# IMPLICATIONS OF THE CHEVRON CASE ON THE PHARMACEUTICAL INDUSTRY

Date: 4 May 2017

By: Paris Petranis, Rebecca Bolton

## TRANSFER PRICING HAS IN RECENT YEARS BEEN A FOCUS OF THE AUSTRALIAN TAXATION OFFICE

In recent years, the Australian Taxation Office (**ATO**) has focused much energy in the transfer pricing arena, firstly due to the issue becoming part of the OECD's ongoing investigation into international tax practices and secondly due to the political and social issues arising from the perception that "big business" fails to pay its "fair share" of tax in Australia.

Last month, the Full Federal Court handed down its much anticipated decision in *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation [2017] FCAFC 62* (**Chevron**). The case involved a related party loan (**Credit Facility Agreement**) between an Australian Chevron entity (**CAHPL**) and a related US company (**CFC**) and the deductibility of interest borrowed from a related party.

The Court dismissed CAHPL's appeal regarding the deductibility of its interest expenses on the Credit Facility Agreement of USD2.45 billion (equivalent to AUD3.7 billion). In reaching its decision, the Court focussed upon the fiscal and commercial functionality of the provisions contained within the applicable legislation.

The Court discussed, amongst other things, the pricing of the loan and interest rate applicable to cross-border financing arrangements. CFC had raised USD2.45 billion through the issue of a commercial paper in the United States at an interest rate of approximately 1.25% and on-lent those funds to CAHPL at a significantly higher rate (approximately 9%) with no security or guarantee, over a five year term. The Court held that an Australian subsidiary of a multinational group should not be treated as a standalone entity when determining if the transaction is at arm's length.

The Court ultimately held that no independent lender and borrower dealing at arm's length would enter into a borrowing arrangement that provided no security, or financial or operational covenants, in the way CAHPL's internal financing arrangements were structured. The decision resulted in a lower interest rate being deemed deductible and a tax liability of approximately, $340 million (including penalties) being payable. The decision means that the interest rate on internal debt arrangements must be at a rate closer to the parent entity's global cost of funds thereby preventing profits from being artificially shifted offshore.

This is an important win for the ATO and the Chevron decision will have broader implications for large multinational taxpayers, including the pharmaceutical sector where both products and debt are routinely supplied

©2005-2026 K&L Gates LLP. All Rights Reserved.

between related parties. The case highlights the need for related party transactions to be carried out in a manner which conforms with transfer pricing principles and which are on both arm's length and commercial terms.

What the decision means for our multinational clients is that they must prepare and maintain contemporaneous documentation which satisfy the significant legislative compliance requirements to show how pricing for cross-border, intra-group, transactions involving goods and services has been set. These requirements include but are not limited to:

- Preparation of records before the time of lodgement of the relevant income tax return
- Documentation that explains the way in which the transfer pricing rules have been applied to intra group transactions
- The particulars of the pricing method used and, where possible, comparisons with other transactions and industries which confirm the arm's length nature of the pricing
- Records that show the commerciality of the pricing applied.

The statutory documentation requirements for taxpayers to evidence the reasonableness of their position with regard to transfer pricing are stringent and can place a heavy compliance burden on multinational companies. However, given the outcome of the Chevron decision, the expectation must be that the ATO will seek to enforce the application of the transfer pricing rules with renewed vigour.

From a governance perspective, companies operating on a cross-border basis with Australia should review their pricing of intra-group transactions to ensure that the methodology for the pricing and documentation which supports it is completely compliant.

For assistance in this regard please contact the K&L Gates Tax Group.

## KEY CONTACTS



**PARIS PETRANIS**
PARTNER

MELBOURNE
+61.3.9205.2014
PARIS.PETRANIS@KLGATES.COM



**REBECCA BOLTON**
SPECIAL COUNSEL

MELBOURNE
+61.3.9640.4285
REBECCA.BOLTON@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved. 