Tax News and Horizon Scanning Podcast Series on Tax Disputes

Episode 3: Tax Disputes in Australia

Tanja Velling	Hello and welcome to this special series on Tax Disputes. I'm Tanja Velling, co-host of Slaughter and May's regular Tax News Podcast. And across the world tax risk is on the rise. What should you be concerned about and how can you prepare? Those are the questions we've set out to answer in this series across G20 countries on six continents. I'm delighted that, for this episode, we will be stopping off in Australia. I'm joined by my colleague, Tax Disputes Partner Richard Jeens, and Angela Wood from Australia. Angela, you are a Partner at Australian law firm Clayton Utz. Give us an outline of your current practice and career.
Angela Wood	Hi there. Thank you very much for the introduction. I specialise in tax disputes and have been doing so for more years than I'd care to admit to. So, my current practice at Clayton Utz involves me acting on behalf of a range of multinationals in relation to the quite intense scrutiny that the ATO does bring to bear in relation to those sorts of businesses operating in Australia and so, that can involve acting for them in the context of reviews and audits but also in litigation, as required.
Tanja Velling	Thank you, Angela. I think we will get onto the ATO's scrutiny of multinationals in a moment. But Richard, I introduced you as a Tax Disputes Partner but your practice is actually quite a bit broader than that, isn't it?
Richard Jeens	Thank you, yes. My career here at the firm, and I've been here a couple of decades now, sort of tracks the trajectory of contentious tax issues across the UK. So, pre-financial crisis, I advised on transactions, tax structuring, all the clever stuff that people used to get up to. Increasingly, that turned into disputes and actually, as time has gone on, I have broadened my tax disputes practice. So I now act on a range of public law commercial disputes as well as large scale tax disputes which obviously is a real advantage because you get to see how you can win a case based on the evidence in a commercial court setting, how you can apply that to a tax dispute and also what might be possible in terms of resolving disputes with tax authorities who will be subject to public law requirements.
Tanja Velling	That is quite an evolution of your practice.
Richard Jeens	It's been fun. I think, though, it'd be interesting, Angela, really interesting to hear your thoughts on how things have evolved in Australia. We've seen the appointment of a new Commissioner of Taxation to lead the ATO. How much do individuals shape the policy and the guidance for an authority that is as important as the ATO?

Angela Wood	The Commissioner of Tax in Australia has the broad responsibility for administering tax laws and obviously a role that requires both tax policy and tax administration expertise, as well as capability for leading a gigantic organisation. The ATO is a very well-funded large organisation. The new commissioner is Rob Heferen. He only took up the role at the end of February, taking the reins from Chris Jordan who had been in the role for a decade before now. Chris Jordan was a former KPMG Tax partner and was the first person who was not born and bred within the ATO to be appointed as Commissioner and that was seen as quite revolutionary at the time. What we have found now is that the appointment of Rob Heferen is almost a return to a tax administrator that is public service born and bred, has deep expertise for treasury in tax matters, has represented treasury internationally in relation to tax policy matters and also has incredible experience running large non-tax departments in the Commonwealth Government. So, he has all of the skills and background to bring to bear in relation to this role. But it is going to be a bit of a shift I think in this changing of the guard because we are going from that more probably more private sector influenced or informed leadership, back to probably the more traditional model that we used to have prior to Chris Jordan's appointment. And no secret that there has been some drama in Australia in relation to consultations regarding some legislation that was going to be introduced many years ago now, the Multinational Anti-Avoidance Law and there has been some well publicised events regarding disclosure of, you know, confidential consultation information in that context that has caused PwC in particular some issues in Australia. And so, you can imagine that having Rob Heferen come into the role at this point in time means that he is going to be a acutely aware that there's some mending to be done in terms of perceptions around the ATO's involvement in events relating to those matters and whether or not there is an appropriate level of distance between the ATO as a regulator and its interactions with advisors and intermediary firms that represent taxpayers in this context.
Richard Jeens	Yeah, it's interesting, isn't it. A while ago there was a similar debate, perhaps not high-profile, in the UK about the role played by external private consultants going in and out of Treasury.
Tanja Velling	And I think there's clearly a balance to be struck here between the government being able to benefit from private sector expertise whilst it maintains a sufficient degree of independence.
Richard Jeens	Moving on, before we talk about any specific cases, it would be useful to understand a bit more of your perception of the ATO's approach to multinationals.

Angela Wood	The ATO is very active in this space. It's regarded as a pretty, well-funded and very savvy revenue authority. And so, over the last sort of 8 to 10 years there's been a real push to ensure that the ATO is well armed in its ability to scrutinise multinationals and assess risk and work out whether they are paying the right amount of tax. And so in 2016, the government provided a whole lot of funding to the ATO in order to form what's known as the Tax Avoidance Taskforce which, sounds pretty fierce. Its role is to examine large public and private businesses and associated individuals to make sure they are paying the right amount of tax. It's probably received a couple of billion dollars in funding since 2016 and it's consistently delivered great returns to the government for that investment.
Tanja Velling	Yes, I've seen a press release by the ATO from early March I think which said that, since 2016, the Tax Avoidance Taskforce has helped secure more than AUS$29.5 billion in additional tax revenue. That's certainly quite a lot.
Richard Jeens	Has that driven changes in behaviour in terms of how large businesses have looked at compliance, have documented their transactions, managed, in fact how they've done business?
Angela Wood	It's definitely involved a huge shift in the way that multinationals interact with the ATO because part of the Tax Avoidance Taskforce has involved it rolling out a significant assurance programme which we call the "Justified Trust Reviews" over here.
Tanja Velling	Is that similar to the UK? Over here, HMRC will determine a risk profile for a given business with periodic reviews every, sort of, one to three years. And the level of investigative work they typically undertake will then follow that risk profile.
Angela Wood	This assurance focus is slightly different and it's almost a pre-risk review. There's a really heavy focus on tax risk governance. The ATO looks at whether the tax risks that they've been flagging to the market from time to time in the various guidance that they, the publications that they put out, whether the taxpayers are falling within the red zone for example in relation to those and trying to enhance their understanding of new and significant transactions and why, you know, accounting and tax results vary. Enormous information requests go to taxpayers in these reviews and they can go on for quite some time. So, it's a huge burden for these businesses to go through. But I think the point that they're just an assurance programme only is important. So it's just about whether you've been able to assure them that you've largely done the right thing on a particular front and, if you haven't, you're then needing to buckle up for the next ride. These reviews, I sort of think about them as being, you know, the broadest part of a funnel where the ATO is really just trying to get its head around all of the available information, work out what the risk flags might be before they then funnel those risks further down and give them the more

	traditional risk assessment scrutiny that we've always seen in the past in reviews and audits.
Tanja Velling	You do kind of start to wonder what would then, be the benefit to business in participating in these reviews to achieve a high-assurance or low-risk ranking… What do you think, Richard, from a UK perspective?
Richard Jeens	We've seen the big multinationals who want to maintain a low risk rating and actually that's proving quite a good return on investment for some businesses particularly when you then get to transactions or, if you're selling part of a business and you can give some reassurance as part of the diligence that actually you have got a low-risk rating there, that perhaps can reduce the diligence or warranty debates that you end up having in that space.
Tanja Velling	And, I suppose, as I said, in the UK, the level of investigative work undertaken by HMRC would typically follow the risk profile. So, if you have a low-risk rating, that should mean that HMRC is less likely to challenge the return. What's the view in Australia?
Angela Wood	It's been part of the messaging from the ATO when they introduced these reviews is that, you know, essentially, if you have a high assurance rating, you, as an organisation, can share that publicly, you can share that with your board. That might be helpful in terms of how customers regard your business, how shareholders think about investing in your business. How the ATO treats you going forward in relation to ongoing interactions, and so that's definitely been a large consideration for a lot of businesses moving through these programmes. Potentially having a lighter touch from the ATO, if you get high-assurance or being able to perhaps have a slightly easier path when you're approaching the ATO about a particular risk or issue. There's quite a bit of a debate about whether that reality rings true. And so, are those benefits tangible and do they outweigh the enormous burden that the taxpayers bear in achieving the high-assurance rating?
Tanja Velling	That will be quite a difficult judgment then. But moving on to thinking further about what happens if you're having a dispute with the ATO, how is it likely to progress? What fraction of cases go to court?
Angela Wood	Well, a very small proportion of cases end up in court and that's good news for taxpayers, I think, given the level of cost and uncertainty that comes with those processes. We find that, well, the ATO is always available to have a discussion around an earlier resolution than at litigation phase. And, you know, in our experience, in the multinational space in particular, the sooner you are prepared to have those discussions and have done enough of your own homework to be able to convince the ATO that they have a much higher level of risk than they might otherwise have thought that they did, you are going to get a better negotiated outcome, if you can do that.

	And so that does involve, you know, some upfront investment in doing your own, you know, a level of your own evidence gathering. It doesn't have to be in a litigation-ready sense. But being ready and confident in the way that you would run your case if you went to litigation really does tend to sharpen the focus on the ATO's ability to strike a resolution.
Richard Jeens	I'd agree – that early preparation with the evidence, whether it's the facts, the documents, the experts, makes a huge difference to successful resolution up-front and it saves a huge amount of time and money. In our experience, it's very, very difficult these days to go and knock out the tax authority, particularly on a cross-border dispute, with just a technical argument. And indeed, frankly, large, sophisticated organisations, if you step outside of the tax department, and the legal team, and the investor relations team find that quite difficult to handle too because there is no real clarity on the risk the organisation faces as a whole and can lead to some of the nastiest surprises if, in fact, the facts turn up shortly before a balance sheet date and you've got an awkward and highly time-pressured debate about provisioning which is something that no one wants to be involved in.
Angela Wood	Completely agree with that.
Tanja Velling	Let's sort shift the conversation slightly to explore what the negotiated outcome that you referred to, Angela, might look like. In the UK, we we've got a published Litigation and Settlement Strategy which essentially says that HMRC will only settle cases on a basis that is a possible technical outcome if this was litigated. So, say, if you have a binary issue with a clear answer one way or the other, you can't in some way split the difference to reflect things like litigation risk. What's the ATO's position?
Angela Wood	They have a code of settlement practice which sort of gives them a little bit more latitude than that because they can take into account whether or not, you know, the cost of running the litigation is worth it for the public, for the Australian public, and is the benefit of continuing a dispute going to outweigh that cost? They think about whether they can achieve future compliance by reaching a settlement that involves future years, they think about overall fairness, they think about litigation risk. They think about all these other factors, including public interest factors, to work out whether an outcome is going to be appropriate as a settlement.
Richard Jeens	That range of additional factors certainly gives more room for manoeuvre. The sort of lack of public interest or sort of time and cost of litigation considerations, I've always found one of the biggest challenges of the Litigation and Settlement Strategy because the working assumption there is the Revenue can have an interesting argument, but it's the taxpayer that picks up the tab for the Revenue running that argument which is perhaps less of an issue if you've got that range of factors from your perspective.

Angela Wood	It is helpful. The other thing we also have is a test case litigation programme. Not sure if you have it in the UK as well. But if there are issues that are real test case issues, the ATO has a panel that considers whether or not those cases should be run as test cases and, if that is the case, they will provide funding for taxpayers to run those cases.
Richard Jeens	Yeah, that sort of test capability is really at the discretion of the courts in the UK. But they are not funded by anyone other than the taxpayers or a group of taxpayers operating collaboratively together, which again is a critical part of being joined up and understanding what the range of disputes are across the taxpayer market.
Tanja Velling	Do multinational issues ever get into the test case programme or is this more in the individual space?
Angela Wood	It can vary. Look, it's less likely that corporate taxpayers would seek to get themselves into that programme even though they might have issues that are going before the court that might be regarded as test case issues. So, you do find that the test case issues tend to be dominated by sort of the middle market and individuals.
Tanja Velling	Yes, that makes sense to me, and we should probably talk about some of the recent cases involving large multinationals because you've had quite a few high-profile decisions in Australia in the last fest months. The one that's caught my eye is the royalties withholding tax and diverted profits tax case involving *PepsiCo*. What was that about?
Angela Wood	The case concerns the arrangements by which Pepsi is made to be sold in Australia. Underpinning those arrangements is an agreement between Pepsi in the US and its exclusive Australian third-party bottler which is Schweppes. The agreement specified that a royalty-free payment was to be made by Schweppes for the concentrate required by it to produce Pepsi in Australia. The agreement also granted a licence to Schweppes to use Pepsi IP, including the recipe and the trademarked labels. The concentrate wasn't supplied by the Pepsi US entity, but another member of the Pepsi Group that was not party to the agreement, but I'll leave those arrangements to one side for simplicity. Schweppes paid for the concentrate. It then bottled and sold the finished drinks to wholesalers in Australia. And the primary issue in the Federal Court litigation related to whether the payments made by Schweppes under that agreement were just for the concentrate or instead, as argued by the ATO, partly royalties for the use of Pepsi's IP. The alternative argument put by the ATO was that the arrangement attracted the operation of Australia's diverted profits tax. Justice Moshinsky of the Federal Court agreed with the ATO on both issues. So for withholding tax purposes, the payments were in part a royalty for the Pepsi IP.

Tanja Velling	Was the conclusion that there was a royalty inherent in the payments based on contractual interpretation, implied terms, or looking sort of realistically at the facts?
Angela Wood	Pepsi US argued that the IP use was provided royalty free and that was consistent with the terms of the agreements and that the payments solely related to the concentrate purchased by Schweppes – so the secret syrup that goes into these drinks – and it pointed to the fact that these arrangements were sort of decades old, they've been doing it this way for a very, very long time and they were on a royalty free basis and had done so globally. But when the Court thought about the importance of the Pepsi brand, the importance of the recipe that underpins the creation of the syrup that is required to be put into these drinks to make the product that is valuable and to be sold, that was the basis upon which they decided that, in substance, part of that payment must have been attributable to the use of IP in Australia and could not have just been in relation to the purchase of the syrup itself. The decision sort of makes that clear on the withholding tax front, that any rights granted, whether expressly or implied, in relation to IP under a contract may render payments made pursuant to that contract a royalty, and it really does give support to the ATO's expansive approach on the characterisation of royalties.
Richard Jeens	That's quite a re-characterisation there! That's real scope to give you a mismatch at the other end.
Angela Wood	Exactly, exactly.
Tanja Velling	And what about the diverted profits tax point?
Angela Wood	The ATO had argued that the entry into the contract with a single payment which was stated to only be for the concentrate or the syrup was, in substance, in part a payment to obtain the valuable IP rights under the agreement. In its view, the single price was set out in the contract in that way for tax and not for commercial reasons with the principal purpose being to avoid paying royalty withholding tax. And Pepsi, of course, argued there was no such principal purpose. The approach was simple and consistent with those arrangements that it had had with many other third-party bottlers around the world for many decades. And so even though the judge didn't need to side with this element of the case, he did make a few comments about it – which is the first time our diverted profits tax has ever been before the courts – and he found that, if it was the case that he had not been able to establish that royalty withholding tax was payable, he would have applied the diverted profits tax. He would have upheld those assessments in relation to diverted profits tax on the basis that this was a scheme entered into for the principal purposes of avoiding the Australian royalty withholding tax and also

	for lowering the US income tax. And so, it was really a comprehensive loss for Pepsi. Having said that it was first instance proceeding, it is going on an appeal.
Richard Jeens	In the UK, our diverted profit tax can be quite punitive: you pay the tax at a higher rate, you pay the tax sooner. And, certainly for many of our clients where there have been DPT disputes, that obligation to effectively pay to play has been a serious stick that has been used to beat them to come to a transfer pricing settlement. But if you do get to a transfer pricing settlement, you can and should be able to make it go away and you agree what the proper characterisation is. How does that play out in this instance or more generally?
Angela Wood	Yeah, it's very similar really. A part of the thing for Pepsi, yes, they lost on the primary case around royalty withholding tax. But that was the least worst option for them in terms of a dollar sense because that punitive nature regarding the diverted profit tax would have been bought to bear, had they ended up in that world. And like in the UK, it is incredibly ferocious in its bite, our diverted profit tax. I think, your penalty rate under your DPTs is around 30%.
Tanja Velling	Yes, in the UK, the DPT rate is 31%, so six percentage points higher than the main rate of corporation tax which stands at 25%.
Angela Wood	So, so our diverted tax profits is a 40% penalty and so we do tend to take these things to the next level. So, the difference between the outcome that Pepsi got the first instance and the outcome that it could have got had DPT been applied is enormous and still at play, that interaction is still at play, in this appeal because both issues are going to be part of the appeal. Pepsi is only appealing in relation to the adverse outcome in relation to royalty withholding tax but the ATO, the Commissioner of Tax, has made sure by also lobbing an Appeal in to make sure that the DPT issue is on foot in the appeal in the event that the Full Court, the three judges, decide to favour Pepsi on royalty withholding tax. So, it remains a live issue. It is going to be heard relatively promptly, more promptly than we expected, and hopefully, that means we'll get a Full Court decision before the end of calendar year 2024.
Tanja Velling	That would be speedy, indeed. Should we talk a bit about transfer pricing litigation especially because we haven't actually seen that much of it in the UK, have we, Richard?
Richard Jeens	Yes, there haven't been really transfer pricing cases going to court. But that's largely because we've had them resolved through the enquiries phase or settlements phase and that's where, certainly in our experience, you almost run a court-like process in terms of witnesses of fact and documentary requests in order to be able to persuade HMRC (or indeed corresponding authorities during the MAP process) to resolve these sorts of things.

	You've had some transfer pricing cases in Australia. Is it fair that they remain some of the most challenging disputes to run just because they're so fact-heavy or have you found ways to cut through with particular technical arguments?
Angela Wood	So, sadly no. We have not found ways to cut through yet in Australia with technical arguments. These cases, there have been a few transfer pricing cases in Australia, still not that many. Certainly, in the last ten years there might have been 6 or so. They are notoriously difficult to litigate for a few reasons. Your first challenge around these cases is the evidence from your business. People leave businesses, documents go missing, people forget where they filed them, they've been poorly filed. It can be really challenging and, as a litigator, I'm sure you're very familiar with all of these things, Richard, but the other part of these cases which is really difficult, too, is often the need for expert evidence. Determining what questions you ask the experts to opine on and then bringing experts together, having the duelling experts in court, is a process that's definitely not for the feint-hearted. And so on both sort of evidentiary fronts, lay and expert evidence, they are really complex cases to manage. And then you've got the overlay of law that has been tested in a few cases but the judicial guidance is still very much under development and we don't yet have a clear sense as to how it is that courts expect us to prepare these cases to their satisfaction. The goalposts seem to shift every time we have another one of these cases. So, they are incredibly challenging and intensive.
Richard Jeens	I'd agree; I absolutely see that. Just on the experts bit specifically: hot-tubbing – is that sort of a common practice? Certainly, I've seen it in commercial disputes but not so much in tax disputes so far.
Angela Wood	Oh absolutely. We like a hot-tub in Australian tax disputes. The parties will each file their expert evidence, so there'll be the duelling expert reports that are filed and then there will be an order that's made by the court that those experts are now to be put in a room together to prepare a joint report. And so, they then need to work together to work out and identify exactly which areas of the issues in dispute they might actually agree from an expert perspective on and which are the areas of disagreement. And so, you'll get that before you get to court. And then what happens in court is that sometimes experts will sit in the witness box together. So, the expert for the ATO and the expert for the taxpayer will sit in there together and will answer questions from both parties' counsel and also from the judge. One of the things that I should mention in relation to experts in these sorts of cases in Australia is that it seems to be the case that often the judge almost disregards the expert evidence that everybody has gone to so much trouble to put

	together and, you know, put before the court and prefers to form their own view as to what the transaction or the appropriate pricing might appropriately look like. And so, expert evidence and hot-tubbing, it's definitely a process, and it can be incredibly useful, but it shouldn't always be assumed that experts will be always relied on and accepted by the courts in deciding these sorts of cases.
Richard Jeens	No, I'd agree. In all disputes, there's a real value in having evidence whether it's expert or lay or otherwise that tells a story. Obviously, that's got to be true and supported by the evidence. But actually, you're ultimately persuading human beings the judges or your counterparty at the revenue authority that there is a story to be told and it's a credible one and it stacks up. It's why I think there are so many challenges that one faces where the tax authority is running competing narratives.
Tanja Velling	And speaking of stories that stack up. Shall we talk a bit about *Minerva* and *Mylan*? Those are the two cases on the Australian general anti-avoidance rule (or GAAR) which were decided in favour of the taxpayer in quick succession in early 2024. What do you think was a key factor in the taxpayers' success in these cases?
Angela Wood	Any case involving a purpose element where you've got – in Australia, under our GAAR, there's eight factors that you need to think about in objectively ascertaining what the dominant purpose was of the transaction – any circumstances where you've got that going on, it's very factually intensive. It's a real balancing act in terms of working out, you know, what is going to be regarded by the court as dominant. And in those two cases, *Minerva* and *Mylan*, they have been successful in preparing their evidence in a way that has been found by the court to be credible, you know, cogent and credible, and accepted in knocking off the ATO's GAAR assessments. And so, I think, they both are a really good illustration of how critical evidence is, as we all know, in on relation to tax cases. You can have the cutest and most clever of technical arguments to make in relation to these cases, but you will rise or fall by your evidence and that has certainly been the case for *Mylan* and *Minerva.* They got that right and it was accepted. They might be subject to appeal going forward but, as first instance judgements go for GAAR matters, they are both great outcomes for multinationals in Australia.
Tanja Velling	That's a great outcome indeed, and I'm sorry that I will now have to be the bearer of some bad news – I think we're coming towards the end of our time together and we should probably start wrapping things up.
Richard Jeens	Are there particular tips or lessons that we might draw from some of these developments - changing risk profile, changing Commissioner at the ATO – if

	you're a business with operations in Australia, with contractual arrangements there, what would be your top few take aways?
Angela Wood	I think, you know, it's pretty clear that multinationals will be the subject of quite a lot of interaction with the ATO. So knowing that, having a very good handle on, what it is that your narrative is going to be regarding the how and why you conduct your operations in the way that you do, the how and why that you undertake particular transactions in the way that you do and being able to support those in a comprehensive fashion and have that material ready (at least in raw form) to be able to deploy to head the ATO off at the pass in these reviews is important. You know, hand in hand with that goes, you know, decisions around how you strategically engage with and interact with the ATO as well. And so, questions often arise for multinationals in this context around: do put your hand up and engage early when you think you have got something that you might need to be having a deeper conversation with them about down the track when they see your return being lodged or is it better to hold your cards close to your chest and wait and see what happens? Being alive to those sorts of decisions that you need to make on that front is also very important along with making sure that you are able to explain your business, explain your reasoning and demonstrate in an evidence-based fashion why it is that you've done things the way that you have.
Richard Jeens	No, that's really helpful and totally aligns with what we've been discussing here in the UK. I think the only point that also come to mind is the importance, particularly for multinationals, is knowing the left hand is joined up with the right hand in the lesson of *PepsiCo* with a very broad view of royalties that might not be the same in other jurisdictions, if that's what it looks like in Australia, what does that mean for what it looks like in the US or Singapore or the UK? Critical – and obviously one of the reasons why we are having these conversations with the leading practitioners across the world.
Angela Wood	Absolutely, and the other part of that global perspective is having that awareness of propensity or the otherwise of particular revenue authorities to share information spontaneously with their friends overseas is very important. And the ATO, and I think HMRC, certainly have a fairly robust process or level of engagement around sharing of information. So, you know, that right-hand, left-hand point equally applies to exchange of information as well.
Richard Jeens	Definitely. Thank you.
Tanja Velling	Yes, thank you very much, Angela and Richard, for this fascinating conversation.
Angela Wood	Thank you for having me.
Tanja Velling	And that leaves me to thank you for listening. This was the third of six episodes in our special series on tax disputes. Next week, Tax Partner Sarah Osprey and Tax

	PSL Counsel Zoe Andrews will speak to Mukesh Butani, founder and Managing Partner of BMR Legal Advocates in India. If you subscribe to Slaughter and May's Tax News podcast or our Horizon Scanning show, you'll be notified when the new episode is released. For more insights from Slaughter and May's tax department, please go to the European Tax Blog, www.europeantax.blog, or follow us on Twitter, @SlaughterMayTax. Or just drop us an email.