressly stated.
2. **Explicit support** refers to a binding parent company guarantee where the parent company is liable to the lender if the subsidiary defaults on the loan. Hence, in such situations the subsidiary's credit rating is usually equalised to that of the parent company.

Implicit support

There is a substantial difference between implicit support and an explicit guarantee. Implicit support is limited to the willingness and ability of the parent company to support its subsidiary and meet any debt obligations when it is not legally bound to do so. The major credit rating agencies (Standard & Poor's, Moody's and Fitch) adjust their credit rating assessments for subsidiaries to account for implicit support. The rating agencies specify that the first step in assessing implicit parental support for a subsidiary is the stand-alone rating indication of the subsidiary.[23] The next step is to raise this to reflect the expected support of the parent. The agencies also recognise that a combination of factors, not any one specific factor, is analysed to determine implicit support.

In this case, there was not a great deal of difference between the experts as to the *stand-alone* creditworthiness of STAI. The real difference between the experts was the impact of *implicit support* provided by STAI's indirect parent, SingTel, and thus the overall issuer credit rating of STAI. All the experts agreed that there would be *some* enhancement to STAI's rating.[24] However, they differed as to the extent of the enhancement.

The Commissioner's credit rating expert, Weiss, was of the view that the implicit support would improve STAI's credit rating by 6 to 8 notches, whereas STAI's credit ratings expert, Chambers, opined an increase of only 2 to 3 notches. The court favoured the views expressed by Chambers on the basis that:

[23] Paragraph [198].
[24] Paragraph [201].

1. Chambers adopted a more cautious approach to the assessment of implicit support, which better reflected the S&P criteria and the Moody's criteria for assessing implicit support.
2. Chambers maintained his opinions during cross-examination and explained in clear and persuasive terms the reasons why he held those opinions.
3. Weiss's analysis did not consider fully whether SingTel would be prepared to provide the $5.2 billion debt voluntarily at a time when STAI was in distress.

Whilst the impact of implicit support will be subject to the individual facts and circumstances of each case, it is clearly a relevant factor that should be considered in any analysis of related party financing.

Explicit support

There was no parental guarantee in the actual SingTel transaction and it was of course unnecessary because the parties to the transaction, SAI and STAI, were both wholly-owned by the same company, SingTel. However, His Honour concluded that in the hypothesis of a transaction between independent parties in the positions of SAI and STAI, the "logic of the situation" (i.e. the large size of the transaction and the parent company preferring its subsidiary to avoid incurring higher interest costs) pointed strongly towards a parent guarantee being provided at arm's length.[25]

It is important to the note that the Full Federal Court in *Chevron* imputed a parental guarantee on the basis that it conformed with the policy of the *Chevron* group to borrow externally at the lowest cost and provide a parental guarantee for subsidiaries that borrow externally.[26] Justice Moshinsky avoided such reliance on group policy in *SingTel*, but rather imputed a guarantee based on the fact that the parent could borrow at a lower cost of funds than its subsidiary, and it would be rational for the parent to make a decision to minimise the group's overall cost of funding by providing a parental guarantee.[27] Additionally, it was noted that SingTel had previously provided a guarantee over third party borrowings of Optus Finance Pty Ltd (a related entity in Australia).

In light of the above, the provision of a parental guarantee should be considered as one of the options realistically available to the parties to the transaction. Any facts which prove (or disprove) the logic and rationale of providing a parental guarantee in the specific circumstances of each case should be supported by appropriate evidence as it is likely to be a key focus of any potential future dispute with the ATO or other revenue authorities.

Guarantee fee

Importantly, STAI argued that if a parent guarantee was to be imputed between the parties, then a guarantee fee paid from STAI to SingTel should also be imputed. The cost of any guarantee fee would reduce the amount of any transfer pricing benefit. Chigas provided

[25] Paragraph [324].
[26] *Chevron* at [63].
[27] Paragraphs [326]-[327].

evidence on this point and quantified an arm's length guarantee fee of between 95 bps to 146 bps.

This argument was rejected on the basis that there was a lack of probative evidence to hypothesise that, assuming the provision of a parent guarantee, a guarantee fee might be expected to be charged. Justice Moshinsky found the evidence provided by Chigas on this point to be expressed in very general terms and the quantification of the guarantee fee was described as "speculative".[28] Furthermore, there was no evidence that SingTel charged a guarantee fee for guaranteeing the obligations of Optus Finance Pty Ltd under its earlier $2 billion bank facility.[29]

In *Chevron*, the same conclusion was reached where the Full Federal Court found that there was insufficient evidence on the case to warrant the conclusion that a fee might reasonably have been expected to have been paid by CAHPL to its parent as part of the consideration that CAHPL might give in respect of the hypothetical loan and the provision of security.[30] However in *Chevron*, no evidence was led in relation to the existence or quantification of a guarantee fee, and obiter from Justice Pagone indicated that a cross border guarantee by a parent to a subsidiary may require the payment of an arm's length guarantee fee.[31]

This aspect of the *SingTel* judgement may surprise transfer pricing practitioners. It has generally been accepted by practitioners that the provision of a parental guarantee would be a chargeable service to the extent it provided a benefit to the recipient, and this approach has been codified in the OECD Transfer Pricing Guidance on Financial Transactions, released in February 2020 and included as Chapter 10 of the OECD Transfer Pricing Guidelines, and expected to be included as "relevant guidance material" in the future for purposes of Subdivision 815-B. In the context of this case, there was a clear benefit provided by the parental guarantee, being the increase in credit rating of STAI from BBB-/BB (the credit rating of STAI with implicit support as accepted by Justice Moshinsky) to A/A+ (the credit rating of the SingTel group, the pricing of which was ultimately used to determine the arm's length consideration for the tested transaction). It would be interesting therefore, to consider whether the same outcome would have been reached had the analysis prepared by Chigas valued the benefit provided by a parental guarantee in respect of the LNIA without amendment, which was found by Justice Moshinsky to be the conditions which might be expected to operate between the parties, or whether some value should be ascribed to the benefit of the parent guarantee.

Discharging the onus of proof and evidence

SingTel was unsuccessful in this case because it failed to prove that the amended assessments issued by the Commissioner were excessive.[32]

Justice Moshinsky expressed the view that the questions asked of both Mr Chigas and Mr Johnson did not conform to the statutory test under Subdivision 815-A.[33] His Honour had

[28] Paragraph [328].
[29] Ibid.
[30] *Chevron* at [133].
[31] Ibid.
[32] *Taxation Administration Act*, s 14ZZO(b).
[33] Paragraph [234] and [268].

particular difficulty accepting Mr Chigas' view in relation to a number of aspects of the LNIA, nor did Mr Chigas sufficiently address whether the changes effected by the Second Amendment might be expected to have been made if the parties were independent.[34] This was predominantly due to the lack of independent comparable data presented to support the arm's length nature of the amendments to the LNIA.

In order to discharge the burden of proof, taxpayers should consider the evidence available. This may include a combination of:

1. Lay evidence from people within the business with respect to all the facts and circumstances surrounding the tested transaction,
2. Evidence of comparable transactions, and
3. Evidence (via independent expert opinions) that the comparable transactions identified are characteristic of arm's length arrangements.

Based on our experience, taxpayers are more likely to resolve disputes successfully without the need for expert evidence and litigation if they are prepared early. Contemporaneous commercial evidence collated at the time of a particular transaction typically provides the "best" evidence in providing the ATO with comfort in respect of cross border arrangements. Efforts upfront can obviate the need to spend the greater time and higher costs that are often involved in gathering evidence during an ATO review, audit or in preparing for litigation.

The decision of *SingTel* reminds taxpayers of the importance of carefully considering what evidence is required to discharge the burden of proof and the importance of gathering that commercial evidence before the ATO come knocking.

Potential implications for Subdivision 815-B

As mentioned above, *SingTel* does not consider the current transfer pricing provisions contained in Subdivision 815-B. Nevertheless, *Singtel* could potentially inform taxpayers as to how Subdivision 815-B might be interpreted.

At its core, Subdivision 815-B also involves identifying a hypothetical transaction between independent entities (ss 815-125(1) and ss 815-130). In essence, it would be necessary for the Commissioner to show that (and the taxpayer subsequently to disprove that) independent entities dealing wholly independently with one another in comparable circumstances "would not" have entered into the actual commercial or financial relations and "would" have done something different or nothing at all. Consequently, a taxpayer that has evidence demonstrating that independent entities do enter into similar transactions should have strong prospects of being able to be resist such an argument and address the potential application of ss 815-130(3). In the recent Decision Impact Statement released for *Glencore*, the Commissioner noted that there are textual differences between the statutory tests in Subdivisions 815-A and 815-B. This may impact how relevant the decisions of

[34] Paragraph [296].

Glencore, *Chevron* and *SingTel* are in the application of Subdivision 815-B by a court. Those differences include:

1. section 815-125 of Subdivision 815-B defines 'arm's length conditions' with specific reference to independent parties dealing wholly independently with one another in 'comparable circumstances' and a non-exhaustive list of relevant factors to which regard must be had in identifying those comparable circumstances is provided, and
2. section 815-130 of Subdivision 815-B sets out a 'basic rule' and 'exceptions' framework for how the arm's length conditions are to be identified and in what circumstances the identification of the arm's length conditions is to be based on the 'actual commercial or financial relations'.

Time will tell as to how the courts will interpret and apply Subdivision 815-B to cross-border arrangements.

Recommendations

The importance of having comprehensive, relevant commercial and economic evidence to support transfer prices of related party transactions is highlighted by the *SingTel* decision.

Revenue authorities have become increasingly concerned with cross border financing, and the ATO continues to undertake risk assessments in accordance with Practical Compliance Guideline 2017/4 (outlining the ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions) which considers any financing arrangements that do not align with the group cost of funds to be high risk. This approach to related party cross border financing is unlikely to change following the *SingTel* decision.

Based on our experience, the most compelling evidence (gathered prior to commencing litigation and/or gathered to support the tax position in the event of scrutiny) often lies and commercial contemporaneous evidence. Our key recommendation is to engage tax controversy and transfer pricing specialists at the time of entering or amending arrangements. Whilst this does not guarantee a taxpayer from being scrutinised by the ATO (as was the case with SingTel), it will assist you in ensuring that you are 'audit ready' before any ATO review.

Following this decision, when undertaking a transfer pricing analysis of related party funding arrangements, the provision of a parental guarantee should be considered as one of the options realistically available as part of the analysis. Additionally, any facts which prove (or disprove) the logic and rationality of providing a parental guarantee in the specific circumstances of each case should be supported by appropriate evidence as it is likely to be a key focus of any potential future dispute with the ATO or other revenue authorities.

More generally, this case highlights the need for care to be taken when making amendments to existing related party arrangements. Not only must the amended arrangement be considered arm's length but importantly, entering into the amendment should be supported as making commercial sense for the parties, having regard to the economic interests and the options realistically available to the parties. Efforts should be

applied to ensure that appropriate evidence exists to demonstrate these considerations, including an examination of comparable transactions to support both the change in the arrangements and ongoing pricing.

Leave to appeal

It is yet to be confirmed if SingTel will appeal the decision of the Federal Court. Our dedicated Tax Controversy and Transfer Pricing specialists look forward to continuing to keep you updated on the transfer pricing dispute landscape in Australia.

KPMG and KPMG Law have a dedicated team specialising in Tax Controversy and Dispute Resolution and Transfer Pricing. Our Tax Controversy and Transfer Pricing team assists multinationals with complex cross border arrangements. We help by reviewing and assessing related party transactions objectively, advising in respect of evidence and helping taxpayers evaluate their arrangements and support their positions. We help taxpayers at the time of entering the arrangements and otherwise prepare for and represent taxpayers in respect of the entire tax dispute lifecycle including ATO reviews, audits, objections, settlement, MAP and litigation.

We work as one team to deliver holistic, practical and commercial advice on how best to prepare for any ATO scrutiny and during your dealings with the ATO.

Contact us

Angelina Lagana
Partner – Tax Dispute Resolution and Controversy
KPMG Melbourne
T: +61 3 8663 8650
E: alagana@kpmg.com.au

Jane Rolfe
Partner – Transfer Pricing Services
KPMG Melbourne
T: +61 3 9288 6341
E: janerolfe@kpmg.com.au

Joseph Tranzillo
Lawyer – Tax Dispute Resolution and Controversy
KPMG Sydney
T: +61 2 9273 5272
E: jtranzillo@kpmg.com.au

Sean Madden
Director – Transfer Pricing Services
KPMG Melbourne
T: +61 3 8663 8056
E: smadden3@kpmg.com.au

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