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Recent Cases – International Aspects of the RCF IV and BHP Billiton Full Federal Court decisions

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Presented by:

Andrew Broadfoot QC

Victorian Bar

(03) 9225 8322

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CONTENTS

1	Introduction	3
2	The BHP Case.....	6
2.1	Background facts and issues for determination.....	6
2.2	Approach of the Majority in the Full Court	8
2.2.1	<i>Whether Ltd and Plc sufficiently influenced the other – Thawley J.....</i>	9
2.2.2	<i>Whether Ltd and Plc sufficiently influenced the other – Allsop CJ.....</i>	12
2.2.3	<i>Whether BMAG was sufficiently influenced by Plc and Ltd.....</i>	13
2.3	Approach of Davies J.....	13
2.4	Observations	14
3	The RCF IV Case	19
3.1	Background facts and issues for determination.....	19
3.2	The Full Federal Court Decision	20
3.3	Were the partners or the partnerships assessed?.....	21
3.4	Full Federal Court Decision – the source issue.....	21
3.5	Implications of the source finding	22
3.6	Issues under the US DTA.	22
3.7	Could the LPs rely on the DTA?	23
3.8	The Ruling issue	27
3.9	Article 7 of the US DTA.....	28
3.10	Whether Article 13 allocated taxing rights to Australia.....	28
4	Conclusions.....	33

1 Introduction

1. The decisions in *Commissioner of Taxation v BHP Billiton Ltd* [2019] FCAFC 4 (**the BHP Case**) handed down on 29 January 2019, and in *Commissioner of Taxation v Resource Capital Fund IV LP* [2019] FCAFC 51 (**the RCF IV Case**) handed down on 2 April 2019 are probably the two most significant international tax decisions handed down by an intermediate appellate court in the last few years.
2. The BHP Case is one in which a Federal Court judge at first instance (Logan J) sitting in the Administrative Appeals Tribunal determined the issue, which concerned the application of the definition of “associate” in the Controlled Foreign Companies (**CFC**) provisions in Part X of the ITAA 1936, in favour of the taxpayer. On appeal, Davies J would have also resolved the issue in favour of the taxpayer, but the conclusions reached by Allsop CJ and Thawley JJ resulted in the Commissioner’s appeal being allowed. On 15 May 2019, an application for special leave to appeal from the majority decision of the Full Federal Court was granted.
3. In the RCF IV Case, the taxpayer was also successful at first instance, before Pagone J. Once again, the Commissioner was successful on appeal, with joint reasons delivered by Besanko, Middleton, Steward and Thawley JJ, with a separate judgment again delivered by Davies J. Her Honour agreed with much of the reasoning in the joint judgment, but disagreed on a significant issue concerning the construction of the *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal evasion with respect to Taxes on Income (the DTA)*. That decision is also the subject of an application for special leave to appeal for the High Court, but as at the time of writing, the application has not been determined.
4. The BHP Case involved a relatively narrow issue of statutory construction in determining whether members of the broader BHP dual-listed group were “associates” of each other within the meaning of s 318 of the ITAA 1936. Although the issue is narrow, many commentators have suggested that the case could be of broader application given that the term “associate” is used in many other parts of the income tax legislation which adopt the s 318 definition. The RCF IV decision on the other hand concerned interpretation of a range of provisions both in the domestic tax legislation and the DTA. Overall, however, discussions on the international implications of that decision have focused on the consequences for private equity structures, particularly with inbound investments into Australia, which is arguably a narrower scope of influence in terms of broader consequence for the application of other provisions of the income tax legislation than that which has been suggested might apply as a result of the BHP Case.
5. As explained below, the author’s view is that the application of the definition of “associate” in the BHP Case was heavily influenced by the facts before the court concerning the arrangements between BHP Billiton Ltd and BHP Billiton Plc. The importance of the decision to companies that are not party to a dual-listed arrangement may be limited, although the scope of influence is unclear. On the other hand, the construction of the DTA adopted by the majority in the Full Federal Court in the RCF IV Case carries significant implications for many overseas investors, especially those that participate in limited partnerships that are commonly adopted to facilitate in the flow of capital into Australia. Further, the complexity of Australia’s treatment of limited partnerships as separate entities from their partners for the purpose of assessing income tax,

continues to evolve with at least Division 832 of the ITAA 1997 (effective 1 January 2019) and Article 3 of the *Multilateral Instrument*¹ (which will effect Covered Tax agreements at different times but ultimately not the US tax treaty) now also potentially relevant to the use of limited partnerships.

6. While the differing outcomes reached as between first instance and on appeal in both decisions demonstrate that the only thing that is certain in tax litigation is that there is uncertainty, the author's very tentative prediction is that:
 - a. if the taxpayer's appeal in the BHP case succeeds, it is likely to be at least in part due to a concession that was made by the Commissioner, that the words "to act in accordance with" in the definition of "sufficiently influenced" require a causal relationship between the directions or wishes of one entity and the actions of another.² Unless the concession is departed from, or the High Court considers there not to have been a concession, the taxpayer is likely to win. If the Commissioner seeks to resile from his concession, and/or if the High Court considers it appropriate to determine the issues regardless of the concession, the outcome may be different; and
 - b. if special leave is granted in the RCF IV Case, there is a reasonable prospect that the taxpayer will succeed in at least some of its arguments. In particular, the trial judge's approach to the first statutory interpretation issue determined at first instance (i.e. whether a partnership is an "entity") was orthodox and recognised by the Full Court as being open on the text of the legislation; and there is much to be said for the approach taken by Davies J in the Full Court that would allow US residents investing into Australia through a corporate limited partnership registered in a third country, and such limited partnerships, to access the benefits of the US DTA in proceedings brought under Part IVC by the limited partnerships. If the first issue was determined in favour of the taxpayer, the appeal would be allowed. This construction issue under Division 5A of the *Income Tax Assessment Act 1936* (Cth) is not addressed in this paper. If the issue of whether the taxpayers were entitled to rely on the DTA was determined in favour of the taxpayer, the taxpayer would still need to succeed in establishing that the gains derived were not derived "from the alienation or disposal of real property" within the meaning of Article 13(1) of the US DTA.
7. The following discussion of each of the decisions focuses on the international tax aspects, as we await with interest the outcome of the appeal in the BHP Case, and the outcome of the special leave application in RCF IV. As a result of the divergence between Pagone J and the Full Court on the first statutory interpretation issue, which concerned whether a partnership is an "entity" for the purposes of the domestic tax legislation, is not addressed. It is also beyond the scope of this paper to address a number of the other issues that were considered in the RCF IV Case and in particular the taxpayer's argument about unconstitutional incontestable taxes, the issues concerning valuation, and the legal character of particular kinds of mining tenements including whether a general purpose lease issued under the *Mining Act 1978* (WA) is a lease of land for the purposes of the Taxable Australian Real Property provisions. Those issues are very important for

¹ *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.*

² The fact that the requirement for a causal relationship was agreed is recorded in the reasons of Thawley J at [87] and [162] and by Davies J at [25].

taxpayers, especially those with Australian mining interests, but they are not addressed in this paper which seeks only to address the international tax aspects.

8. Ultimately the consequences of both decisions must be regarded as uncertain pending the outcome of BHP's appeal and the outcome of RCF's special leave application and the subsequent appeal, should leave be granted.

2 The BHP Case

2.1 Background facts and issues for determination

9. In short, BHP Billiton Ltd (**Ltd**) and BHP Billiton Plc (**Plc**) are parties to a dual-listed arrangement, discussed in more detail below, under which the companies' affairs are, broadly speaking, managed on the basis that they are collectively a single notional economic entity. Both Ltd and Plc have subsidiaries in Australia that sell commodities. The facts demonstrated that commodities were sold to a Swiss resident marketing entity, BHP Billiton Marketing AG (**BMAG**) which was held 58% (indirectly) by Ltd and 42% (indirectly) by Plc. BMAG purchased the commodities from Ltd's Australian subsidiaries and from Plc's Australian subsidiaries, and derived income from on-selling those commodities at a profit.
10. Under the CFC regime, again broadly speaking, income defined as "tainted sales income" generated by a CFC is characterised as attributable income of the CFC, which can be included in the assessable income of a resident Australian taxpayer.
11. Section 447 of the ITAA 1936 identified what constituted "tainted sales income", and s 447(1) relevantly provided:

"Tainted sales income

- (1) Subject to this Division, for the purposes of this Part, the following amounts are tainted sales income of a company of a statutory accounting period:
 - (a) income from the sale of goods by the company where all of the following conditions are satisfied:
 - (i) the goods were sold to the company by another entity;
 - (ii) either of the following sub-subparagraphs applies at the time of the sale of the goods to the company:
 - (A) the seller of the goods to the company was an associate of the company and a Part X Australian resident;
 - (B) the goods were sold to the company by an associate of the company who was not a Part X Australian resident, in the course of a business carried on by the associate at or through a permanent establishment of the associate in Australia".
12. There was no doubt that income derived by BMAG from the sale of commodities purchased from Ltd's Australian subsidiaries was "tainted sales income" under s 447(1)(a)(ii)(A), as the seller of the goods to the company (i.e. the Ltd subsidiaries) were accepted as being associates of the company (BMAG) and were Part X Australian residents as defined. 58% of profits generated by BMAG from commodity sales made in respect of commodities purchased from Ltd's Australian subsidiaries were returned as tainted sales income and attributable income by Ltd.

13. The substantive dispute concerned the words in sub-paragraph (A), and the issue was whether the commodities were “sold to [BMAG] by an associate of [BMAG] who was an associate of the company and a Part X Australian resident”. That required determination of whether or not each of the subsidiaries of Plc that sold commodities to BMAG could be characterised as an “associate” of BMAG. The Commissioner sought to assess Ltd to 58% of profits generated by BMAG from commodity sales made in respect of commodities purchased from Plc’s Australian sales income.
14. The definition of “associate” was set out, as relevant, in s 318(2). A copy of s 318(2) is attached as Annexure A. It can be seen from the text of s 318(2), that sub-paragraphs (d)(i) and (e)(i) adopt a test of whether one entity or company is “sufficiently influenced” by another entity, or by other entities. The Commissioner contended that they were. This was on three alternative bases, each of which would have been successful to result in a successful outcome for the Commissioner.
15. The reasons of Thawley J at [58] record that the Commissioner’s alternative grounds for contending that the Plc Australian subsidiaries were “associates” of BMAG were that:
 - a. Ltd was “sufficiently influenced” by Plc for the purposes of s 318(2)(d)(i)(A);
 - b. Plc was “sufficiently influenced” by Ltd for the purposes of s 318(2)(e)(i)(A); or
 - c. BMAG was “sufficiently influenced” by Plc and Ltd for the purposes of s 318(2)(d)(i)(B).

It is very difficult to read s 318(2) and track through the various provisions and entities to discern how the arguments came to be put in these terms but, helpfully, the reasons of Davies J at [22] record that it was common ground that these were the issues. It may that the issues were able to be distilled to these terms because:

- a. Plc held a majority voting interest in the Plc Australian subsidiaries, and they were therefore associates of Plc;
 - b. Ltd was an associate of BMAG because of its majority voting interest; and
 - c. the effect of s 318(2)(f) is that other entities (i.e. Plc and Ltd) will be associates if a third party is an associate due to s 318(2)(d) and the other entities would be associates of the third party because of another provision. In this respect s 318(2)(d)(ii) establishes the relationship of “associate” where majority voting interests are held.
16. How the issues came to be framed as they were does not matter for the purposes of this paper, because the issues as set out at paragraph [15] above were agreed, as noted by Davies J.
 17. What is critical is the scope of the phrase “sufficiently influenced”.
 18. The meaning of the phrase “sufficiently influenced” is set out in s 318(6)(b). The provision provides that, for the purposes of the section:

“A company is sufficiently influenced by an entity or entities if the company, or its directors, are accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of the entity or entities (whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts).”

19. It is clear that the concept of “sufficiently influenced” does not require majority voting control – majority voting control is an alternative means by which one company can be determined to be an associate of another: see e.g. s 318(2)(d)(ii) and (e)(ii).
20. It was important to the outcome in the Full Court, as discussed below, that the definition refers to “the company, or its directors” being accustomed to or being under an obligation, or satisfying the reasonable expectation requirement to act “in accordance with” the directions, instructions or wishes of the other entity.

2.2 Approach of the Majority in the Full Court

21. The leading judgment was delivered by Thawley J with whom Allsop CJ agreed, subject to a number of further observations.
22. Thawley J set out a number of provisions of the contractual arrangements between Ltd and Plc that established the dual-listed structure and that were critical to the resolution of the dispute. It is not proposed to recite them in detail in this paper. It is sufficient to note the following significant features of the arrangements:³
- a. The DLC Structure Sharing Agreement (**the DLC Agreement**) between Ltd and Plc provided that Ltd and Plc were to operate on the basis that they were a “single unified economic entity”, with common boards and a “unified senior executive management”;
 - b. The directors were to have regard to the interests of shareholders in each entity as if Ltd and Plc were a single unified economic entity;
 - c. Ltd and Plc agreed to pursue and procure that each member of their respective groups would pursue (among other things) the matters referred to in (a) and (b) above;
 - d. Clause 13 of the DLC Agreement provided that each party would:

“enter into such further transactions or arrangements, and do such acts and things, as the other may reasonably require from time to time in furtherance of the common interests of the holders of BHP Ordinary Shares and the holders of Billiton Ordinary shares as a combined group or to give effect to this Agreement”
 - e. There was a mechanism that required dividend entitlements to be equalised;
23. Each of Ltd and Plc had issued a share known as a Special Voting Share (**SVS**) under arrangements which enabled, broadly speaking, Ltd to vote the SVS in Plc and Plc to vote the SVS in Ltd in respect of certain matters known as “Joint Electorate Actions” and “Class Rights Actions” put before a General Meeting of the other company. These included such things as appointments of directors and adoption of accounts, any matters considered by shareholders at an annual general meeting of the other company, amendments of the DLC Agreement and the voluntary liquidation of either entity. The SVS voting mechanism was structured, broadly speaking, to enable Ltd (via the SVS which was held by a Special Voting Corporation (**SVC**)) to

³ See per Thawley J at [63]-[65], and at [112]-[123] where the provisions and their effect are set out in more detail.

vote the same number of votes for or against a resolution at a general meeting of Plc as had been cast by Ltd ordinary shareholders at a general meeting of Ltd; and likewise the votes of ordinary shareholders of Plc at a general meeting of Plc were voted (through the SVS) at general meetings of Ltd. This was achieved by keeping both general meetings open until the number of votes cast at the other meeting was known, and the number of votes cast communicated to each SVC which voted the SVS at the other company's general meeting.

24. In substance, consistently with the notion that there was to be a single economic entity, the votes of shareholders in each entity were counted at general meetings of the other entity. The effect of the SVS arrangement was that, depending on the number of votes attaching to ordinary shares at a general meeting of either company that were voted in favour of a particular resolution, a resolution might be carried if the SVS votes supported it notwithstanding that a majority of votes cast by ordinary shareholders was against it; and vice versa.⁴

2.2.1 Whether Ltd and Plc sufficiently influenced the other – Thawley J

25. At first instance the AAT (Logan J) had relied in part, on reasoning by analogy to the language used in the *Corporations Act* to determine whether a person who is not a validly appointed director is nevertheless a director; the concept commonly referred to as being a “shadow director”. As relevant the definition of “director” provided that a person not validly appointed would be a director if:

“the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes”

26. In concluding that the parties were not sufficiently influenced, Logan J held that neither company had the ability to control, usurp or exercise the powers of the directors in the other entity.
27. Thawley J considered that this approach did not meet the argument that had been put by the Commissioner, which relied on the fact that s 318(6)(b) refers to “the company, or its directors” being accustomed, or under an obligation, or reasonably being expected to act in a particular way. BHP sought to meet this by arguing that “the company, or its directors” should be read as not referring to the company in general meeting but merely recognising that a company must act through natural persons, in which case the fact that an entity was merely accustomed to acting in accordance with directions of another entity would not, absent control of the directors, result in a conclusion of sufficient influence.
28. Ltd submitted⁵ that s 318(2)(d)(i) and (e)(i) are “directed at control of the business or daily acts of the company, such control usually being reposed in the board” and not de facto control of the company in general meeting.
29. Thus, the question of control, and whether control of the board is necessary in order to reach a conclusion as to “sufficiently influenced” under s 318(2)(d)(i) and (e)(i), was critical. Ltd relied extensively on the fact that (as the AAT had found) neither company acted subserviently to the

⁴ Thawley J at [124]-[128].

⁵ As recorded by Thawley J at [130(2)]; and Davies J at [26].

other, the directors exercised their judgments independently and there was no abrogation of effective control by either the directors or the shareholders of each company in favour of the other.

30. The argument was rejected as impermissibly reading down the words of s 318(6)(b) which refers to “the company, or its directors” rather than referring only to the directors.⁶ Accordingly, it being accepted that the directors exercised independent judgment and had not abrogated their responsibilities to act in the interests of the company, it became necessary to assess whether each company was accustomed, or under an obligation, or might reasonably be expected to act, in accordance with the directions, instructions or wishes of the other.
31. Thus, Thawley J went on to focus on the manner in which voting instructions in respect of the SVS were determined and communicated: the number of votes of the shareholders at a general meeting of each of Plc and Ltd where Joint Electorate Actions and Class Rights Actions determined the way in which the SVS would be voted – the shares were in fact voted in each case by a Special Voting Corporation (**SVC**). This was achieved by Plc (or Ltd) notifying the number of votes cast to the SVC; which then voted the SVS as required. Ltd submitted that:
- a. Notification of the number of votes was merely a provision of information rather than a communication of directions, instructions or wishes;
 - b. In any event, the communication was not of the wishes of Plc (or Ltd) as opposed to the wishes of the holders of the ordinary shares;
 - c. In any event, any wishes were not acted upon by Ltd (or Plc) but by the SVC as the holder of the SVS.
32. These submissions were rejected. In summary:
- a. the notifications were in fact instructions as to how the SVS were required to be voted;⁷
 - b. the wishes of the ordinary shareholders determined the wishes of the company as to the content of the instructions;⁸ and
 - c. the notifications were acted on by Plc and Ltd and the directors, at least to the extent of keeping their meetings open until each SVC in fact cast the votes permitted to be cast by the SVS.⁹
33. Ultimately Thawley J determined the question of “sufficient influence” on the basis that although neither Plc nor Ltd was in a position of subservience to each other, the implementation of directions, instructions or wishes through the exercise of the SVS mechanism was determinative.¹⁰ His Honour held:¹¹

⁶ Thawley J at [131]-[134].

⁷ Thawley J at [140].

⁸ Thawley J at [144].

⁹ Thawley J at [146].

¹⁰ The dividend arrangements were also relevant: Thawley J at [156]-[163].

¹¹ Thawley J at [154].

“The SVS arrangement did not put either Plc or Ltd in a position of subservience to the other. It involved mutuality of obligation and the taking into account of the wishes of both companies, **not just by mere consideration of the position of the other, but by implementation of the ‘directions, instructions or wishes’ of the other communicated under clause 2 of the SVS Deed** (in the case of Joint Electorate Actions) through votes cast on a poll pursuant to a structure agreed to by both Ltd and Plc. The arrangement with respect to Joint Electorate Actions was one in which both had what was in substance a say (and potentially a controlling or determinative say) in the passing of resolutions on relevant matters in the other.”

(Emphasis added)

34. Further, the definition of “sufficiently influenced” did not require one entity to be controlling the other, and:¹²

“The fact that Ltd and Plc both have influence or control under the DLC Arrangement on a day-to-day basis, and may be seen to be ‘joint venturers’ in relation to substantially all of their commercial affairs, does not alter (and, if anything, underscores) the fact that the relationship, as disclosed by the voting arrangements, is one of which it is appropriate to say that one is “sufficiently influenced” by the other. At least in the circumstances of this case, it is no objection to the application of ss 318(2) and 318(6)(b) according to their terms that the sufficient influence or control might be seen to go both or different ways depending on the particular occasion or subject matter.”

35. In the author’s view this passage makes clear that it was the particular voting arrangements under the DLC structure that were determinative. The reference to “joint venturers” and the significance (if any) that the passage may have for other commercial circumstances where parties act in furtherance of a joint objective is discussed below.

36. A further feature of Thawley J’s reasons worth mentioning, particularly in the context of special leave having been granted, is that Ltd had contended, and the Commissioner conceded, that the words “in accordance with” require a causal relationship between the directions, instructions or wishes of one entity and the actions of the other.¹³ It is difficult to find any finding in the reasons as to how the causation requirement was satisfied: indeed to the contrary in respect of dividends, Thawley J said that it could be accepted that it was recommendations of the Ltd board that caused Ltd to pay dividends. His Honour went on to say however that it could reasonably be expected that the Ltd board would recommend that the same dividends be paid in accordance with the wishes of both Ltd and Plc: in the author’s view it is difficult to see how this satisfies a requirement to establish causation. Arguably the observation that directions, instructions or wishes were implemented through the SVS voting mechanism is a finding of causation, but if so, it is not expressly stated. Moreover the votes cast through the SVS mechanism would not necessarily result in the other company taking a particular course: if a majority of Plc shareholders voted to appoint a particular firm of auditors, for example, the SVS mechanism would not enable that to occur if a sufficient number of Ltd shareholders voted against the firm, and vice versa – it is hard to see how one entity could *cause* the appointment by the other of the auditors in such an

¹² Thawley J at [155].

¹³ The fact that the requirement for a causal relationship was agreed is recorded in the reasons of Thawley J at [87] and [162] and Davies J at [25].

example; and in any event, the wishes of ordinary shareholders may not be congruent with the wishes of the company. That is because:

- a. it is generally accepted as fundamental principle of corporate law that it is the board that embodies the directing mind and will of a company,¹⁴ as well perhaps as those for whom authority may have been delegated for particular transactions.
- b. in this instance, the wishes of the holder of the SVS in each case are not determined by either company, but by the manner in which holders of the ordinary shares in the other company exercise their voting rights.

2.2.2 Whether Ltd and Plc sufficiently influenced the other – Allsop CJ

37. Allsop CJ agreed with Thawley J but made a number of further observations. His Honour identified the issue as whether “sufficient influence” would be established between equals acting in each other’s mutual interests as one economic entity, or whether the provisions are limited to circumstances where one entity has some degree of controlling influence. His Honour concluded that dominance or subservience is unnecessary:¹⁵

“It may be in the mutual best interests of both to act in accordance with each other’s wishes, as it was undoubtedly thought to be the case here. That such acting in accordance with the wishes of the other is understood to be in one’s own interests, and is conduct freely undertaken, does not diminish the reality of the fact that each acts in accordance with the wishes of the other, for the mutually beneficial operation of a single economic entity, and in accordance with the underlying agreement of the parties.

If the purpose or object is assessing closeness of association in order to assess the appropriateness of attribution of income, s 318(6)(b) can be seen to be wide enough to include circumstances of mutually advantageous decision-making by parties as equals acting in accordance with the direction, instructions and wishes of each other for the common economic goal of operating a single economic entity.”

38. In the author’s view that passage makes clear that critical to the outcome was the objective of operating a single economic entity – this is a peculiar feature of DLC arrangements and is not a feature of ordinary joint venture relationships.

39. Allsop CJ did not deal with the causation requirement that the parties had agreed was required to be established by “in accordance with” (except inferentially, to the extent that he agreed with the reasons of Thawley J).

¹⁴ See e.g. *AWA Ltd v Daniels* (1992) 7 ACSR 759 at 850.

¹⁵ Allsop CJ at [14]-[15].

2.2.3 Whether BMAG was sufficiently influenced by Plc and Ltd

40. This issue was dealt with only briefly and in the author's view, unsatisfactorily. This issue may be dealt with briefly as in light of the other conclusions reached it was not strictly necessary to be determined.
41. The Tribunal had approached s 318(2)(d)(i)(A) and (B) as mutually exclusive, on the basis that "sufficiently influenced" required control and subservience. Once it was recognised that this was not necessary, it followed that BMAG could be sufficiently influenced by both Ltd and Plc, which Thawley J concluded to be the case based on findings that he considered had been made by the AAT. It is this aspect of Thawley J's reasons that are considered to be unsatisfactory.
42. Thawley J suggested¹⁶ that by paragraph [52] of the AAT's reasons, the AAT found "that BMAG did follow the directions or wishes of Ltd or Plc" and said further¹⁷ that "[o]f course BMAG would reasonably be expected to follow the instructions of Ltd and Plc, its ultimate owners, as the Tribunal found at [52]."
43. Paragraph [52] of the AAT's reasons is in the following terms:
- "Ltd submitted that BMAG was neither accustomed to treating, nor could it reasonably be expected to treat, the wishes or directions of either Ltd or Plc, or both (if that were possible), as a sufficient reason to act without more. I agree. The reason for this agreement is twofold. In law, the BMAG board was obliged to act in the best interests of that company and its shareholders. In fact, it so acted on the evidence. BMAG's board only followed the wishes or directions of Ltd or Plc if the board considered that to do so was in BMAG's best interests."
44. In the author's view Thawley J's decision in this respect is unsatisfactory because paragraph [52] of the AAT's reasons in fact makes clear that BMAG *only* followed the wishes of Ltd or Plc if the board of BMAG considered that doing so was in BMAG's best interests. This allows for the possibility that BMAG's directors may not have followed instructions or directions from either Plc or Ltd if they considered that doing so was not in BMAG's best interests.
45. In the author's view it does not follow from what the AAT said, that BMAG in fact followed the wishes of Ltd or Plc or would reasonably be expected to do so generally, which is what is implied by the reasons of Thawley J. Thawley J seems to have not allowed for the qualification entailed by the use of "only" by the AAT as to when BMAG followed wishes or directions, i.e. only when the BMAG board considered that it was in BMAG's best interests to do so did it follow the wishes or directions of Plc or Ltd. In the author's view, Thawley J misstated what the AAT in fact found at [52].

2.3 Approach of Davies J

46. Davies J, in summary, noted that the s 318(6)(b) definition of "sufficiently influenced" would be satisfied where a third party exerts effective control over a company, but concluded that on the

¹⁶ Thawley J at [170].

¹⁷ Thawley J at [171].

findings of fact made by the AAT this had not occurred.¹⁸ It was significant that “[w]hilst there was a mutuality of interest and common aim, as part of which the directors of each company were obliged in the exercise of their powers to take into account the interests of the ordinary shareholders of the other entity ‘as if the two companies were a single unified economic entity’, the finding [of the AAT] was that the boards of the respective companies each met and exercised independent judgment and decision making as to their own best interests. Without more, to act in concert with a common aim and mutuality of interest is not ‘to act in accordance with the directions, instructions or wishes of [another] entity’ within the meaning of s 318(6)(b).”¹⁹

47. As to the special voting arrangements, her Honour noted that in entering into and implementing the DLC arrangements, which included the special voting arrangements, each company was pursuing its own interests. Following the procedure designed to achieve uniform resolutions at general meetings was not acting “in accordance with” the other company’s directions, instructions or wishes, but rather was each company giving effect to the terms governing the DLC arrangements pursuant to which the companies acted jointly out of mutuality of interest.²⁰

2.4 Observations

48. Ltd’s submission that control of the board is a necessary element for sufficient influence under s 318(2)(d)(i) and (e)(i) has the attraction of allowing “sufficient influence” to be determined by an objective criteria or standard, and thus assists in providing certainty as to the application of the Act. Its approach also arguably sits logically with the structure of the provision. In support of Ltd’s approach it can be said that there are two ways that a company can be controlled, i.e. through controlling the shareholders’ voting or controlling the board. Section 318(2)(d)(ii) and (e)(ii) are undoubtedly concerned with voting; it should follow, the argument goes, that (d)(i) and (e)(i) are concerned with control of the board.

49. In the author’s view there are two difficulties with that argument:

- a. Control of voting under (d)(ii) enables control of the composition of the board (assuming that a majority vote is sufficient to appoint or remove a director) and, it might be said, already enables de facto or indirect control of the board;²¹
- b. The text of s 318(6)(b) in defining “sufficiently influenced” refers to “the company, or its directors”; not simply the directors. It would have been easy for the legislature to define “sufficiently influenced” by reference to a test directed to whether or not the directors of a company are accustomed to act in accordance with another party’s instructions or wishes, if that had been intended. That language has long been used in the definition of “director” in s 9 of the *Corporations Act* and its statutory predecessors but in contradistinction, s 318(6)(b) refers to “the company, or its directors”. Thawley J correctly recognised this.

¹⁸ Davies J at [36]-[37].

¹⁹ Davies J at [38].

²⁰ Davies J at [41].

²¹ Noting of course that board members owe obligations to act in the interests of the company, not the shareholder who appointed them.

50. On the other hand, once it is accepted that “in accordance with” imputes a causation test, it is, arguably, difficult to escape the conclusion that “sufficiently influenced” requires a conclusion that, to some degree, either or both of the company, or the directors, have ceded control in favour of somebody else or at the very least enabled a third party’s wishes to materially influence their decision-making. In the absence of ceding control, or acting as a consequence of a third party’s influence, it is difficult to see how the requirement that one entity’s directions, instructions or wishes can *cause* the other entity to act in a particular way to be met. If one entity makes a decision in its own interests, that happens to coincide with the directions, instructions or wishes of the other, it is difficult to see how the decision has been *caused* by the directions, instructions or wishes of the other. Rather the decision has been caused by the directors concluding that the course of action is in the company’s own interests.

51. The decision of White J in *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2010) 77 ACSR 410 contains an example that demonstrates this point, and is inconsistent with a requirement for causation, at 464-5 [245]:

“The Oxford English Dictionary definition of ‘accordance’ is that it is ‘the action or state of agreeing; agreement; harmony; conformity’. Ordinary usage of the phrase ‘in accordance with’ does not necessarily require a causal connection between the expression of a wish by A and the action of B. To take a homely example I advanced during argument, if on a Wednesday I decide to take my son or daughter to his or her football game on Saturday, and on Friday my wife asks me to take the child to football on Saturday, to which I agree, in performing that task I am acting in accordance with my wife’s wish (or instruction). I am acting in agreement, harmony or conformity with her wish, even though I have already determined on that course of action.”

52. White J went on to recognise that “in accordance with” in the context of s 9 of the *Corporations Act* has been construed to require a causal connection, and in light of that authority approached “in accordance with” as requiring a causal relationship. His approach was affirmed on appeal.²²

53. Thawley J’s reasons, in the author’s respectful opinion, do not address how causation is established given the findings made by the AAT that neither the board nor the shareholders abrogated effective control under the DLC arrangements and neither company had the ability to dictate to the other.

54. The passage from [52] of the AAT’s reasons set out above that Thawley J appears to have misread, demonstrates clearly the importance of which meaning is to be adopted of “in accordance with” and the significance of whether it requires causation to be established. If company B determines through its board acting independently that it should adopt a particular course of action because it is determined in the judgment of its directors acting independently to be in the interests of company B to do so, then even if company A has communicated to company B its wish that it should so act, it is difficult to see how the wishes of company A have caused company B to act; the exercise by the board of company B of independent judgment severs the chain of causation. An analogy exists to situations where misleading representations do not cause a party to act to its detriment by entering into a particular transaction, because the party

²² Affirmed on appeal at (2011) 81 NSWLR 47.

would have entered into the transaction anyway: e.g. *Eric Preston v Euroz Securities Pty Ltd* [2011] FCAFC 11; 274 ALR 705. A requirement for “causation” to be established also gives rise to uncertainty, given that the word does not appear in the Act. Moreover the scope of what is required to establish causation can vary in different contexts, as McHugh J identified in *Henville v Walker* (2001) 206 CLR 456 at 491 [100]:

“In some situations, the legal framework may require a finding that, despite a causal connection in a physical sense between the breach and the damage, no causal connection exists for legal purposes. In other situations, the legal framework may require a finding that a causal connection exists even though no more appears than that the damage followed after a breach of a legal norm.”

55. In the author’s view, if “in accordance with” requires causation in the conventional sense to be established, there is a logical inconsistency at least in finding that BMAG acted “in accordance with” the wishes of Plc and Ltd in circumstances where its board made decisions independently based on what were considered to be the best interests of BMAG. It may be that, adopting the words of McHugh the “legal framework” would enable a finding that Party B has acted in accordance with the wishes or directions of Party A to be reached even though no more appears than a course of action following the existence of a wish or direction; it may alternatively be that “in accordance with” requires the wishes or directions to be a materially contributing factor to the actions of Party B, even though the wishes or directions need not be causative. But if either of those possibilities is correct, it is unnecessary and unhelpful to analyse the issue through the prism of causation: the ordinary meaning of “in accordance with” provides the necessary connection.
56. Accordingly, the author finds it surprising that the Commissioner conceded that “in accordance with” requires causation. If the taxpayer wins the appeal, it may be because of the findings made in the AAT that were not challenged that the directors acted in the interests of each company, and because of the Commissioner’s concession that causation is a necessary requirement of “in accordance with”. It is difficult to see why the Commissioner conceded that causation was necessary – in the author’s view, to act “in accordance with” the wishes of another does not require causation, merely that one party’s actions are consistent with the wishes of another. This approach would be consistent with the ordinary usage of the phrase identified by White J. The fact that the phrase has been construed to require causation in the context of the *Corporations Act* does not necessarily mean that it should be so construed in the context of s 318.
57. Thawley J did note that:
- “The s 318(6)(b) description of “sufficiently influenced” may be seen to describe a species of control or influence, or expected control or influence, which falls short of legal control. The critical issue in the proceedings is how far short it falls.”
58. The problem is, his Honour’s reasons do not identify any test or standard to identify when control or influence falling short of legal control will be sufficient to engage the provision. There is a lack of clarity about when the majority’s approach will apply. If the standard is that the directions, instructions or wishes of one entity must *cause* the other to act in a particular way, then given the findings made by the AAT (which the Commissioner does not seem to have challenged) that each

party acted in its own interests, it is difficult to see how a causation requirement is satisfied in this case.

59. An alternative approach and one that is probably closer to the approach taken by Allsop CJ, would be to conclude that one company will be sufficiently influenced by the other where it has independently determined that acting in the interests of the other will be consistent with its own interests. In this case, that conclusion was arguably enabled by choice made by each of Plc and Ltd to enter into the DLC Agreement. The DLC Agreement contemplated that the group would be managed as a single unified economic entity, conferred obligations on the directors of each company to have regard to the shareholders in each entity, and required things to be done by each entity that the other might reasonably require, to further the common interests of all shareholders in both legal entities as though they were a single economic entity: see para [22] above. On this analysis, because one entity has determined that it is in its interests to act in the interests of the other, it would be concluded that there is a reasonable expectation that it will act “in accordance with” in the sense of acting consistently with the wishes of the other, in the absence of a requirement for causation. Each entity would reasonably be expected to act in accordance with the wishes of the other, because each had independently determined that it would be in its own interests to do so and entered into the DLC Agreement as a consequence. This can be seen to exist as between Ltd and Plc (but it is more difficult to see as between those entities and BMAG). On this analysis one would not look for a causal relationship between the wishes of one entity and the actions of another with respect to particular transactions.
60. Put another way, and as applied to this case Ltd for example would not enter into any particular course of action if doing so would be contrary to the interests of Plc, because the pre-existing obligations under the DLC Agreement would preclude it from doing so; conversely Ltd would be entitled under the DLC Arrangement to embark upon a particular course of action because it is consistent with the interests of Plc (regardless of the communication of any particular instruction or wish). It is this feature of the DLC relationship that in the author’s opinion makes the decision distinguishable from other kinds of relationships such as for example unincorporated joint ventures, where each party commonly funds say the development and operation of a mine or petroleum project but where each takes title to its own share of the production. In this conventional joint venture scenario, the participants commonly can and do sell their production entitlements separately and indeed in competition with the other. Alternatively the participants might choose for one of them to sell all of the production, but each would do so based on a decision by each venturer that joint marketing would be in its own interests, rather than as a consequence of a pre-existing obligation to act in the interests of the other joint venturers with respect to marketing.
61. Nevertheless, this alternative approach does not seem to have been argued by the Commissioner and is arguably inconsistent with his concession that “in accordance with” requires causation.
62. The Commissioner’s written submissions in the High Court arguably suggest, at least implicitly, that he intends to resile from his concession with respect to causation.²³ Nowhere does the word causation feature in the Commissioner’s submissions. In paragraph [41] the Commissioner

²³ The submissions are currently available on the High Court website at http://www.hcourt.gov.au/cases/case_b28-2019.

argues that the words “might reasonably be expected” do not point to control, because if the relationship were one of control, the entity *would* act in accordance with the exercise of control and there would be no requirement to ask about reasonable expectations. And in paragraph [50] the Commissioner argues that “in accordance with” does not require subordination of action by the influenced party to that of the other party such that, if the allegedly influenced party believes conduct to be in its own self-interest, it is not sufficiently influenced. The Commissioner’s submissions contain an example of how he says “in accordance with” should be applied. The example is that of a patient who independently chooses to follow a doctor’s recommendation as to what medicine to take, because the patient considers that taking the medication will be in his or her best interests. That example is unhelpful, because ordinarily at least, a patient’s belief that taking the medication will be in his or her best interests, will be caused by, or materially contributed to, the recommendation of the doctor. In this case, the findings of fact made by the AAT,²⁴ in the author’s view, do not permit such an analysis because the boards of each entity did not abrogate control, and neither company had the ability to dictate to the other or act subserviently.

63. It remains to be seen whether the Commissioner will be called on by the High Court to state unequivocally whether he wishes to resile from the concession made, and whether he will be permitted to do so. If this occurs, or the Commissioner is able to argue that causation can be established notwithstanding that each company acts independently in its own interests and makes its own decisions, the Commissioner may well succeed.
64. As to the implications of the decision to other commercial arrangements, in the author’s opinion the decision of the Full Court, and the appeal, if the Commissioner succeeds, may be of limited if any application beyond a DLC arrangement. That is because the determination of “sufficient influence” relies heavily on the features of the DLC arrangement: see paras 35, 38 and 60 above.
65. Finally, there is a potentially unattractive consequence of the majority decision. If the Commissioner succeeds, 58% BMAG’s income from the sale of commodities supplied to it by Plc Australian subsidiaries will be attributed to Ltd. Depending on the operation of the UK CFC rules, there might be potential for double taxation, if BMAG was regarded as a CFC under those rules and if the UK were to seek to tax more than 42% of BMAG’s income, with no relief under available under any DTA because Ltd and Plc are separate taxable entities.

²⁴ As summarised by Davies J at [235].

3 The RCF IV Case

3.1 Background facts and issues for determination

66. In the RCF IV Case, two similarly structured limited partnerships (incorporated in the Cayman Islands under the Cayman Islands *Exempted Limited Partnership Law*), had invested in an Australian registered mining company, Talison Lithium Ltd (**Talison**). Talison shares were listed on the Toronto stock exchange. In the RCF IV Partnership, 73 of the 77 limited partners were resident in the United States; in the RCF V Partnership (the second respondent), 130 of the 137 limited partners were resident in the United States.²⁵
67. Decisions of the funds were made by investment committees, under recommendation of an investment management corporation. The management corporation was incorporated in Delaware and based in Colorado; but it had entered into an agreement with an Australian company (which had between 11 and 14 Australian resident individual employees) which provided administrative and management services to the Delaware corporation.²⁶ The key human beings involved in the decisions were split between Toronto, Denver, Perth, New York and elsewhere at various times – the majority of decision-makers were generally outside of Australia when making decisions.
68. The Commissioner assessed the limited partnership to tax on gains made on the disposal of Talison shares. The shares were sold via a scheme of arrangement approved by the Federal Court of Australia to a Chinese buyer. The assessments issued on the basis that:
- a. the limited partnerships were taxpayers;
 - b. the gains made (which were considered to be on revenue account) were from an Australian source;
 - c. the partnerships were not entitled to protection under the *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (the US DTA)* in respect of the income or gain, or alternatively the gains were taxable by reason of Article 13 of the US DTA;
 - d. the shares in Talison were taxable Australian property (**TAP**) as the assets of the company derived more than 50% of their value from taxable Australian real property (**TARP**) within the meaning of Division 855 of the *Income Tax Assessment Act 1997* (Cth) (**the ITAA 1997**).
69. At first instance, RCF IV's objections to the assessments were allowed on the basis that the partners, and not the limited partnerships, were the taxpayers that should have been assessed;

²⁵ Trial judge's reasons, *Resource Capital Fund IV LP v Commissioner of Taxation* [2018] FCA 41 at [28] and [29].

²⁶ Trial judge's reasons at [27] and [31].

that taxing rights were allocated to the US in respect of the US partners under the US DTA; and that the shares in Talison were not TAP. The Commissioner appealed.

70. The Full Court approached the appeal by reference to seven issues:

- a. Were the limited partnerships liable to be taxed as entities, separately from the partners?
- b. Had the assessments been issued to the partnerships, or the partners themselves?
- c. Was the imposition of tax on the limited partnerships invalid as imposing an incontestable tax, and thus unconstitutional? The argument here depended upon the consequence that would follow if the Commissioner's arguments were accepted which, it was contended, would result in the partners having joint and several liability to pay tax assessed to the limited partnerships, without having a right to object;
- d. Did the gains on disposal of Talison shares have an Australian source?
- e. Could the limited partnerships rely on the US DTA?
- f. Could the limited partnerships rely on the Commissioner's ruling, TD 2011/25? This required consideration of whether the ruling required that the limited partnerships be permitted to rely on the US DTA (assuming that the US DTA did not permit it), and if so whether the gains were "taken out" of the scope of the protection offered in respect of business profits under Article 7(1) of the US DTA, by reason of the fact that the gains were "items of income which are dealt with separately" within the meaning of Article 7(6). There is a lot more to this issue as discussed below.
- g. Was the trial judge, Pagone J, wrong in relying on the valuation evidence put forward by the limited partnerships on the issue of whether the shares in Talison were TAP?

This paper focussing on international tax issues, addresses only the issues identified in paragraphs (d), (e) and (f) (in part).

71. It is unclear at this stage whether the High Court will say anything at all relevant to the international tax issues determined by the Full Federal Court if special leave is granted. This will depend on the scope of any grant of special leave, and the conclusion reached on whether the limited partnerships were liable to be taxed as entities. If the taxpayers succeed on that issue any decision of the High Court may say nothing about the international tax issues.²⁷

3.2 The Full Federal Court Decision

72. The Commissioner's appeal was heard before a five member bench of the Full Federal Court. It is likely that this is because the conclusion reached by the primary judge on whether limited partnerships are liable to tax was inconsistent with the way in which an earlier appeal had been determined, in *Resources Capital Fund III LP v Commissioner of Taxation*. In that case the issue

²⁷ Unless, perhaps, the High Court agrees with the primary judge's conclusion that the assessments can be seen as issued to the members of the limited partnerships.

had not been argued either at first instance of the Full Federal Court and it had simply been assumed that limited partnerships were taxable entities. The five member bench was probably constituted because the taxpayer's arguments were inconsistent with propositions that had previously been assumed by an earlier Full Court (without the issue being argued) to be correct.

73. Four members of the Full Federal Court delivered a single judgment, with Davies J delivering a separate judgement concurring in the outcome but offering a different approach to construction of Article 4 of the US DTA (i.e. issue (e) above).
74. All of the issues identified above were determined in favour of the Commissioner although the taxpayers had some success in parts of issue (f) in proving they sought to rely on the ruling, and could potentially rely on the ruling, but lost on the ultimate issue that no protection arose under the ruling as the gains were taken out of the scope of the protection of Article 7 of the DTA by operation of Articles 7(6) and 13 of the US DTA.

3.3 Were the partners or the partnerships assessed?

75. Having disagreed with the primary judge on the question of whether the limited partnerships to be treated as taxpayers²⁸ (a critical issue for the purposes of the special leave application but beyond the scope of this paper), the Full Court concluded, unsurprisingly, that by sending the assessments to the office of the limited partnerships, the Commissioner had in fact assessed the limited partnerships.²⁹

3.4 Full Federal Court Decision – the source issue

76. Both the trial judge and the Full Federal Court determined the issue of source in favour of the Commissioner. As a general proposition, non-residents are only taxed on income with an Australian source. This issue was always going to be difficult for the taxpayer in the appeal given the findings made by the trial judge, and in circumstances where the ascertainment of the source of income has long been described as “a practical, hard matter of fact”: see *Nathan v Federal Commissioner of Taxation* (1918) 25 CLR 183 at 190.
77. The location of the mining operations of Talison in Australia, the fact that Talison was incorporated in Australia, the fact that the management company had staff in Australia, and the fact that the Talison shares were sold pursuant to a Scheme of Arrangement ordered by the Federal Court of Australia all tended against the taxpayer. In light of these (and other) factors the gains accordingly were determined by the trial judge as having an Australian source, notwithstanding the fact that the shares in Talison were listed on the Toronto Stock Exchange, negotiations for the disposal of the shares took place outside Australia and the consideration for the shares was paid in Canadian dollars.

²⁸ The conclusion that the partnerships were taxable entities is at [25] of the joint reasons.

²⁹ Joint reasons at [47].

78. In the appeal, the Full Federal Court contrasted this case with the situation in *Tariff Reinsurances v Commissioner of Taxes (Vic)* (1938) 59 CLR 194 where income of an English company derived from reinsuring Victorian risks, was found to have no connection with Victoria. The source of the income in that case was said to be the place where the contract of reinsurance had been made, which was England. The Full Federal Court considered that the location of the scheme of arrangement was analogous to the place where the contract was made in *Tariff Reinsurance* and, in circumstances where the taxpayers' right to obtain the proceeds of the sale arose from the Scheme of Arrangement, it was concluded that the gains had a source in Australia³⁰ or, at the very least, it had been open to the trial judge so to conclude and there was no error in him having done so.

3.5 Implications of the source finding

79. The decision suggests that where sale proceeds are derived from a transaction implemented by means of a Scheme of Arrangement effected in Australia under the *Corporations Act*, they are highly likely to be considered to have an Australian source.

80. The fact that the Scheme took place in Australia seems to have been regarded as highly significant particularly in the Full Federal Court. It is debateable whether a different conclusion would have been reached had the taxpayers sold their shares on-market in Toronto with them being transferred to a non-resident purchaser. In the author's view, the fact that the gains depended upon the value of Australian assets held by Talison may not have resulted in a conclusion that the gains had an Australian source, absent the Scheme of Arrangement. Certainly, it is difficult to see that the gains would have had an Australian source if Talison had been registered in Canada rather than Australia, and the shares had been transferred on-market, subject to the weight given to other factors such as the location of personnel and where decisions were made. This raises the question whether in other cases, subject to detailed consideration of all relevant impacts, it might be desirable to transfer the place of registration before implementing a Scheme of Arrangement elsewhere (which could of itself give rise to CGT event I1 on ceasing to be a resident).

3.6 Issues under the US DTA.

81. The starting point was that the respondents, i.e. the limited partnerships, could only invoke the US DTA in the Full Federal Court if they were a "resident" of the United States for the purposes of the US DTA. It was common ground that each limited partnership was a "look through" entity for US income tax purposes, and neither was liable to pay tax in the US.

82. In order, the issues under the US DTA were:

³⁰ Also see *Premier Automatic Ticket Issuers Ltd v Federal Commissioner of Taxation* (1933) 50 CLR 268.

- a. Were the partnerships entitled to rely on the US DTA, either by reason of the terms of the US DTA or because the Commissioner had bound himself by TD 2011/25 to enable limited partnerships to rely on the ruling where it applied?
- b. What was the effect of Article 7(1) of the US DTA which, broadly speaking, allocates taxing rights in respect of gains made by US and Australian enterprises to the US and Australia respectively unless the enterprise carries on business in the other jurisdiction through a permanent establishment?
- c. If Article 7(1) applied, were the gains “taken out” of the field of relief provided by Article 7(1) by reason of Article 7(6) on the basis that they were “dealt with separately under other Articles” of the US DTA?
- d. Further to (c), did Article 13(1) allocate taxing rights to Australia in this case on the basis that the gains were from the alienation or disposition of “real property” as defined in Article 13(2)(b)?.

3.7 Could the LPs rely on the DTA?

83. Davies J stated at [236] that neither party sought to argue that the primary judge was wrong to conclude that Article 4(1)(b)(iii) did not apply to the limited partnerships. That being so, it is perhaps surprising that the Full Court dealt at all with the issue of whether the limited partnerships – which were not US residents - could rely on the US DTA, otherwise than by virtue of the ruling, once it had been determined³¹ that the partnerships and not the partners had been the entities assessed and where the partners were not before the Court. Perhaps it was thought appropriate to say something about the issue because if the taxpayer had succeeded on the point, it would have been unnecessary to deal with the issue of whether the ruling applied; but given that the issue was not argued, one can imagine the Commissioner complaining about procedural fairness had the issue been determined against him. There is some confusion about whether the issue was argued: the joint reasons suggest, at least at paragraph [78], that the issue was the subject of submissions to some extent, in that they rejected an argument that relied on the definition of “qualified persons” in Article 16 on the basis that it had not been raised at first instance.³²
84. In the author’s view there are significant problems (sought to be identified below) with the approach adopted by the Full Court and especially in the joint reasons.
85. The starting point is Article 4(1)(b) of the US DTA, which is in the following terms:

“a person is a resident of the United States if the person is:

- (i) a United States corporation;

³¹ At [47] of the joint reasons.

³² See further para [0] below.

- (ii) a United States citizen, other than a United States citizen who is a resident of a State other than Australia for the purposes of a double tax agreement between that State and Australia; or
- (iii) any other person (except a corporation or unincorporated entity treated as a corporation for United States tax purposes) resident in the United States for purposes of its tax, provided that, in relation to any income derived by a partnership, an estate of a deceased individual or a trust, such person shall not be treated as a resident of the United States except to the extent that the income is subject to United States tax as the income of a resident, either in its hands or in the hands of a partner or beneficiary, or, if that income is exempt from United States tax, is exempt other than because such person, partner or beneficiary is not a United States person according to United States law relating to United States tax.”

86. The limited partnerships clearly did not fall within 4(1)(b)(i) or (ii) as they were neither US corporations nor citizens.

87. The approach of the plurality was that Article 4(1)(b)(iii) did not apply for two reasons:³³

- a. **first**, although it was concluded that a partnership is not necessarily excluded from being a “person” for the purposes of Article 4(1)(b)(iii), it was concluded that that it would only apply “to the extent that the income is subject to United States tax as the income of a resident, either in its hands or in the hands of a partner or beneficiary”. The Full Court stated that there was “no evidence that the income of either partnership was ‘subject to tax in the United States’”;³⁴
- b. **secondly**, the plurality concluded³⁵ that the words “resident in the United States for purposes of its tax” were inapplicable and nor was the requirement that “the income is subject to United States tax as the income of a resident” applicable.

88. The provision is difficult to read and apply. Notwithstanding that, in the author’s view there are significant problems with the reasoning of the plurality as identified in [87a] above for at least three reasons.

89. First, by the use of “to the extent that” the article contemplates apportionment³⁶ and thus provided the inquiry permits looking to the partners and not only the partnership it would be sufficient if some of the partners are US residents.

90. Secondly, approaching the lack of evidence inquiry (as the joint reasons did at [70]) by reference to whether the income “of either partnership” was subject to tax in the United States ignores the words “either in its hands or in the hands of a partner”. It is unsurprising that income of the partnerships was not taxable in the United States given that (as was common ground) the partnerships were regarded as fiscally transparent i.e. a “look through” approach is adopted under

³³ Joint reasons at [70]-[74].

³⁴ Joint reasons at [70].

³⁵ At [73], approving the approach adopted by Edmonds J at first instance in *Resource Capital Fund III LP v Commissioner of Taxation* (2013) 95 ATR 504.

³⁶ Cf *Ronpibon Tin NL v FCT* (1949) 78 CLR 47 at 55 per Latham CJ, Rich, Dixon, McTiernan and Webb JJ.

US law. However, in the author's view the provision permits consideration of not only how income is treated in the hands of the partnership but also in the hands of the partners themselves.

91. Thirdly, and as to the lack of evidence, the Full Court made no mention of the evidence at trial given by an expert in US law, accepted by the trial judge and set out at [60] of the first instance decision that "each Fund's partners are subject to U.S. taxation as if they had realized directly their distributive share of such Fund's items of income, gain, loss, deduction or credit" and that "it is the partners, not the partnerships, who are subject to tax on partnership income". As noted above 73 of the 77 RCF IV partners, and 130 of the 137 RCF V partners were US residents.³⁷ The Full Court made no mention of the finding by the trial judge as to the operation of US law that:³⁸

"The law thus treats the individual members of the partnership as those who are acting in law, with the consequence that tax law and policy directly attributes to them individually the fiscal consequences of their activities which were undertaken by them in association."

92. As to the reasoning identified in [87b] above, it is true that "any other person ... resident in the United States for purposes of its tax", read in isolation, do not apply to the limited partnerships. There was no doubt that the limited partnerships were not US residents. However, there is much to be said for the approach adopted by Davies J which is in effect to read the proviso built into Article 4(1)(b)(iii) as in effect deeming US residency in respect of a partnership, an estate of a deceased individual or a trust. The deeming operates to the extent that the income is subject to US tax in either the hands of a partnership, the hands of an executor of a deceased estate, the hands of a trustee, the hands of a partner or the hands of a beneficiary either of a deceased estate or trust. As Davies J said at [238]:

"On this construction, it is the residency of the United States partners for United States tax law purposes which would dictate whether a partnership is a resident of the United States for the purposes of the DTA."

93. Davies J expressly disagreed with the approach of the joint reasons, and with the approach adopted by Edmonds J in *RCF III*, on this issue. There is much to be said for the approach of Davies J:
- a. as her Honour pointed out, at [239], the outcome would mean that US members of a limited partnership could get the benefit of the US DTA where Australia taxes the partnership as the relevant taxpayer. This ameliorates the mismatch created by the fact that Australia – unusually – treats a limited partnership as a taxpayer while the US does not.
 - b. Her Honour further stated that this interpretation is open on the text and is not inconsistent with the terms of the DTA considered in context and in light of their purpose and objects.

³⁷ Trial judge's reasons, *Resource Capital Fund IV LP v Commissioner of Taxation* [2018] FCA 41 at [28] and [29].

³⁸ At [61] of the trial judge's reasons. The trial judge was approaching the issue on the basis (that the Full Court determined to be incorrect) that the partners had been assessed and were taken to be before the Court.

- c. The result would also probably avoid the need for the taxpayer's argument about unconstitutional taxes (at least on the facts of this case and under the US DTA), which relies on the fact that individual partners can be jointly and severally liable for the partnership's tax liabilities without having an entitlement to object under Part IVC if the *Taxation Administration Act 1953 (Cth)* (**the TAA**). If individual partners, through the medium of the partnership as an entity, are taken to be parties to an objection and any subsequent appeal, then their rights are better protected. This is far preferable to the scenario contemplated in the joint reasons, in which it was suggested that the partners could rely on the US DTA in recovery proceedings and that the partners would "probably" have standing to seek declaratory relief.
94. As indicated, the joint reasons suggest that although the partnerships cannot rely on the DTA, individual partners could invoke it in recovery proceedings and that they "probably" could seek declaratory relief.³⁹ There are numerous difficulties inherent in this approach, which are important but are given no consideration in the joint reasons:
- a. in recovery proceedings or in proceedings for declaratory relief, the Commissioner could seek to tender the relevant notice(s) of assessment and rely on them as conclusive evidence under s 350-10 of Schedule 1 to the TAA;⁴⁰
 - b. it may be impracticable and prohibitively expensive for non-resident members of widely held partnerships, some of whom may have only small entitlements, to individually approach an Australian court to seek declaratory relief;⁴¹
 - c. the suggestion gives rise to the potential for multiplicity of proceedings if, for example, multiple partners each having different entitlements were to commence proceedings for declaratory relief seeking to assert an entitlement to treaty benefits;
 - d. if the Commissioner had already collected part, but not all of the tax (e.g. by issuing a garnishee notice to a bank or other third-party holding funds for the partnership) it might be said by the Commissioner that the tax was properly collected from the limited partnership which (assuming the Full Court is correct) was properly assessable and taxable as a non-resident not entitled to treaty benefits. There is an issue as to what if any entitlement to declaratory relief would be available to individual partners, if the partnership is properly assessable and tax has been paid. And if only part of the tax has been paid there would be no question of double recovery.
95. Finally on this issue, a word of caution: the Commissioner's reliance on Article 16 and the taxpayers' alleged failure to discharge the onus of proof on the issue of whether the members of the partnerships were "qualified persons" was not permitted to be argued given that it was raised for the first time on appeal, and the partners were not before the Court. It is beyond the scope of this paper to analyse the scope of the meaning of "qualified persons" and it was not addressed by

³⁹ Joint reasons at [75].

⁴⁰ Section 350-10 is not limited, in terms, to being applicable only in debt recovery proceedings issued against the taxpayer whose name appears on the assessment.

⁴¹ Query whether under US law, a partner could seek injunctive or declaratory relief against the Commissioner in a US Court.

the Full Court, but in other cases the Commissioner might raise the issue early enough to be permitted to rely upon it.

3.8 The Ruling issue

96. The Full Court determined that the Ruling did bind the Commissioner to enable the partnerships to access US DTA benefits under Article 7(1) of the US DTA unless the profits or gains in question were dealt with under another article of the US DTA.⁴²
97. This is significant for inbound private equity investments via limited partnerships that do not invest in assets categorised as “real property” as defined in an applicable DTA. It is noted that TD 2011/25 is not limited to the US DTA. The result of the case enables limited partnerships to access treaty benefits under the business profits article (Article 7) of Australia's tax treaties, on the basis that Article 7 applies to Australian sourced business profits of a foreign limited partnership, where the limited partnership is treated as fiscally transparent in a country with which Australia has entered into a tax treaty, and the partners are residents of that country.⁴³
98. The Commissioner sought to argue that the taxpayer had not established that the members of the partnership (or at least some of them) were residents of the United States. He was not permitted to do so, given that the issue had not been raised prior to the appeal and the issue was one on which evidence could have been given at trial⁴⁴ and the Full Court also noted that evidence was that the overwhelming majority of the partners were US residents.⁴⁵
99. The relief available under the ruling only applies, according to the ruling:
- “to the extent the business profits are treated as the profits of the partners (and not the LP) for the purposes of the taxation laws of the country of residence of the partners; the profits are not dealt with under another Article of the Treaty (such as Article 13); and the resident partners meet any other applicable tax treaty requirements.”
100. In respect of “any other applicable treaty requirements” the Commissioner sought to argue that the partners were not “qualified persons” within the meaning of Article 16⁴⁶ but the argument was not permitted as a consequence of having been raised for the first time on appeal.
101. The Commissioner also sought to argue that the Ruling did not apply because the limited partnerships were not residents of the United States or “enterprises” for the purposes of the DTA.⁴⁷ The argument was rejected on the basis that the application of the Ruling depended on the terms of the Ruling.⁴⁸

⁴² Reliance having been established as a factual matter: see the trial judge's reasons at [75]; cf s 357-60 of Schedule 1 to the TAA.

⁴³ Subject to reliance, in the sense described in s 357-60 of Schedule 1 to the TAA.

⁴⁴ Joint reasons at [90].

⁴⁵ Joint reasons at [93] and see para [66] above.

⁴⁶ As mentioned above this issue was also sought to be raised in respect of whether the partnerships could access the treaty, and the Commissioner was not permitted to rely on it: see joint reasons at [78].

⁴⁷ The argument is recorded at [88] of the joint reasons.

⁴⁸ Joint reasons at [94].

102. Consequently, it having been determined that the limited partnerships could rely on the ruling to access treaty benefits (if it provided treaty benefits to them), it became necessary to assess the application of the US DTA.

103. At this point it is useful to set out Articles 7(1), 7(6) and Article 13(1) of the US DTA.

3.9 Article 7 of the US DTA

104. Article 7(1) provides:

“The business profits of an enterprise of one of the Contracting States shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.”

105. There was no dispute that Article 7(1) applied and thus the gains in this case would not have been assessable to the limited partnerships in Australia, as a consequence of the limited partnerships' entitlement to rely on the ruling, unless Article 7(6) affected that.

Article 7(6) provides:

“Where business profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.”

106. The Commissioner contended that the gains in this case were deal with separately, specifically by Article 13.

3.10 Whether Article 13 allocated taxing rights to Australia

107. The Commissioner contended that Article 13 applied to allocate taxing rights to the gains on the basis that they were income or gains “from the alienation or disposal of real property” within Article 13(1). Article 13(1) provides:

“Income or gains derived by a resident of one of the Contracting States from the alienation or disposition of real property situated in the other Contracting State may be taxed in that other State.”

108. This required consideration of the concept of “real property” which was relevantly defined in Article 13(2) as follows:

“For the purposes of this Article:

(a) [not reproduced]

(b) the term “real property”, in the case of Australia, shall have the meaning which it has under the laws in force from time to time in Australia and, without limiting the foregoing, includes:

- (i) real property referred to in Article 6,
- (ii) shares or comparable interests in a company, the assets of which consist wholly or principally of real property situated in Australia; and
- (iii) an interest in a partnership, trust or estate of a deceased individual, the assets of which consist wholly or principally of real property situated in Australia.”

109. Importantly Article 6(2) provided, in relation to real property, that:

“For the purposes of this Convention:

- (i) a leasehold interest in land, whether or not improved, shall be regarded as real property situated where the land to which the interest relates is situated; and
- (ii) rights to exploit or to explore for natural resources shall be regarded as real property situated where the natural resources are situated or sought.”

110. At this point one might think that the question of whether Article 13 allocated taxing rights to Australia, should have been determined solely by reference to the text of Article 13 and the other provisions of the US DTA as well as any domestic provision implementing or modifying the US DTA as a matter of domestic law. In this case the effect of s 5 of the *International Tax Agreements Act 1953 (Cth) (the Agreements Act)* is that each provision in the US DTA “has the force of law according to its tenor” and the effect of s 4 is that the domestic income tax legislation is incorporated and read as one with the Agreements Act but that in the event of inconsistency, the Agreements Act prevails. Section 3A of the Agreements Act modifies the operation of the DTA to enable alienation or disposal of real property through interposed entities to be captured by Article 13.⁴⁹

111. If it had been determined that the US DTA allocated taxing rights to Australia, the next step in the analysis adopting a conventional approach would have been to see whether Australia had domestic legislation taxing the gain: in this case, the gain was on revenue account so s 6-5 of the ITAA 1997 would have captured it, assuming taxation rights had been allocated to Australia under the terms of the US DTA and relevant provisions of the Agreements Act. There may have been a difference in the quantum of the assessable amount, depending on whether s 6-5 or Division 855 was applied.

112. Accordingly, it might have been expected that before one got to Division 855 it would first have to be determined that the assets of Talison were wholly or principally attributable to “leasehold interests in land” and “rights to exploit or to explore for natural resources” within the

⁴⁹ As the trial judge noted at [85]. This ensured that the result reached in *Commissioner of Taxation v Lamesa Holdings BV* in which the alienation of real property article in the Netherlands-Australia DTA was found not to apply to indirect alienations through interposed entities.

meaning of those words as used in the US DTA. If so, taxing rights would have been allocated to Australia. The next step would have been to determine whether or not the shares were TAP (if Div 855 was applicable) or whether the gains were assessable under s 6-5 as being on revenue account.

113. However, the case did not proceed on that basis, it appears as a result of agreement between the parties. The agreement was that if the shares in Talison constituted TAP for the purposes of Division 855 of the ITAA 1997, Article 13 would be satisfied. Although the Full Court questioned the validity of this approach, noting that “[b]efore us the parties were pressed to explain the relevance of Div 855 given the primary judge’s finding that the profits were ordinary income”,⁵⁰ subject to one issue about the meaning of “real property” in Article 13 which was dealt with very briefly,⁵¹ the Court proceeded to determine the remaining issues by reference to whether the shares sold were TAP for the purposes of Division 855.

114. Nevertheless, the Court and the parties proceeded directly to Division 855 – in effect Division 855 was adopted as a proxy for the requirements of the US DTA. The result was probably not affected by this course insofar as the US DTA language of “leasehold interests in land” and the term “lease of land” in s 855-20 is almost identical.

115. However, the term “rights to exploit or to explore for natural resources”, may not have the same meaning as the phrase “an authority, licence, permit or other right ... to mine” in the definition of “mining, quarrying or prospecting right”⁵² (MQPR). A general purpose lease issued, for example, to authorise processing of lithium bearing rocks into lithium concentrate can constitute a right “to mine” given the view taken by the Full Court on the scope of the taxpayer’s mining operations on the facts of this case.⁵³

116. It is debateable however, whether the concept of a right “to exploit” natural resources necessarily has the same meaning as a right “to mine”. On one view a right to exploit is broader than a right to mine. On this basis a “right ... to mine”, i.e. an MQPR would also be a “right to exploit ... natural resources” within the meaning of the US DTA. On the other hand, it might be said in the context of the US DTA reference to “rights to exploit or to explore for natural resources” that the concept of exploitation should be regarded as limited to, for example, extracting minerals from a mine or quarry, harvesting timber from a forest, catching fish, intercepting water for use in agriculture, collecting salt from salt deposits or producing crude oil or natural gas from a well. On this view a right to “exploit” would not extend to downstream processing operations or other non-extractive activities, and may not extend for example, to a right to conduct sawmilling operations (in the case of a right to exploit a natural resource being timber), to a right to handle or process fish, to a right to process raw salt into a food grade product, to a right to crush quarried rocks into gravel, or to a right authorising processing operations carried on, for example, to turn lithium bearing rocks into lithium concentrate. Such a reading would allow for the fact that “natural resources” in the US DTA can apply to a broader category of things than those that can be mined. The definition of MQPR is relevant to things that

⁵⁰ Joint reasons at [102].

⁵¹ At [103]. The taxpayer’s argument that “real property” in Article 13(2)(b)(ii) did not have the same meaning as in 13(2)(b)(i) because (b)(ii) did not pick up the definition from Article 6 was rejected.

⁵² Sections 855-20(b) ITAA 1997 and 995-1 ITAA 1997.

⁵³ It remains to be seen whether the High Court will agree with this, if special leave is granted.

can be mined, whereas “natural resources” is a broader category and it might be expected that whereas taxing rights in respect of the activities that result in natural resources being taken from the State and placed into private ownership (i.e. when minerals are extracted, or when fish or timber belonging to the State are harvested⁵⁴) should be allocated to the State, on the basis that profits attributable to the natural resources in the form and place when they were first exploited, by extraction or otherwise coming into the hands of a non-State entity should be allocated to the State, taxing rights in respect of activities that add value subsequently should be treated no differently from other manufacturing activities. Which particular reading is appropriate requires detailed consideration of which better reflects the ordinary meaning of the language in light of the context, object and purpose of Articles 6, 7 and 13 and the broader US DTA⁵⁵ and, where the meaning remains ambiguous, supplementary materials⁵⁶ from the negotiation of the original US DTA text in 1982.⁵⁷

117. A number of significant findings were made for purposes of Division 855, which it is not possible to address in detail in this paper. Two significant findings were made as to the character of a general purpose lease issued under the *Mining Act 1978 (WA)*, that were alternative bases for concluding that the general purpose lease was TARP and that in turn the gains made were attributable to TARP for the purposes of Division 855 (and in turn Article 13):

- a. the general purpose lease was held to fall within the description “an authority, licence, permit or other right ... to mine” in para (a) of the definition of MQPR in s 995-1 of the ITAA 1997;
- b. the general purpose lease was alternatively considered to fall within the description “a lease of land” in s 855-20 of the ITAA 1997 on the basis, principally, that s 87 of the *Mining Act* entitled the lessee thereof to “exclusive occupation” of the land for various purposes.

118. The Full Court rejected the view that the general purpose lease was a right in respect of buildings or other improvements etc within the meaning of para (d) of the definition of MQPR. The trial judge had also rejected the Commissioner’s argument on this issue.

119. The conclusion that the general purpose lease was a right “to mine” turned on the view that the Court took as to the nature of the taxpayer’s particular operations and the view of the concept

⁵⁴ For example s 10 of the *Fisheries Act 1995 (Vic)* vests title in wild fish in the Crown; property passes, broadly speaking, when fish are taken from the water, i.e. when they are landed on the boat. Separate licences are needed to receive and process fish or abalone from those needed to take them from the wild. Section 9 of the *Mineral Resources (Sustainable Development) Act 1990* vests ownership of minerals in the Crown but provides that ownership passes to the holder of a licence “when the minerals are separated from the land”. Section 9 of the *Mining Act* vests title in the Crown to gold, silver and precious metals in their natural condition below the surface of land and in the case of minerals in their natural condition below the surface of land that was not the subject of a fee simple estate before 1 January 1899; in respect of minerals title to minerals is transferred under s 85(2) in respect of “all minerals lawfully mined”. It is the act of mining that results in the transfer of title: on the view taken by the Full Court, transfer of title would not take place until the lithium concentrate was produced.

⁵⁵ Article 31 of the *Vienna Convention on the Law of Treaties 1969*.

⁵⁶ Article 32 of the *Vienna Convention on the Law of Treaties 1969*.

⁵⁷ The definition in Article 6 was not replaced or relevantly altered by the 2001 protocol to the treaty. However there may be subsequent agreement or practice as to how the term should be interpreted relevant to its construction revealed by an examination of the materials surrounding the negotiation of the Protocol: Article 31(2)(a)&(b) of the *Vienna Convention on the Law of Treaties 1969*.

of mining – it is not addressed further here, although it may be addressed by the High Court if special leave is granted.

120. Similarly the view that the general purpose lease was a lease of land by reason of the *Mining Act* conferring a right to “exclusive occupation” is beyond the scope of any detailed analysis in this paper. There is arguably, however, a difference between a right of “exclusive occupation” *for particular purposes* which the *Mining Act* conferred as a statutory right granted to holders of general purpose leases, and a right of “exclusive possession” as granted by a lease at common law. In addition, the High Court may have something to say about how the matter was dealt with in the joint reasons, given the outcome reached was not argued for by either party. According to the joint reasons at [192] the issue was raised by the Court at the hearing (and it is not suggested that either side asked for an adjournment to deal with the issue), but Davies J expressly declined to express a view on the issue stating that the issue had not been the subject of argument.
121. In light of the view taken by the Full Court as to the character of the general purpose lease as an MQPR, it followed that the shares were TAP and thus, on the agreed basis of adopting Division 855 as a proxy for Article 13, it was concluded that Article 13 allocated taxing rights to Australia.
122. It is beyond the scope of this paper to deal with the valuation issues that then were considered by the Full Court in determining to allow the Commissioner’s appeal.

4 Conclusions

123. Both decisions potentially give rise to significant uncertainties, although in the author's view the BHP case is capable of being seen as confined to circumstances where one party has agreed to act in the interests of the other through the implementation of a DLC structure or some other similar arrangement. The approach taken to assessing "sufficient influence" may have application in circumstances where, for example, stapled securities are issued by two different entities, subject to assessment of the terms of issue. It is unlikely however to be of application in conventional joint venture arrangements.
124. The decision in the RCV IV case gives rise to potential problems for limited partnerships investing in TARP assets in Australia. It may be that some of these could be ameliorated by adopting a different inbound investment entity: a general law Cayman partnership, for example, constituted by members comprising a corporate limited partnership of non-US residents, with US investors participating through a special purpose LLC, might be more attractive because a general law partnership would not be able to be assessed through Division 5. This would however likely give rise to other regulatory and liability issues, including the members of the general law partnership being exposed to partnership liabilities.

Annexure A
Text of s 318(2) of the ITAA 1936

- (2) For the purposes of this Part, the following are associates of a company (in this subsection called the primary entity):
- (a) a partner of the primary entity or a partnership in which the primary entity is a partner;
 - (b) if a partner of the primary entity is a natural person otherwise than in the capacity of trustee--the spouse or a child of that partner;
 - (c) a trustee of a trust where the primary entity, or another entity that is an associate of the primary entity because of another paragraph of this subsection, benefits under the trust;
 - (d) another entity (in this paragraph called the controlling entity) where:
 - (i) the primary entity is sufficiently influenced by:
 - (A) the controlling entity; or
 - (B) the controlling entity and another entity or entities; or
 - (ii) a majority voting interest in the primary entity is held by:
 - (A) the controlling entity; or
 - (B) the controlling entity and the entities that, if the controlling entity were the primary entity, would be associates of the controlling entity because of subsection (1), because of subparagraph (i) of this paragraph, because of another paragraph of this subsection or because of subsection (3);
 - (e) another company (in this paragraph called the controlled company) where:
 - (i) the controlled company is sufficiently influenced by:
 - (A) the primary entity; or
 - (B) another entity that is an associate of the primary entity because of another paragraph of this subsection; or
 - (C) a company that is an associate of the primary entity because of another application of this paragraph; or
 - (D) 2 or more entities covered by the preceding sub-subparagraphs; or
 - (ii) a majority voting interest in the controlled company is held by:
 - (A) the primary entity; or
 - (B) the entities that are associates of the primary entity because of subparagraph (i) of this paragraph and the other paragraphs of this subsection; or
 - (C) the primary entity and the entities that are associates of the primary entity because of subparagraph (i) of this paragraph and the other paragraphs of this subsection;

- (f) any other entity that, if a third entity that is an associate of the primary entity because of paragraph (d) of this subsection were the primary entity, would be an associate of that third entity because of subsection (1), because of another paragraph of this subsection or because of subsection (3).