Commissioner of Taxation v BHP Billiton Limited: an influential consideration of sufficient influence

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In brief

On 29 January 2019, the Full Federal Court handed down its decision in *Commissioner of Taxation v BHP Billiton Limited*[1]. The case concerned the application of the Controlled Foreign Company (CFC) provisions to a marketing entity (BMAG) which was jointly held by the dual listed companies, BHP Billiton Limited and BHP Billiton Plc. The decision was an appeal from the anonymised Administrative Appeals Tribunal judgement *MWYS v Commissioner of Taxation (Taxation)*[2].

Essentially, the technical question considered by the case concerned the meaning of "associate" and whether there was sufficient influence as between the parties to make Plc's Australian entities "associates" of BMAG.

The majority found that Plc's Australian subsidiaries were "associates" of BMAG because there was the requisite level of "sufficient influence" in each of the relevant relationships. A dissenting judgement found that there was a lack of "sufficient influence".

Technically, the case is only a precedent relevant to the application of CFC rules to a very specific factual scenario involving dual listed companies. However, the definition of "associate" is widely used within the tax law and therefore the decision is relevant in a wide range of legislative contexts, not just the CFC rules, but including, for example, thin capitalisation, debt equity rules, and the non-portfolio interest test generally which is relevant to the non-resident capital gains tax (CGT) rules, participation exemptions and withholding tax provisions.

The decision could also be relevant to a wide range of business relationships beyond dual listed companies, including, for example, stapled structures and joint ventures. It may also impact the interpretation of concepts related to "sufficient influence" including, for example, the Australian Taxation Office's (ATO's) controversial views on negative control (including veto rights).

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[1] [2019] FCAFC 4.
[2] [2017] AATA 3037

In detail

BHP Billiton Ltd and BHP Billiton Plc are part of a dual-listed company arrangement (DLC Arrangement). BHP Billiton Marketing Ag (BMAG) is a Swiss entity which, during the relevant years, was 58% indirectly owned by Ltd and 42% indirectly owned by Plc[3].

BMAG is the main company conducting BHP's Singapore marketing business[4] under which it purchases commodities from Ltd's Australian subsidiaries and also from Plc's Australian entities. BMAG then on-sold those commodities and derived income from the sale of those commodities at a profit.

Ltd had prepared its tax returns on the basis that income derived by BMAG from the sale of commodities which had been purchased from Ltd's Australian subsidiaries was "tainted sales income". This tainted sales income was included in the calculation of the attributable income of BMAG for CFC purposes, which was included in the assessable income of Ltd.

However, Ltd had not included income derived by BMAG from the sale of commodities it purchased from Plc's Australian entities as "tainted sales income", on the basis that those entities were not "associates" of BMAG.

The case turned on whether Plc's Australian entities were "associates" of BMAG. If they were associates of BMAG, then the "tainted sales income" of BMAG, and therefore the CFC attributable income of Ltd, would be increased to take into account purchases BMAG made from both Ltd and Plc.

The Commissioner argued that Plc's Australian entities were "associates" of BMAG for three reasons:

1. Ltd was "sufficiently influenced" by Plc;

2. Plc was "sufficiently influenced" by Ltd; and

3. BMAG was "sufficiently influenced" by Plc and Ltd.

If any of those propositions were satisfied, then Plc's Australian entities would be taken to be associates of BMAG.

The case primarily turned on a detailed factual analysis of the "DLC Structure Sharing Agreement" under which Ltd and Plc followed certain "DLC Structure Principles" and "DLC Equalisation Principles", including that:

1. Ltd and Plc must operate as if they were a "single unified economic entity" through common boards of directors and a "unified senior executive management";

2. The directors of each entity, in addition to their duties to the company concerned, shall have regard to the interests of the holders of the ordinary shares in each entity as if Ltd and Plc were a "single unified economic entity" and "for that purpose the directors of each company shall take into account the exercise of their powers the interests of the shareholders of the other"; and

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[3] Based on BHP Billiton's press release dated 19 November 2018, BHP Group Limited will increase its ownership of BMAG from 58% to 100% from July 2019.

[4] BHP Billiton, *BHP settles longstanding transfer pricing dispute,* 19 November 2018.

3. The "DLC Equalisation Principles" must be observed where those principles were designed to ensure that the economic and voting rights of the respective shareholders in Ltd and Plc would be proportion to the "Equalisation Ratio" from time to time. The "Equalisation Ratio" is the ratio of the dividend, capital and (in relation to Joint Electorate Actions) voting rights of Ltd ordinary shares to Plc ordinary shares in the Combined Group.

The Commissioner's case then focussed on particular aspects of the DLC Arrangement in respect of voting on "Joint Electorate Actions" and "Class Rights Actions" and also around the requirement that matching dividends be paid.

On the basis of the peculiarities of these arrangements, the Commissioner held that it was reasonable to expect that BMAG, or its directors, would act in accordance with the directions, instructions or wishes of Ltd and Plc, which together were its 100 per cent indirect owners. The Commissioner noted that there were many group-wide (i.e. binding both sides of the DLC) standards which were promulgated by the group or by Ltd and PLC jointly and which BMAG was bound to follow.

At first instance

Logan J, acting as Deputy President of the AAT, found at first instance in *MWYS and Commissioner of Taxation*[5] that no requisite associate relationship existed because the definition of "sufficient influence" should be construed similarly to section 9 of the *Corporations Act 2001 (Cth)* and by reference to "shadow director" company law cases. Logan J further found that the requisite influence would likely require abrogation by either party to the DLC Arrangement of "effective control" either by the shareholders or the board of directors. In making this finding, Logan J accepted the submission by the taxpayer that the DLC Arrangement effectively created a joint venture between each entity (and by inference found that merely a joint venture would not create the requisite relationship between Plc and Ltd).

In respect of BMAG (its identity thinly veiled as "QMAG" in the AAT matter), Logan J found that there was not the requisite level of influence exerted on BMAG by either Plc singularly or Plc and Ltd acting jointly, due to the evidence of BMAG's directors carefully deliberating and passing resolutions based on those deliberations. In reaching his conclusion in respect of BMAG, Logan J also made a finding that as a matter of construction s318(2)(d)(i)(A) and s318(2)(d)(i)(B) are mutually exclusive.

The majority opinion

The majority opinion was delivered by Thawley J, with Allsop CJ agreeing and providing further comments (which were in turn agreed with by Thawley).

Thawley J's judgement considered the Tribunal's findings carefully but ultimately rejected both elements of the legal reasoning and certain findings of fact. Importantly, Thawley J found that:

- *Section 318(6)(b) is not engaged only where decisions actually made elsewhere are "rubber-stamped"*[6]*;*
- *[Section] 318(6)(b) [does not] necessarily require a finding of abrogation of responsibility or surrendering of control…* further noting that "*[t]he fact that a board of directors considers a direction or wish of another entity, and will not implement it unless to do so is an appropriate exercise of power in the interests of the company of which they are a director,* ***does not***

[5] [2017] AATA 3037.
[6] [2019] FCAFC 4 at [96].

necessarily immunise the company or its directors from the conclusion that they were "sufficiently influenced"[7] [emphasis added]*;*

- *Whilst the meaning of "sufficiently influenced" is supplied for the purpose of determining whether an entity is a "controlling entity" or "controlled company", s318(6)(b) may be satisfied where there is something less than legal control and does not necessarily require "the imposition by one of its wishes on the other" (Tribunal at [32]), or "subservience" (Tribunal at [31])*[8]*.*

In short, Thawley's judgement suggests that the Tribunal had set too high a bar for determining whether a relationship constituted "sufficient influence". Thawley J also considered the voting arrangements under the DLC Arrangement in more detail than the Tribunal did - and it is the specific nature of elements of the DLC Arrangement's voting arrangements that might narrow the precedential value of the case.

Importantly, Thawley J said that due to the Special Voting Share (SVS) arrangement, which was a critical aspect of the DLC Arrangement, it was possible that a resolution could be passed by one of the companies even where its own shareholders voted against the resolution. This could occur because the SVS arrangement effectively made "Joint Electorate Actions" decided by the joint majority of shareholders so an overwhelming majority of one group of shareholders could overrule the majority vote of the other company's shareholders. On this basis, Thawley J found that Ltd or Plc could "sufficiently influence" "the company, or its directors" - notwithstanding a submission by the taxpayer that the phrase "the company, or its directors" should not be read as referring to the company in general meeting. In making this finding, Thawley J made another finding which could have broader application saying that:

> *"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 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."*

Thawley J's reasoning on BMAG is more pithy. Essentially, he finds that BMAG was "sufficiently influenced" by Ltd and Plc on the basis that the threshold for "sufficient influence" is lower than the subservience or abdication of responsibility threshold that had been applied by the Tribunal and evidence such as group-wide standards suggested that BMAG was likely to follow the wishes of Ltd and Plc.

Another important finding of Thawley J was that s318(2)(d)(i)(A) and s318(2)(d)(i)(B) were not mutually exclusive. That is, an entity could be sufficiently influenced by one entity (i.e. satisfy subparagraph (A)), and still satisfy subparagraph (B) that the entity is influenced by one or more entities. The taxpayer had argued that Ltd sufficiently influenced BMAG (by virtue of its 58% shareholding) and therefore BMAG could not be sufficiently influenced by Ltd and Plc jointly - Thawley J dismissed this argument.

As well as agreeing with Thawley J's reasoning, Allsop CJ added some additional comments surrounding the appropriate interpretation of "sufficient influence" in the context of the CFC rules. Essentially, he suggests that the difference between Thawley J and Davies J's reasoning is resolved by the question[9]:

> *"whether s 318(2)(d)(i), as informed by s 318(6)(b), is satisfied or engaged 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 over the other[?]"*

His finding, which is unsurprising given his agreement with Thawley J is that[10]:

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7 [2019] FCAFC 4 at [97].
8 [2019] FCAFC 4 at [106].
9 [2019] FCAFC 4 at [5].

> *"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. In my respectful view, there is no reason in the text, structure or purpose of Part X to limit the operation of ss 318(2)(d)(i) and (6)(b) to a unidirectional analysis of influence or control.*

This broad comment by the Federal Court Chief Justice on the appropriate interpretation of the "associate" definition may be the finding of broadest application to other factual scenarios (in particular because Thawley J agreed with the comment).

The dissent

Davies J's strong dissent begins with a textual analysis of the statutory meaning of "sufficiently influenced". Davies J suggests that, contrary to Thawley J's view, all three elements of the definition must be present, that is:

1. *A direction, instruction or wish communicated or expressed by an entity to the company or its directors;*

2. *For the company or its directors to act "in accordance with" that direction, instruction or wish, that direction, instruction or wish must relate to how the company is to act, and the action which the company takes must be consistent with that direction, instruction or wish; and*

3. *The company or its directors must be "accustomed" or "under an obligation" or "might reasonably be expected" to act in accordance with the directions, instructions or wishes communicated or expressed by that entity.*[11]

Davies J then turns to corporations law cases on shadow directors (i.e. *Buzzle*[12]) to interpret "accustomed to act" and anti-avoidance cases (i.e. *Peabody*[13]) to interpret "might reasonably be expected to act".

An essential difference between Thawley J's opinion and Davies J's dissent is this interpretation of subsection 318(6)(b). Thawley J held that the three matters are "*not a composite phrase denoting a single test*" but instead "*the three matters comprise different considerations, each of which is independently sufficient to attract the conclusion that a company or its directors are "sufficiently influenced"*[14] whereas Davies J cautions that it is "important to read s318(6)(b) as a whole" and therefore reads the provision giving rise to a:

> *"requirement or practice of the company (or its directors) to follow, or a reasonable expectation that the company will follow, the directions, instructions or wishes of that entity."*[15]

In this respect, Davies J supports the conclusion of Logan J in his AAT decision.

Davies J also specifically considers the "special voting arrangements" which were such a focus of Thawley J's judgement, and parses these carefully to suggest that rather than being a means by which one

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[10] [2019] FCAFC 4 at [15].
[11] [2019] FCAFC 4 at [28].
[12] [2019] FCAFC 4 at [29].
[13] [2019] FCAFC 4 at [29].
[14] [2019] FCAFC 4 at [85].
[15] [2019] FCAFC 4 at [31].

company will act "in accordance with" the direction, instruction or wishes of the other company, instead suggest that these arrangements are simply:

> *"each company giving effect to the contractual terms governing the DLC Arrangement pursuant to which the companies act jointly with a mutuality of interest."*[16]

Davies J also dissents from Thawley J and Allsop CJ in respect of their finding that BMAG was sufficiently influenced by Plc and Ltd. Potentially importantly for broader contexts, Davies J finds that the group-wide "Marketing Risk Management Standard" is not relevant to a finding of "sufficient influence" on the basis that:

1. The document is not an expression of "directions, instructions or wishes" by Ltd or Plc as to how BMAG is to act;

2. The document was considered and approved by BMAG's board before being implemented and was capable of being revoked or amended at any time by BMAG's board;

3. BMAG's board actively evaluated matters and recommendations put to it from BMAG's perspective; and

4. BMAG's board rejected recommendations made to it and requested revisions to recommendations or resolutions to be put to it.[17]

As a matter of construction, Davies J does disagree with the Tribunal regarding the construction of s318(2)(d)(i)(A) and (b) by finding that they are not mutually exclusive but instead can be read compendiously.

The takeaway

The takeaway from this case should be considered on two levels. Firstly, what does the case mean for the interpretation of "sufficiently influenced" within the statutory context of the CFC provisions? Secondly, what if anything, does it mean for the interpretation of "sufficiently influenced" as used in other statutory provisions, or indeed for related terms such as "control"?

In respect of the meaning of "sufficient influence" in the context of the CFC provisions, the key elements of the majority decision are:

- Sufficient influence is a lower threshold than control. Sufficient influence does not require dominance and subservience or an abrogation of duties by directors.

- A company can be influenced by more than one entity, or indeed can be influenced by one entity when it is controlled by another (note, practically this finding may be less likely to apply to most arm's length consortia or joint ventures - although this will depend on the specific terms of the relevant agreements). In this respect, sufficient influence can be exercised by parties acting as equals where they are acting "*in accordance with the direction, instructions and wishes of each other"* and is not limited to a unidirectional analysis of control.

- The adoption by a company of standards promulgated by another entity may be evidence that the company is likely to act in accordance with the directions, instructions or wishes of another or others.

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[16] [2019] FCAFC 4 at [41].
[17] [2019] FCAFC 4 at [45].

- The test of "sufficient influence" is applied to "the company or its directors" and therefore influence can be exercised by way of votes at a general meeting of shareholders. In this respect, evidence that one company can control the votes of a general meeting of another company is prima facie evidence of sufficient influence.

It is important to note that the above are conclusions reached by the majority and as noted above, there are two Federal Court judges who have reached contrary views. However, in the absence of a successful appeal, the above reflects the Federal Court's interpretation of the relevant term.

The question of the relevance of the decision to other provisions is more nuanced. The section 318 definition of "associate" is incorporated into the ITAA 1997, with the section 995-1 definition merely cross-referring to section 318. The defined term "associate" is then directly referenced in provisions relating, inter alia, to:

- the provision of tax depreciation information under Division 40;
- elements of the employee share scheme provisions (Subdivision 83-A) and the personal services income rules (Division 85);
- the CGT rules (including Division 112 and various roll-overs);
- the Taxation of Financial Arrangement rules (Division 230);
- the Commercial Debt Forgiveness rules (Division 245);
- Research and Development provisions (Division 355);
- the denial of debt deductions under the thin capitalisation provisions (Subdivision 820-I);
- the definition of participation interest in Subdivision 960-GP and consequently many other provisions such as the participation exemptions (Subdivision 768-A and Subdivision 768-G) and the non-resident CGT provisions (Division 855);
- certain targeted anti-avoidance rules around prepayments (Section 82KZL);
- elements of the share buy-back provisions (Division 16K); and
- the withholding tax rules relating to dividend, interest and royalty withholding (Division 11A).

This (incomplete) laundry list of potentially affected laws shows the arguably broad cross-section of the law affected by the decision.

However, the level of the case's impact on the interpretation of the definition beyond the realm of the CFC provisions is unclear. Davies J, albeit in dissent, quoted McHugh J in the High Court[18], as cautioning that the function of a definition is not to enact substantive law but rather the purpose of a definition clause is that it shortens, but is part of, the text of the substantive enactment to which it applies.

This common sense caution suggests that the findings of the Full Federal Court as to the meaning of "associate" in the context of the CFC provisions cannot simply be transposed into interpreting the myriad of other provisions as a technical legal matter. This appears to be particularly relevant given that the

[18] McHugh J in *R v Kelly* (2004) 218 CLR 216 at [103] quoted at [27] of [2019] FCAFC 4.

Commissioner argued that it was Part X's role as anti-avoidance provisions that warranted a broad reading of the statute.

Practitioners should have regard to the Full Federal Court's ratio in determining the bounds of an associate relationship, but must be conscious of the relevant statutory context in applying the definition to specific facts and circumstances. The definition of "associate" may not mean the same thing in a different statutory context.

The above caution is even more important when seeking to apply the Court's reasoning to differing but related concepts. A key issue for many taxpayers is the definition of "control" and the ATO's views on the concept of "negative control". Importantly, the Full Federal Court's mention of control in this case is largely to use the concept by way of contradistinction to "sufficient influence". In this respect, extreme caution should be exercised in attempting to infer any broader meaning of control by reference to this case.

Having given the above warnings, there is no doubt that the decisions of the majority, which sets out (in obiter) many guiding principles as to how to interpret "sufficient influence" will strongly guide how the term is understood in a wide range of situations. However, the degree to which these principles are determinative will depend on the similarity of the particular statutory context, and the relevant facts and circumstances of each matter.[19]

The finely balanced nature of the decision and given the case has now been decided 2-2 by Federal Court Justices, means that an appeal to the High Court is possible, and indeed may even be desirable for the tax community at large to give greater clarity to this uncertain issue.

[19] Noting that the ratio of the Full Federal Court's decision was based on facts such as the Special Voting Arrangements which may well be unique to this taxpayer.

Let's talk

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