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2019 International Tax Day

8 August 2019 | RACV City Club, Melbourne

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SESSION 4:

Recent Cases

Presenter:

Andrew Broadfoot QC, Victorian Bar

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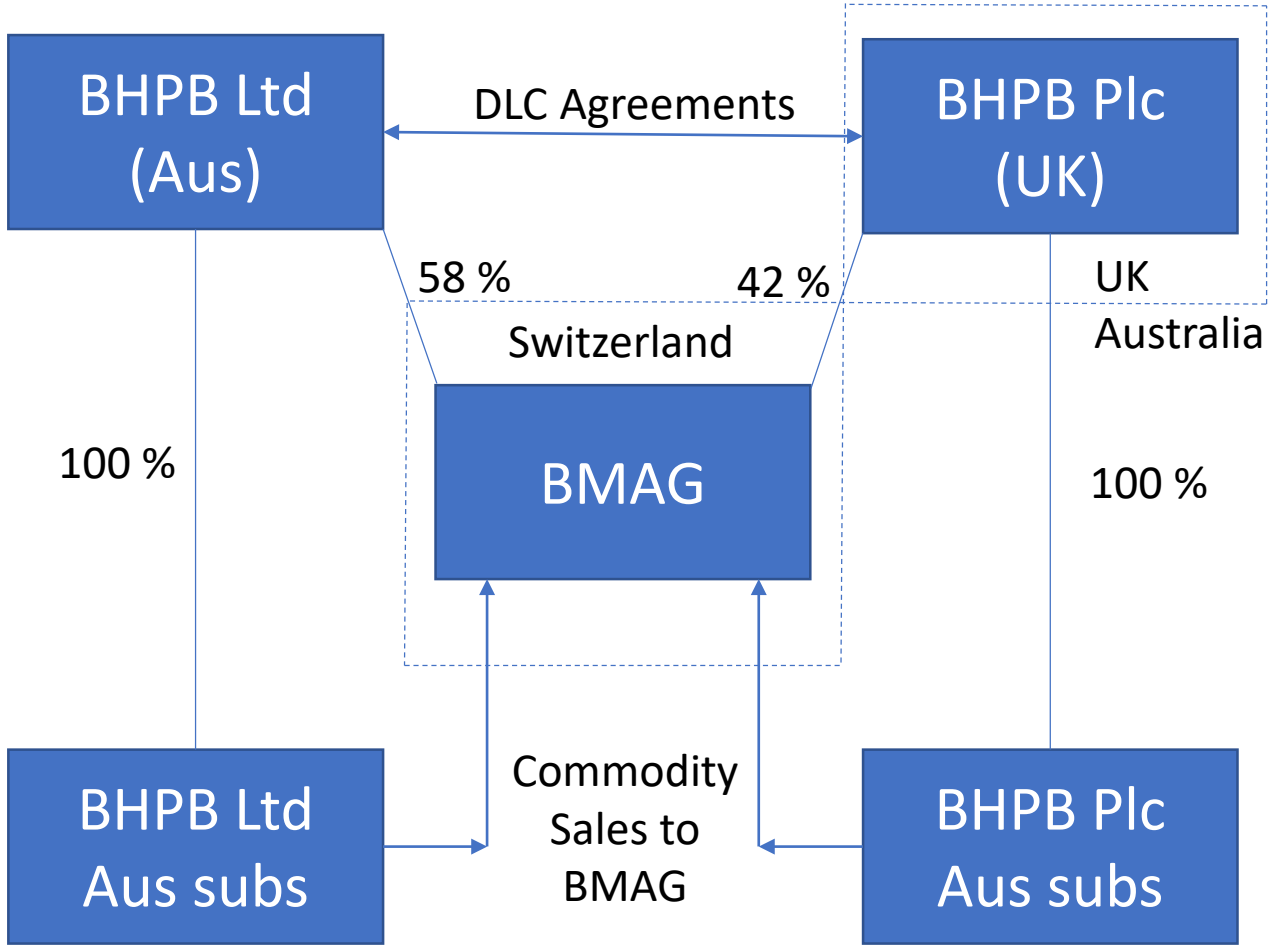
BHP Billiton case



- Under DLC structure two separately listed entities agree to act as a single unified economic entity (SUEE).
- Common holding company boards must have regard to shareholders in each entity. Dividend entitlements equalised.
- Each party must do such things as the other may reasonably require in furtherance of the common interests of shareholders in both entities.
- Plc shareholder votes counted at Ltd general meetings (and vice versa) through a Special Voting Share.
- BUT – no subservience, ability to control or dictate, and BMAG directors act independently in interests of BMAG.

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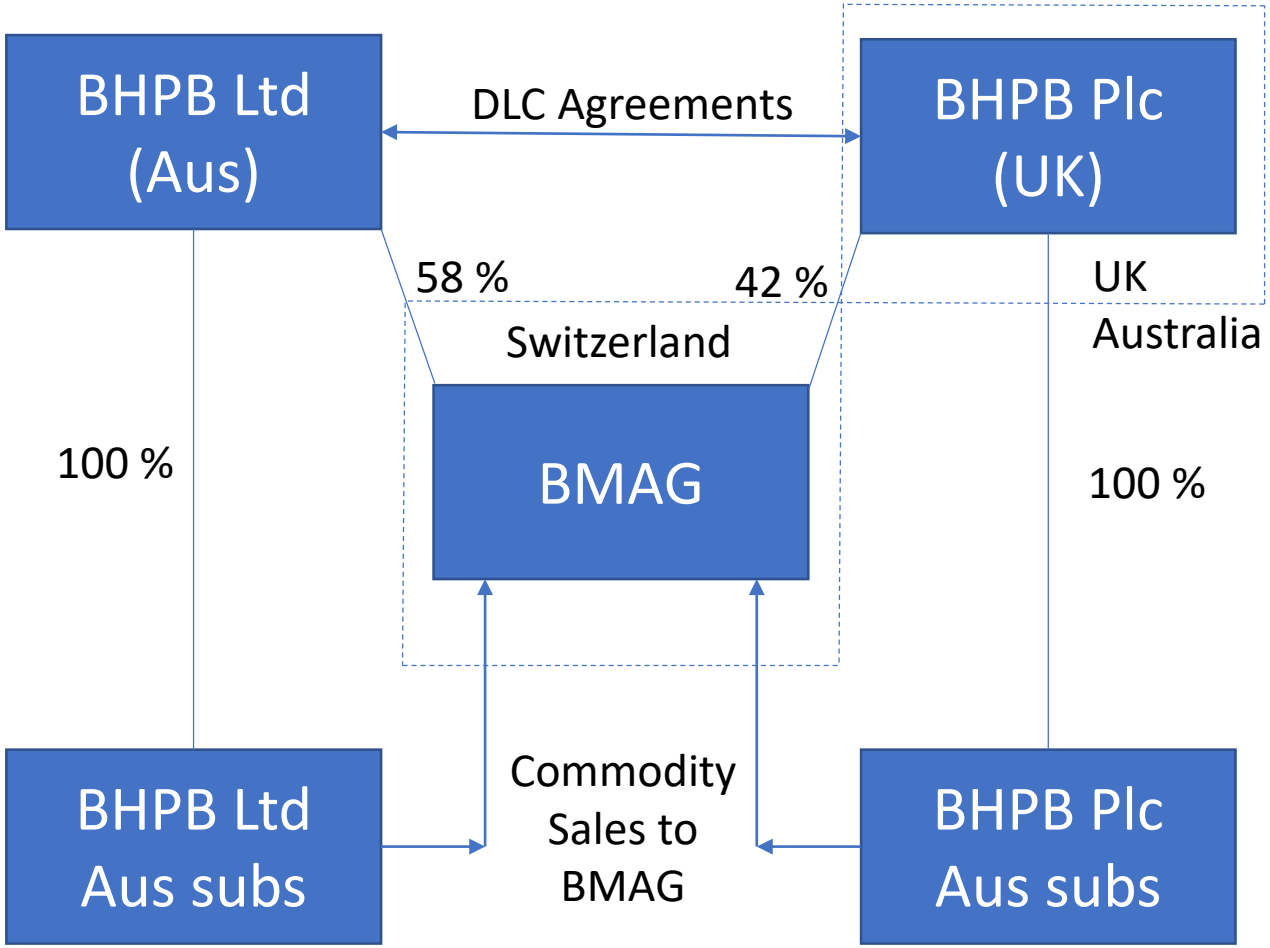
BHP Billiton case



- Was 58% of income derived by BMAG from on-selling commodities purchased from BHPB Plc Australian subsidiaries tainted sales income attributable to BHPB Ltd in Australia?
- s 447(1)(a)(ii)(A) refers to income from the sale of goods where:

  > "the seller of goods to [BMAG] was an associate [BMAG] and a Part 10 X Australian resident"

- Were BHPB Plc Australian subsidiaries "associates" of BMAG?

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BHP Billiton case

- Associate definition – ITAA s 318(2).
- Parties are associates where Party A has majority voting interest in Party B.
- Parties are associates – broadly - where Party B is “sufficiently influenced” by Party A, or by Party A and other associates.
- Concept of “sufficiently influenced” critical.

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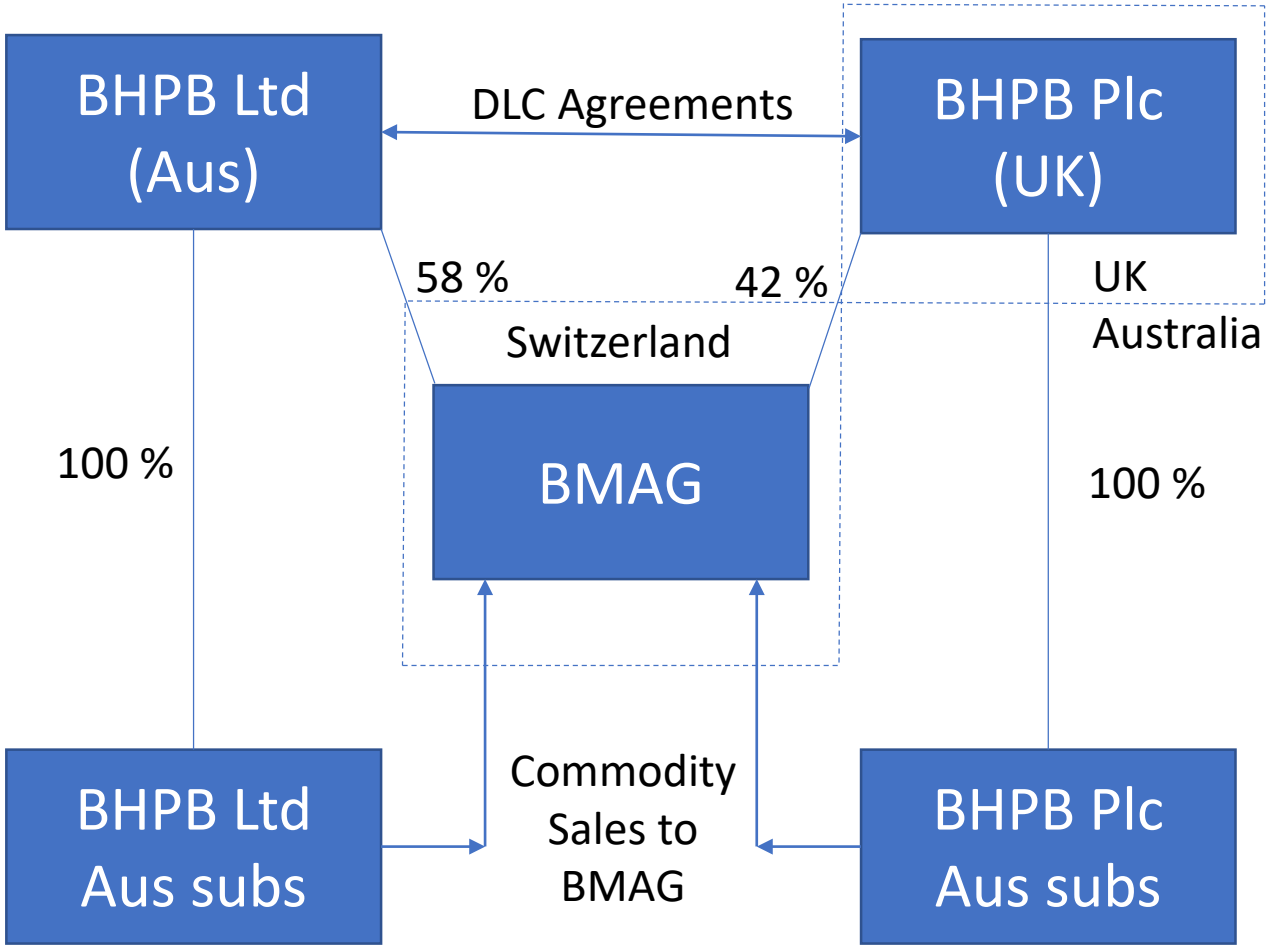
BHP Billiton case



It was agreed that Plc Australian subsidiaries would be associates of BMAG if:

1. BHPB Ltd was "sufficiently influenced" by BHPB Plc;
2. BHPB Plc was "sufficiently influenced" by BHPB Ltd; or
3. BMAG was "sufficiently influenced" by BHPB Plc and BHPB Ltd.

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BHP Billiton case

Sufficiently influenced definition is in s 318(6)(b):

> "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)."

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BHP Billiton case

- Contrast definition of “sufficiently influenced” in ITAA:

  “if the company, or its directors, … might reasonably be expected, to act in accordance with the directions, instructions or wishes of the entity or entities…”

- With definition of “director” (aka shadow directors) in CL:

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

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BHP Billiton case

- BHP argument that “the company, or its directors” should be read as reflecting that companies act through natural persons and thus control of the directors is necessary, was rejected.
- Thawley J correctly recognised influence can be between the companies, focusing on the DLC arrangements and SUEE.
- SVS – a synthetic mechanism to allow Plc shareholders to vote at Ltd general meetings, and vice versa, consistent with SUEE.

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Did Plc and Ltd sufficiently influence the other?

- SVS arrangement, per Thawley J:

  "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"

- BUT - notifications of how shareholders voted were instructions; shareholder votes determined each company's instructions; and were acted on by the other "at least to the extent of keeping their meetings open".

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Did Plc and Ltd sufficiently influence the other?

- On appeal – will the High Court agree that the wishes of shareholders are to be assimilated with wishes of the company?
- Usual principle is that the board embodies the directing mind and will of a company (e.g. *AWA v Daniels* (1992) 7 ACSR 759).
- Commissioner conceded that "in accordance with" requires causation … how can Party A *cause* Party B to act, where Party A cannot control Party B? SVS does not enable control; voting is determined by shareholders (not the company).

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Commissioner's concession as to causation

- Example - *Buzzle Operations* (2010) 77 ACSR 410 (White J):

  > "[I]f 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."

- If that satisfies "in accordance with", BHPB will lose the appeal.
- But that does not satisfy a "causation" requirement.
- Commissioner's concession may be significant in the appeal.

Allsop CJ and Davies J (very briefly)

- Allsop CJ – acting in the other's interests because it is thought to be in one's own interests, where there is a SUEE, is "in accordance with" the wishes of the other. Attributes significance to DLC arrangements. But how does this sit with causation?
- Davies J (in dissent) and Logan J in the AAT: no control, subservience, and directors of each company met and exercised independent judgment – not "sufficiently influenced".

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Did Plc and Ltd sufficiently influence BMAG?

- Thawley J – the AAT found at [52] “BMAG would reasonably be expected to follow the instructions of Ltd and Plc”.
- In fact the AAT said, at [52]:

> “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.”

- Thawley J probably got this wrong.

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BHP case – Appeal to the High Court

- Special leave was granted on 15 May 2019.
- Some other provisions use the same “associate” definition:
  - CGT rules; TOFA (Div 230); Commercial Debt Forgiveness (Div 245); R&D (Div 355); Thin Cap (Div 820-I) and more…
- See the detailed paper for a more thorough discussion of the issues and arguments. May not be of application beyond DLC structures (and possibly certain stapled structures).
- In conventional joint venture arrangements there is no overriding concept of operating as a SUEE.

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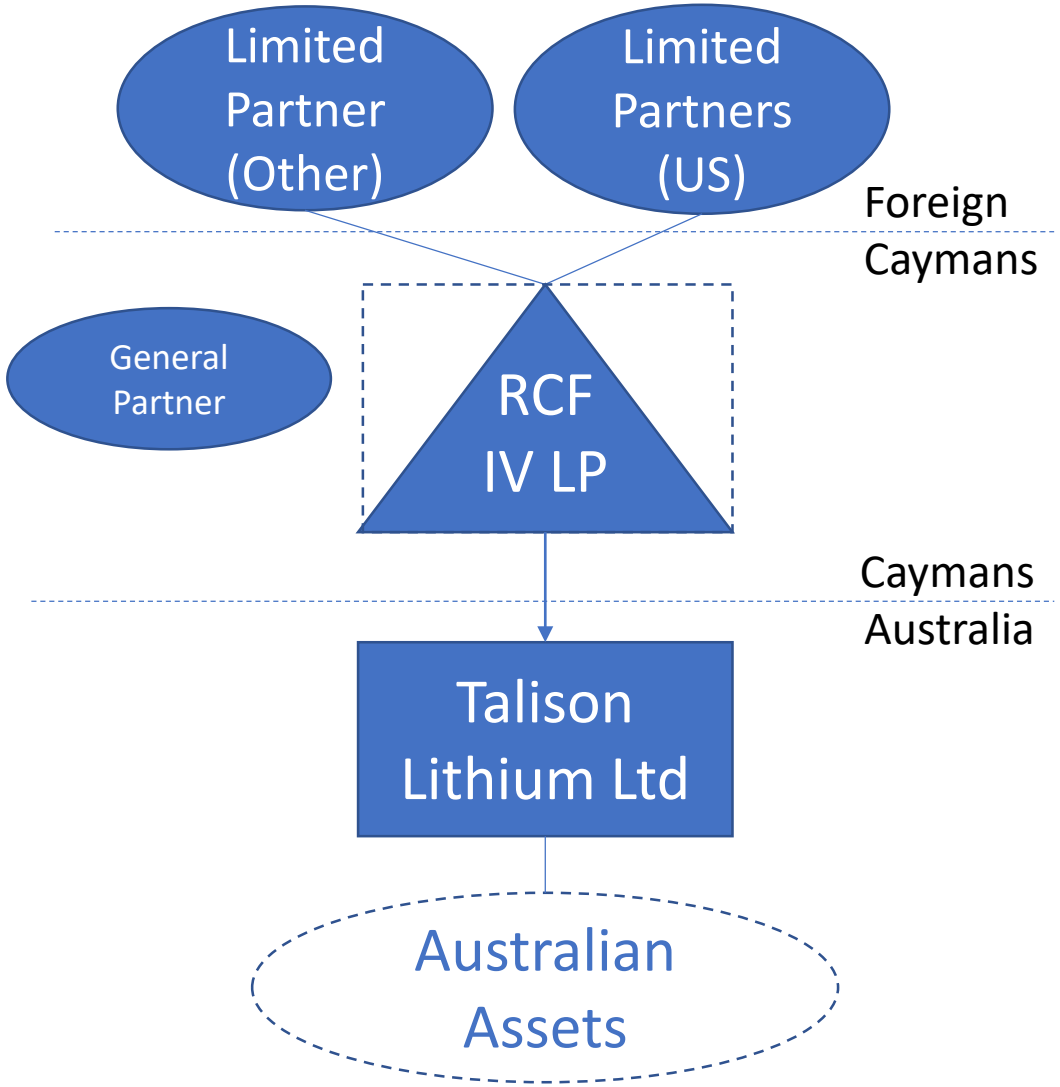
RCF IV Transaction Structure



- Thanks to Gareth Redenbach and James Strong for the diagram and some of the RCF slides!
- Two similarly structured LPs (RCF IV & RCF V) sold shares in Talison Lithium Ltd.
- Commissioner sought to impose tax on LPs as separately taxable entities pursuant to Division 5A of the ITAA 1936.

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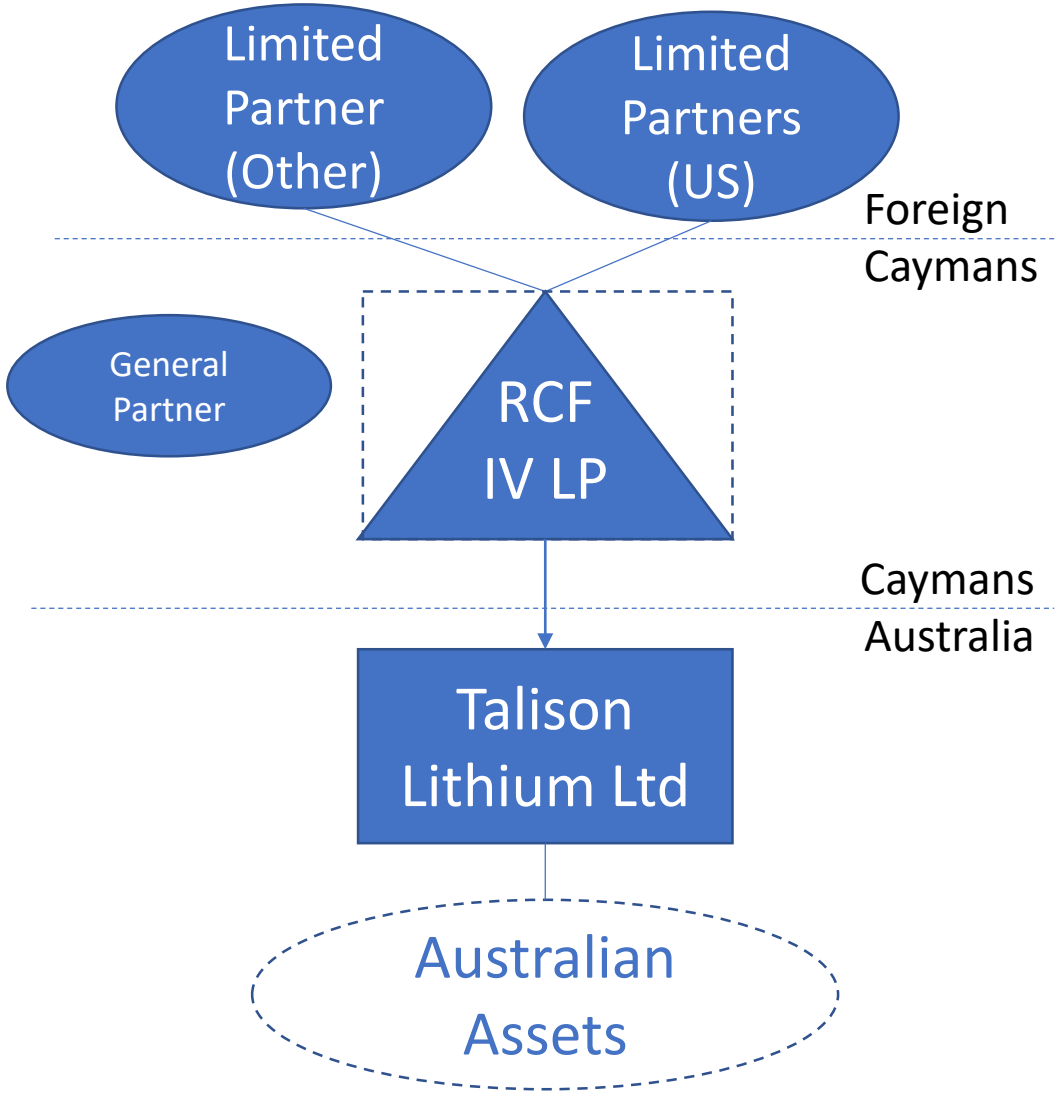
RCF IV First Instance



At first instance the primary judge held:

- The gain on the Talison Lithium shares had an Australian source.
- Division 5A, and s 94V in particular, fixed liabilities on the partners as the correct taxpayers.
- RCF IV LP was not a taxable entity separate from its partners and the partners could assert treaty benefits against the assessment of the LP.
- Gain was Treaty protected as (subject to further calculation) not Div 855 'TAP'.

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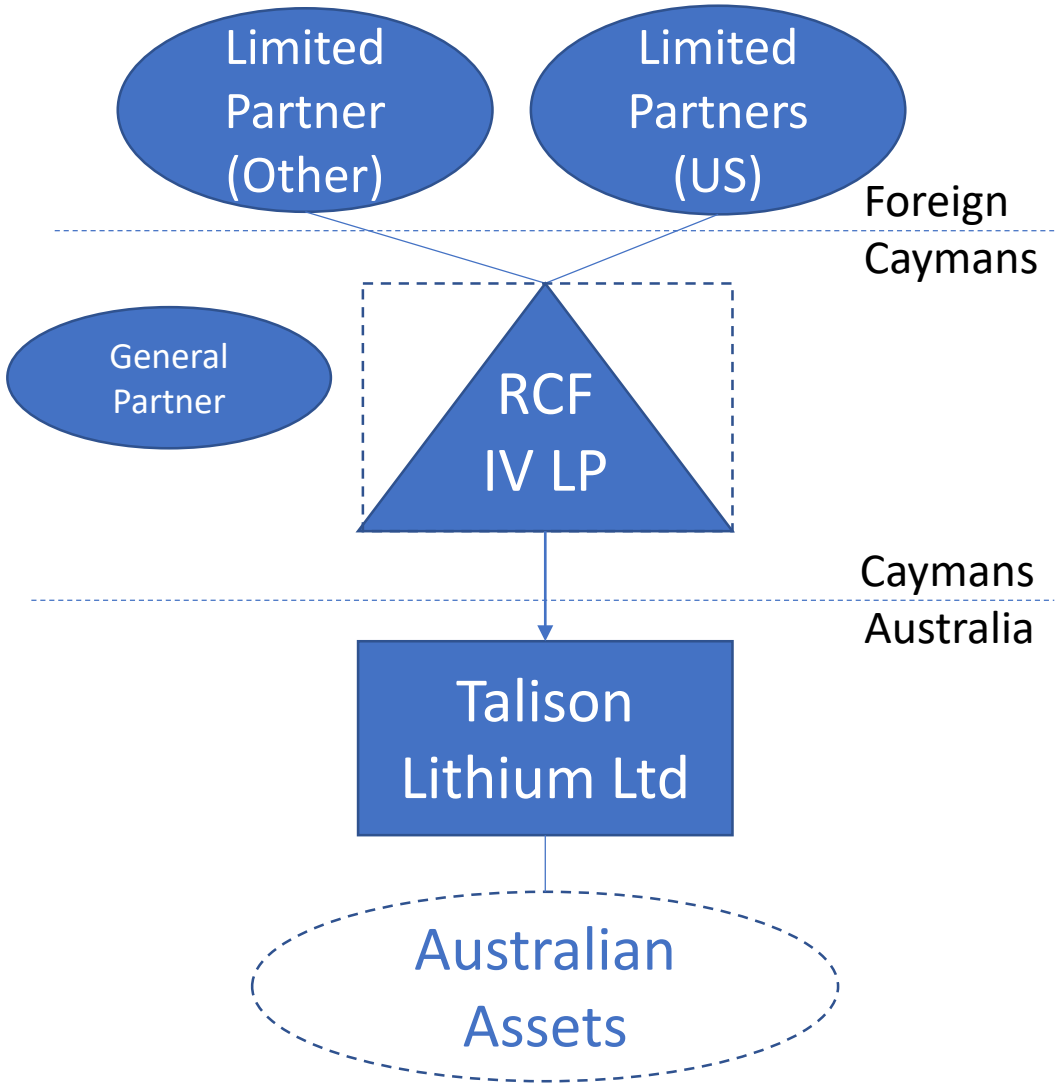
Issues Addressed by the Full Court



1) Are LPs liable to tax separate from the partners? Answer – yes. Reasoning not addressed in this session.

2) Who had been assessed – the LP or the partners? Answer – yes. Reasoning not addressed in this session.

3) Was tax on the LP constitutionally invalid? Answer – yes. Reasoning not addressed in this session.

4) Did the gain on disposal of Talison shares have an Australian source?

5) Could the LPs rely on the US DTA?

6) Could the LPs rely on TD 2011/25 (and thereby rely on the US DTA)?

7) Valuation. Taxpayer lost. Reasoning not addressed in this session.

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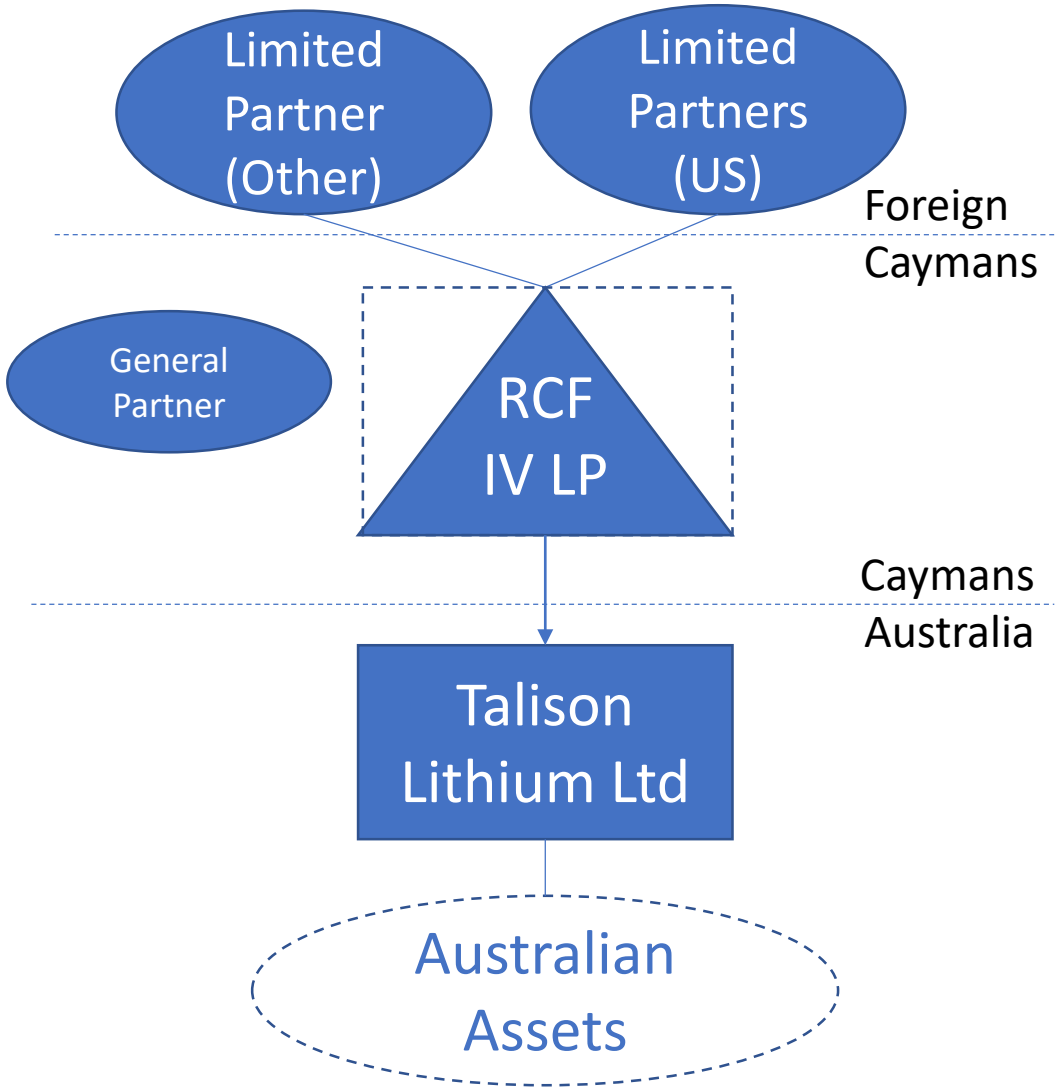
RCF IV – the source issue



- Non-residents are, broadly, only taxable on gains with an Australian source. Source is a "hard practical matter of fact" (*Nathan* (1918) 25 CLR 183). Can source be apportioned? See *Nathan*; also *Australian Machinery* (1946) 180 CLR 9.
- The mining assets, incorporation of Talison and some investment management staff all being in Australia meant it was open for the primary judge to conclude there was an Australian source.
- The Full Court emphasised that the sale was under a Federal Court of Australia scheme of arrangement and the locus of the scheme was analogous to the place of contract (*Premier Automatic Ticket Issuers Ltd* (1993) 50 CLR 268; contrasting *Tariff Reinsurers* (1938) 59 CLR 194).

Could the LPs rely on the US DTA?

- Article 4(1)(b)(iii).
- A person is a resident of the United States if the person is:

  "[A]ny 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…"

- Joint reasons conclude that LPs could not rely on the US DTA (except if the ruling permitted them to).

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Could the LPs rely on the US DTA?

Article 4(1)(b)(iii)

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Approach in joint reasons

- Not applicable because, although a partnership could be a person, there was "no evidence that the income of either partnership was subject to tax in the US".
- The words "resident in the United States for purposes of its tax" don't apply, nor does the requirement that "the income is subject to United States tax as the income of a resident".

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Could the LPs rely on the US DTA?

Approach in joint reasons

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Issues with this approach

- The provision states "…subject to United States tax as the income of a resident, either in its hands or in the hands of a partner…"
- As to lack of evidence, expert evidence accepted by the trial judge was 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 …"
- What is the effect of the words following "provided that…"?

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Could the LPs rely on the US DTA?

Article 4(1)(b)(iii)

"[A]ny 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…"

Davies J

- Alternative approach relies on the words following "provided that, in relation to any income derived by a partnership…"
- Deems the partnership not to be a US resident except to the extent that the income is taxed in the US in the hands of partners or beneficiaries.
- In effect deems the LPs to be US residents (and therefore able to access the DTA) to the extent that partners are taxed in the US.

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Consequences of alternative approaches to LPs' ability to rely on the US DTA

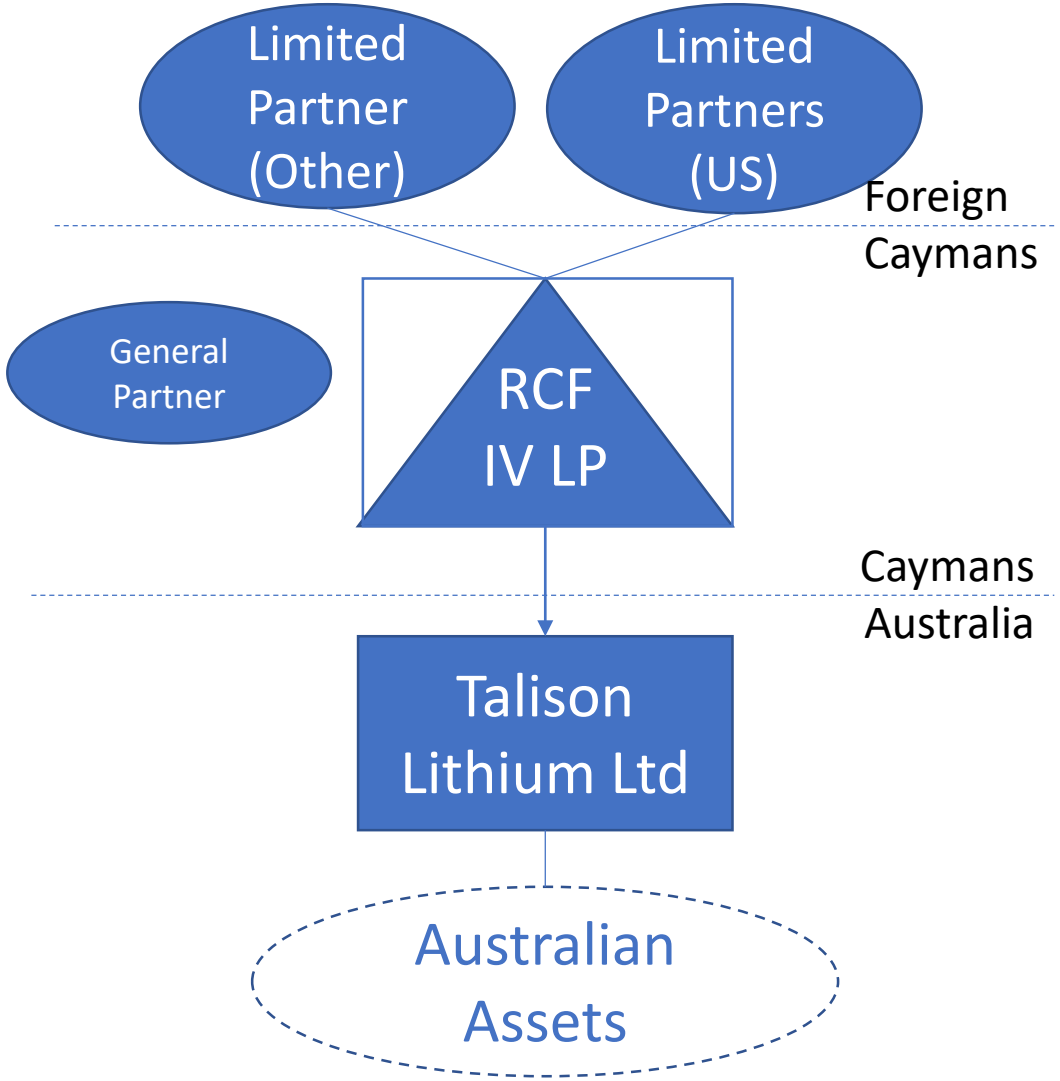
Joint reasons, and issues

- Partners could invoke US DTA in recovery proceedings and "probably" in proceedings for declaratory relief – but what about conclusive evidence under s 350-10 of TAA Sched 1? Not addressed. Is this practical if widely held?
- If the Commissioner has collected part (or all) of the tax from the LPs, which (it was held) are taxable; or by garnishee notice and 94V makes partners and LPs jointly and severally liable?
- LPs are assessable on income before distribution.
- In declaratory proceedings, Commissioner might say tax was properly collected from the LPs.

Davies J approach

- US partners could get treaty relief in Part IVC proceedings brought by the LP, "through" the partnership (need evidence of residence).
- Ameliorates the mismatch created by Aus taxing LPs as entities while the US adopts a "look through" approach.
- Arguments about incontestable taxes and difficulties with declaratory relief go away because partners, through the medium of the LP, can take the benefit of the Part IVC appeal and get treaty relief through it.

Could the LPs rely on TD 2011/25, and through it, the US DTA?



Extract from TD 2011/25

"Income tax: does the business profits article (Article 7) of Australia's tax treaties apply to Australian sourced business profits of a foreign limited partnership (LP) where

- the LP is treated as fiscally transparent in a country with which Australia has entered into a tax treaty (tax treaty country)
- and the partners in the LP are residents of that tax treaty country?"
- See also Article 7(6).
- Answer – the LPs could rely on the ruling…
- BUT …

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Could the LPs rely on TD 2011/25, and through it, the US DTA?

- Could the LPs rely on the ruling?
- Ruling allows access to treaty benefits under business profits article (Article 7), 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) (this wording reflects Article 7(6));
  - and the resident partners meet any other applicable tax treaty requirements.

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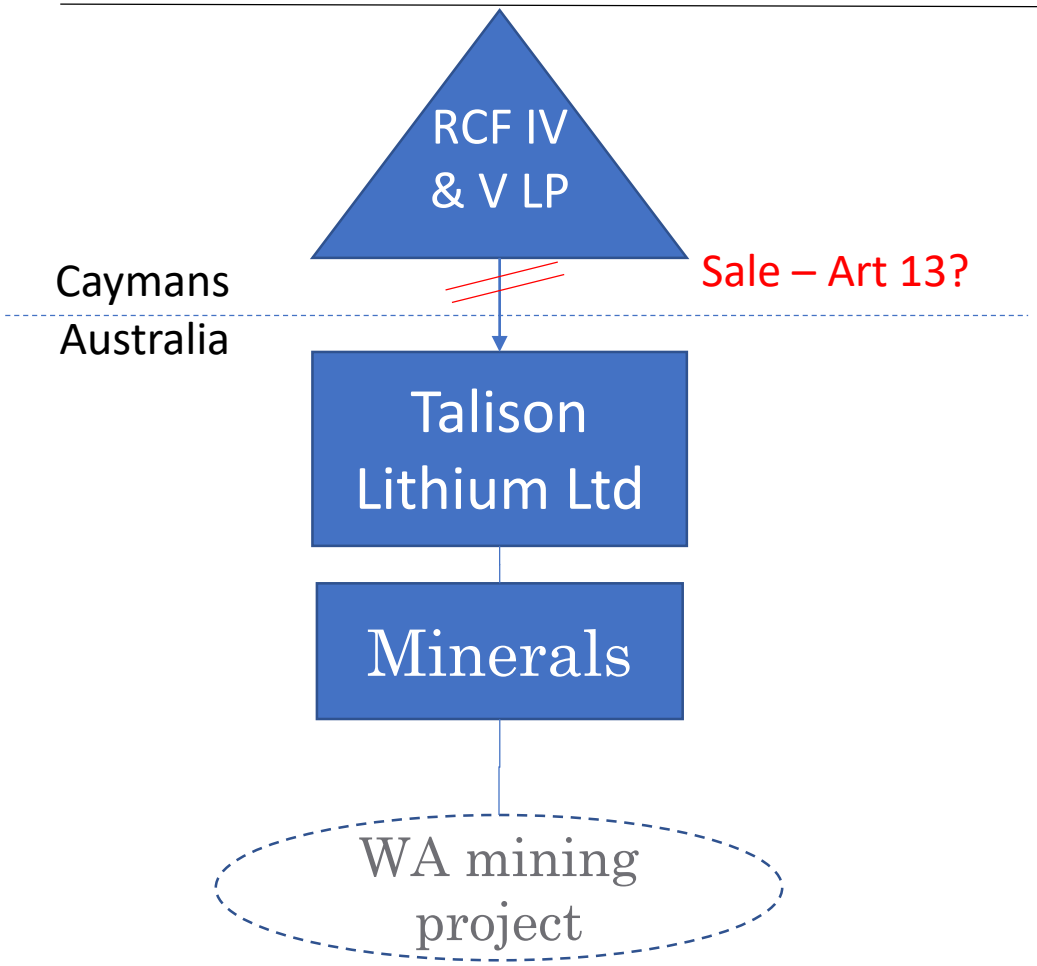
Were the profits dealt with under another Article of the Treaty?



- **Alienation of real property Article 13(1):** Income or gains derived by a resident of [the US] from the alienation of..real property situated in [Australia] may be taxed in Australia.
- **Article 13(2)(b) 'real property' in Art 13 means:**

  13(2)(b)(i) Real property as defined in Article 6 (includes rights to exploit…natural resources situated in Australia)

  13(2)(b)(ii) - [shares] in a company, the assets of which consist wholly or principally of real property situated in Australia.....
- Note extension of Art 13(2)(b)(ii) by s 3A(2) of International Tax Agreement Act 1953 ('*Lamesa* amendments') to cover indirect disposals.

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Approach taken – straight to Div 855

- It was agreed that whether Article 13 applied should be determined by reference to whether Div 855 applied. Div 855 was effectively used as a proxy for the requirements of Article 13 – *notwithstanding that the gains were on revenue account.*
- Conclusion: Div 855 applied. Taxpayer lost. (More detail on this is in the paper). Significant findings about “mining”, and whether a general-purpose lease under the Mining Act (WA) is a “lease of land”.
- The issue of whether different results might have been reached under Article 13 and under Division 855 was consequently not considered.

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Could a different result have been reached under Article 13 compared to Div 855?

Article 6(2)

- Real property definition refers to:
  - "a leasehold interest in land…"
  - "rights to exploit or to explore for natural resources shall be regarded as real property situated where the natural resources are situated or sought"

Div 855

- Division 855 disregards a capital gain by a foreign resident from sale of shares in a company where:
  - Sum of Market value of **TARP** assets

    exceeds
  - Sum of Market value of non-TARP assets

  - TARP = **T**axable **A**ustralian **R**eal **P**roperty:
  - Land (including leasehold interests)
  - Mining quarrying or prospective right (**MQPR**)

  - Non-TARP = Everything else

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Could a different result have been reached under Article 13 compared to Div 855?

Article 6(2) real property

- First concept is “leasehold interest in land”

MQPR definition

Para (a): “authority, licence, permit or right … to mine…”

Para (b): “a lease of land that allows the lessee to mine…”.

Observations

- “lease of land” same as “leasehold interest in land” so no different outcome if Article 13 had been applied.
- Held to apply to general-purpose leases (contrary to the position taken by both parties).
- Query whether “exclusive occupation” for purpose of specific activities authorized under a general-purpose lease equates to “exclusive possession” as that term is used in the context of “traditional” leases.
- High Court cases such as *Ward, Wik, TEC Desert* and VSCA decision in *Living and Leisure Australia* are relevant here.

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Could a different result have been reached under Article 13 compared to Div 855?

Article 6(2) real property

- Second concept is “rights to exploit or to explore for natural resources shall be regarded as real property situated where the natural resources are situated or sought”.
- “natural resources” are broader than things that can be mined and cover e.g. water, timber, fish, salt.
- Is a right “to exploit … natural resources” narrower than what is done “to mine” if mining has an extended operation as the Full Court considered to be the case?
- Would a right “to exploit” apply e.g. to rights to undertake sawmilling, or processing fish? If not, why should it apply to general purpose leases authorising mineral processing? Such a general-purpose lease (not authorising extraction) may not be a right “to exploit” under Article 6(2) definition? This was not considered given the agreement that Div 855 was to be used as a proxy for Article 13.
- What of the words “situated where the natural resources are situated”?

MQPR definition

- “an authority, licence, permit or right under and Australian law to mine, quarry or prospect for minerals, petroleum or quarry materials”.
- Full Court held that in this case a general purpose lease where processing occurred fell within that description: at para [139], [173].
- “Processing here formed part of the mining operations” (at [173]).

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RCF IV – High Court Special Leave Application

- Taxpayer has applied for special leave.
- Next special leave day after filing of submissions is 13 September 2019, if the High Court determines to hear argument rather than deal with it based solely on the written arguments.
- Unclear what international issues will be deal with if leave is granted – this will depend on the scope of any grant of special leave.

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Thank you

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