A CASENOTE ON THE FEDERAL COMMISSIONER OF TAXATION V. COMMONWEALTH ALUMINIUM CORPORATION

BY

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PART I: INTRODUCTION

A case about the price at which bauxite was sold by a mining company resident in Australia to Japanese alumina smelters came before the High Court of Australia in 1980.

The case involved allegations of transfer pricing, that is the shifting of profits out of Australia to avoid income tax, and is of interest in Papua New Guinea because one of the partners in the mining venture was Conzinc Rio Tinto of Australia (C.R.A.). C.R.A. is the major shareholder in Bougainville Copper Limited, which operates Papua New Guinea's largest copper mine.[1]

The case is also of interest in Papua New Guinea because it was about transnational enterprise and the apportionment of profit between the state and ownership; it was about the submergence of foreign capital into a national economy, and its transformation under a cloak of corporate management nominally into a "domestic" industry; it was about transfer pricing; about a mode of commercial activity that transcends national boundaries obscuring the true identity of the interests who own, control, and operate the enterprise; it was about the part played by the courts, lawyers, and the legal system as

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1 This article does not suggest that BCL is involved in pricing arrangements in Papua New Guinea. Economic opinion is of the view that the copper market is regulated by market forces, and that it is not feasible for a custom concentrate producer, like BCL, dealing with independent refineries to manipulate copper prices. See Law Reform Commission of PNG Transfer Pricing Manipulations in PNG, Occasional Paper No. 12, Port Moresby, August 1980, 21.

facilitators and protectors of these arrangements; it was about the inactivity and inertia of parliamentarians and taxation officials who allow obsolete tax avoidance provisions to remain on the statute books and who fail to take prompt action to avoid loss to the revenue.

The case considered by the High Court of Australia was the *Federal Commissioner of Taxation* v. *Commonwealth Aluminium Corporation Limited.*[2]

PART II: THE FACTS

The Bauxite Market

The Commonwealth Aluminium Corporation was a joint venture company ultimately owned by two transnational corporations, and the case involved sales of bauxite in a market where prices are determined by a cartel.

Lanning and Mueller have described the manner in which the aluminium cartel controls prices thus -:

> "World aluminium production is controlled by six major companies. Tight control of world bauxite mining, alumina smelting, and aluminium production has enabled the companies to keep aluminium prices both low and stable. To reduce unit costs, production facilities are installed on a high-volume basis, and production capacity has frequently run ahead of demand, so intensifying the companies' search for new sales outlets and discouraging any price increases. Indeed: the high capital cost and the excess capacity have resulted in the acceptance of sales at low prices simply for purpose of covering the high fixed costs. The companies have consciously decided to encourage future demand at the expense of present profits, and the low prices reflect the determination, and discipline of the producers to offer aluminium on terms which would virtually compel users to switch from other metals to aluminium. Aluminium contracts are made on the

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2 1980 ATC 4373.

> basis of prices ruling at the time of delivery. The fabricators accept this arrangement because prices have been stable over the years. The aluminium producers thus prevent the possibility of buying forward or hedging, so that no group of speculators and agents can play havoc with the market price, as happens in the case of copper."[3]

Mr. Justice Murphy in his judgement on the case described this market in the following terms -:

> "The history of the aluminium industry is short and well documented. It is possible to account for practically every ton of aluminium that has ever been produced, and it is possible to say exactly who produced it. The main features of the market structure appear to be a high degree of concentration in a few large commercial enterprises, an associated high degree of vertical integration in the industry, the transnational character of the main enterprises concerned, and the high degree of foreign ownership and control of productive activities in the raw materials producing companies.
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> The industry is dominated by a group known as 'The Big Six', the Aluminium Company of America (ALCOA), Reynolds Metal Company, Kaiser, Alcan Aluminium Ltd., Pachiney Ugine Kuhlmann and Swiss Aluminium Ltd. At least one of these firms is involved in virtually every major bauxite, alumina and aluminium project undertaken in the world. Rio Tinto is one of the smaller transnationals who have joined the Big Six in the last 25 years. In Australia, bauxite is mined by three companies -Comalco, Nabalco and Alcoa of Australia. Comalco is the largest producer.
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> The market structure of the industry has resulted, among other things, in a virtual monopoly of advanced technology in the sector by the major companies, and their vertical integration makes it difficult to establish bauxite and alumînium enterprises that are independent of these companies as they control such a large proportion

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3 G. Lanning, M. Mueller Africa Undermined , Penguin Books, Harmondsworth United Kingdom 1979, 379.

of the market for these commodities."[4]

Corporate Structure

The Commonwealth Aluminium Corporation Limited was owned wholly by another company, Comalco Limited. Both companies were registered in Australia and were residents of Australia for taxation purposes. Forty-five percent (45%)of the shareholding in Comalco was owned by the Kaiser Aluminium and Chemical Corporation, a company incorporated in the United States and ultimately owned by Mellon family interests. The other forty-five percent (45%) of the shareholding in Comalco was owned by Conzinc Rio of Australia Ltd. (CRA), a company both incorporated and resident in Australia. About eighty percent (80%) of the shares in CRA was owned through a series of holding companies in Australia and the United Kingdom, by the Riotinto Zinc Corporation Ltd. of London, which is ultimately owned by British and European banking and commercial interests including Rothschild trusts.

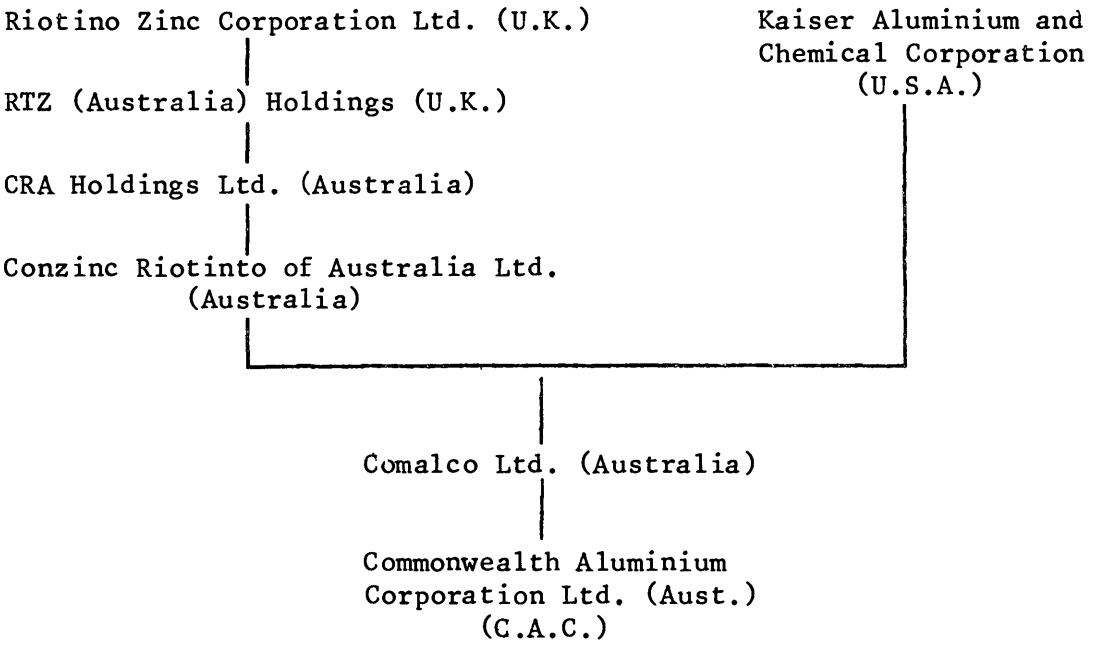

Diagram: *The Ownership of Commonwealth Aluminium Corporation*

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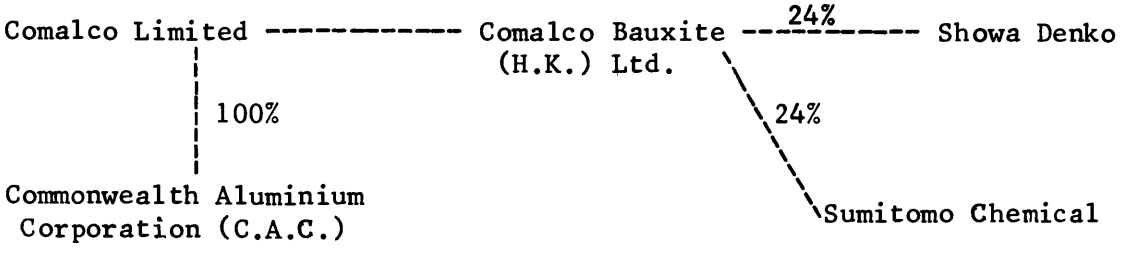
4 1980 A.T.C. 4371, 4382.

Development of Cape York Deposits

In 1955 the world's largest deposits of bauxite were confirmed in Weipa on the Cape York Peninsula, Queensland, Northern Australia. Originally, it was considered that these deposits could be developed using hydro-electric power from the Purari River System in Papua New Guinea. But the Queensland state government, and later the Australian Federal Government, decided these deposits would form the basis of an Australian aluminium industry. However, at that time, Australia had neither the capital nor the technology to develop an aluminium industry on the necessary scale required. Kaiser, Alcan, Pechiney and Comalco were given mining leases at Cape York, and joined in establishing an aluminium refinery based on large coal deposits near Gladstone in Queensland. Comalco planned to market only part of its bauxite through the Gladstone refinery, the balance was to be sold to Japan. It has been claimed by Comalco that penetration of the Japanese market presented the company with difficulties that caused it to enter into a special arrangement with two Japanese alumina smelters. Instead of binding themselves to a long term supply contract, Comalco and two Japanese corporations, Showa Denko and Sumitomo Chemical agreed to establish a jointly owned sales company in Hong Kong. Hong Kong is a low-tax jurisdiction, with a company tax rate of 15%.

Marketing Arrangements

The Commonwealth Aluminium Corporation was to sell its bauxite to the Hong Kong company, Comalco Bauxite (H.K.) Ltd., at less than cartel prices. Comalco Bauxite (H.K.) Ltd. would then sell the bauxite to Showa Denko and Sumitomo Chemical at cartel prices. The profit from these sales transactions accumulating in Hong Kong was to be returned to Comalco and Showa Denko and Sumitomo Chemical in the form of dividends. The share structure of the parties was -:



Shipments of bauxite went directly from the Commonwealth Aluminium Corporation mine at Weipa to Japan.

Comalco, in a statement released on the 1st June 1981, justified these arrangements in the following terms -:

> "The case involved an arrangement whereby C.A.C. sold bauxite to two Japanese companies through Comalco Bauxite (H.K.) Limited, which is jointly owned by C.A.C. and those two Japanese companies."
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> "In the early 1960s, the Commonwealth Aluminium Corporation needed to achieve long term export sales in the Japanese market to provide the assured cash flow necessary to enable financing to be arranged for the development of the Weipa bauxite deposit. It faced a significant number of obstacles in achieving this objective, including Japanese reluctance to enter into long term contracts (Japanese purchasers previously having purchased traditionally on one year contracts), commercial competition and technology problems in adapting Japanese alumina refineries to utilise Weipa bauxite."
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> "Because it was not possible to offer Japanese companies equity in the Weipa operation, (a) Hong Kong company was established as a means of enabling (Comalco) to dedicate a large quantity of bauxite to a company jointly owned by both Japanese purchasers and C.A.C. (Commonwealth Aluminium Corporation). This arrangement provided the Japanese with an assured long term supply and achieved the company's objective of penetrating the Japanese market. For a number of reasons the Japanese would not agree to the joint company being incorporated in Australia, and C.A.C. would not agree to it being incorporated in Japan."

This statement contains a significant factual discrepancy. The Comalco Bauxite (H.K.) company was not owned by the Commonwealth Aluminium Corporation during the tax years in dispute. The Hong Kong company was partly owned by Comalco (52%). Also, the extent to which Comalco depended upon sales to Japanese refineries in order to ensure the development of the Weipa deposits is unclear. Operating statistics of Comalco Limited for 1975 indicated that bauxite exports to Japan constituted only 13.7% of production. Production figures to 1975 were:[5]

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5 Comalco Limited Annual Report 1979, 40.

		Kilotonnes
Bauxite used by Comalco	.....	1170
Comalco sales to Australia	.....	3640
Japan	.....	1300
Europe	.....	2780
Other	.....	539
Production:		9429

The bulk of Weipa's production goes to the Queensland Alumina refinery at Goldstone, and the Eurallumina refinery on Sardinia, in Europe

In summary, C.A. sold its bauxite to Comalco Bauxite (H.K.) Ltd., at less than cartel prices. The Hong Kong company resold the bauxite to the Japanese refineries at ruling cartel prices, but retained the price differential as profit. These profits were remitted to the owners of Comalco Bauxite (H.K.) in the form of dividends. Comalco Limited was the Australian partner in the Hong Kong company with 52% of the shareholding. Comalco was also the parent of C.A.C. Comalco therefore received dividends ultimately sourced in the economic activities of C. A.C. According to Australian tax law, a resident public company is entitled to a rebate of tax in respect of all dividends including in its taxable income - whether received from resident or non-resident, public or private companies. [6]

The amount of tax in issue between the Federal Commissioner of Taxation and C.A.C. is not recorded in the report of the decision of the High Court of Australia. Neither is it recorded in the reports of the lower courts which dealt with the case. [7] The case was also heard by the No. 2 Board of Review, and the full facts of the case would have properly been considered there. A report of the Board of Review proceedings has not been published.

The Annual Report 1980 for Comalco Limited under the heading 'Contingent Liabilities and Commitments' states that: -

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6 Income Tax Assessment Act (Australia) Section 46(2)(b)

7 Supreme Court of Victoria, Federal Court: 1979 38 FLR 19.

"At 31st December 1979 a subsidiary was awaiting judgement concerning tax assessments totalling $1,087,000 which were the subject of appeals in the High Court of Australia. Of the amounts assessed the subsidiary had paid $543,000 to the Commissioner of Taxation. This amount was included in trade debtors".

The Annual Reports 1979, 1980 for Comalco Limited under the heading 'Dividends from Subsidiaries' show that Comalco Limited received from Comalco Bauxite (H.K.) Limited dividends in the amounts as follows -:

1978	$ 752,000
1979	$ 488,000
1980	$ 362,000

PART III: LEGAL ISSUES

The appeal before the High Court of Australia dealt with tax assessments for the years 1967 - 1971[8] made in accordance with the discretion contained in Section 136 of the Income Tax Assessment Act. This provision is in the following terms:

'where a *business* carried on in Australia -

(a) is controlled principally by non-residents;

(b) is carried on by a company a majority of the shares in which is held by or on behalf of non-residents; or

(c) is carried on by a company which holds or on behalf of which other persons hold a majority of the shares in a non-resident company,

and it appears to the Commissioner that the *business* produces either no taxable income or less than the amount of taxable income which might be expected to arise from that business the person carrying on the business in Australia shall, notwith-

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8 An appeal for the year 1968 had been lodged separately, and was adjourned in the Supreme Court of Victoria, pending resolution of the appeals to the High Court.

> standing any other provision of the Act, be liable to pay income tax on a taxable income of such an amount of the total receipts (whether cash or credit) of the business as the Commissioner determines.' [9]

The Commissioner relied upon paragraph (a) of Section 136, asserting that C.A.C. carried on a business in Australia that was controlled principally by non-residents, and it was the words 'controlled principally' which gave rise to the main legal issues canvassed by the High Court. Did these words mean that in order for the section to apply, the Commissioner had to show evidence of de facto or actual control of the business by non-residents as C.A.C. contended? Or did they mean that the Commissioner merely had to show that non-residents had a capacity to control the business of the taxpayer - without producing any evidence of actual control?

These questions raised a broader issue, strangely unarticulated by the majority of the High Court of Australia, namely the extent to which the court was required to investigate beyond the corporate veil to determine the identity of those who controlled the company, or of those through whom the company exercises its control of its business. [10]

Judgment of Sir Garfield Barwick CJ

The Chief Justice, one of the four majority judges who decided this appeal in favour of C.A.C., found as a matter of fact that there had not been any direction given to, or interference in the business of C.A.C. He decided that: -

> "the decision so to handle the transaction with the Japanese buyers was made entirely by the respondent without any participation in the decision by either of the non-resident companies". [11]

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9 PNG: Income Tax Act Section 197 is in almost identical terms. This section was repealed in 1982 and replaced by a new "Division 15 - Agreements and Determination of the Source of Certain Income" Act No. 36 of 1982.

10 F.C.T. v. Commonwealth Aluminium, 1979 38 F.L.R. 19, 21, and also P.J. Jopling 'Companies Controlled by Non-Residents' A.T.R. 229, 229.

11 80 A.T.C. 4374.

He accepted the view adopted by the Federal Court of Australia, that even if the non-resident companies did have a capacity to exercise control, it had not in fact been exercised.

Joint Judgment of Stephen, Mason and Wilson JJ.

Three of the majority judges found as a matter of the statutory interpretation of Section 136 (a) that the words "controlled principally" should be construed in such a way, that in order for the Commissioner to exercise the discretion under Section 136, he had to prove that C.A.C. had actually been controlled by non-residents, and that these words did not imply a mere capacity on the part of non-residents to control the business of C.A.C. The judges then decided that there was no evidence to support a finding of actual control of the business by non-residents. In their consideration of the facts relating to the formation of Comalco Bauxite (H.K.) Ltd., and the evidence of the sales of bauxite by C.A.C. to that company the judges said -:

> "Comalco played a part in negotiating those developments and there is no doubt that the taxpayer acted on directions given to it by Comalco in connection with these transactions. As Jenkinson J. in the Supreme Court of Victoria found, the decision that the majority of the shares in the Sales Company would be held by Comalco and not by the taxpayer was forced upon the taxpayer's directors in consequence of Comalco's general policy that its subsidiaries would not have subsidiaries and that the share capital in all subsidiaries in the group of companies controlled by Comalco would be held by Comalco. Jenkins J. found that the decision of the taxpayer's directors that the taxpayer would sell bauxite to the company was substantially influenced by a direction by Comalco. His Honour also found that decisions by Comalco concerning the advance of funds to the taxpayer also influenced decisions made with respect to the taxpayer's business by its directors. However, on the whole of the evidence, Jenkinson J. found that the business was controlled by the taxpayer's directors. With these findings we agree and we do not think that the evidence relating to the Sales Company and the transactions entered into with it justify the general inference that the taxpayer's business was controlled by the two overseas companies behind

Comalco."[12]

Barwick C. J. in his judgement, does not refer to the role Comalco played in directing C.A.C. to sell its bauxite to the Hong Kong company.

P. J. Jopling in an article in the *Australian Tax Review*, was of the opinion that the joint judgment in the High Court regarded Comalco's intervention with C.A.C.'s business as an isolated incident. He said -:

> "Although this may have been an 'isolated' incident, one might be forgiven for concluding that such an incident was a direct indication of the possibility and likelihood of the foreign parent companies exercising their control over the management and policies of the taxpayer in circumstances where the foreign parent deemed it appropriate to intervene. Such an occurrence must, however, be viewed in the context of a particular tax year, despite its obvious appeal as a general indicator of the foreign companies' interference with the taxpayer's business affairs. As a single instance of corporate interference it is singularly unhelpful in the context of Section 136 of the Act, though it plainly alerts the reader to the inadequacies of the legislative provisions".

Jopling's view is attractive - but as is indicated in the final sentence of the passage quoted from the judgment of Stephen, Mason, and Wilson JJ., Comalco was a company resident in Australia, and because of the interpretation put on Section 136 by the majority, there would need to be evidence that Riotinto Zinc or Kaiser had given a direction or interfered in the business of C.A.C. As it was, there was no direct evidence of intervention by these companies.

Dissenting Judgment of Murphy J.

The judgment of Murphy J. eschewed the strict and literal construction of Section 136 (a) adopted by the majority, favouring instead a

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12 80 A.T.C. 4381.

13 1980 December A.T.R. 231.

purposive approach to statutory interpretation. Murphy J. said -:

> "Section 136 was intended to be an effective instrument for the Commissioner to deal with non-residents controlling business in Australia in such a way that they were able to reduce taxable income by shifting available profits elsewhere or by other devices. The section would be virtually useless if it could not be applied whenever the immediate corporate owner was incorporated in Australia. It would for example, make nonsense of Section 136 (a) to read it so that a resident company, all of whose directors and shareholders were non-resident, was outside its scope."[14]

On the facts, Murphy J. rejected the argument that C.A.C. was a resident company which carried on its own business. He reviewed at length the structure of the Comalco group, and the nature of the worldwide aluminium industry, concluding that the directors, officers and employers of C.A.C. did not conduct the business of C.A.C., free from non-resident interference. In a revealing passage, he said -:

> "In my opinion, the taxpayer was at all relevant times controlled by non-residents and its business was controlled by non-residents. There is no point in this case in distinguishing between the company and the business, which was the corporate business."
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> "I do not think that any rigid formula is appropriate for determining whether a company is controlled by non-residents. The test of whether there are more non-resident directors is superficial, and in practice, would often be an absurd formalism"[15]

Murphy J. agreed with the Chairman of the Board of Review who in his dissenting opinion drew an adverse inference from the arrangements involving the Hong Kong company. The Chairman was quoted with approval by Murphy J. as saying -:

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14 80 A.T.C. 4382

15 80 A.T.C. 4384

> "... I am unable to detect any business exigency which so far as the taxpayer itself was concerned required the interposition of the company between it and the Japanese customers. Moreover, the decision to supply the Hong Kong company with bauxite at 33 shilling per ton was one which was voluntarily undertaken and which in my view, operated to the detriment of the taxpayer and to the advantage of its parent. I am of the opinion that the taxpayer got less for its bauxite that went to Japan than might be expected, and that in consequence, the amount of taxable income which arose from the taxpayer's business was also less than might be expected."[16]

Finally, Murphy J. found that Jenkinson J. in the Supreme Court of Victoria had not given proper weight to the findings that Comalco had directed C.A.C. to participate in the establishment of Comalco Bauxite (H.K.) Ltd., and to sell its bauxite to that company at less than the cartel price. From the judgement of Murphy J., it can be concluded that he regarded the investigation in the Supreme Court of Victoria for the purpose of establishing primary facts, as far too narrow. Murphy J. incorporatesin his judgment an academic description of the nature of corporate power within Transnational corporations, which led him to the conclusion that -:

> 'Where the business is conducted by a subsidiary of transnationals, whose headquarters is not Australia, it would require very strong evidence to show that it was not "principally controlled by non-residents". The purpose of transnational organisation would be frustrated if there were not such control.'[17]

PART IV: WIDER ISSUES

The *Commonwealth Aluminium* case raises issues concerning the conduct of courts when determining complex economic problems which themselves have wide social and political consequences. One view of the case is

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16 *Id.*

17 80 A.T.C. 4385

that the analysis of the majority thwarted a just resolution of the dispute, which involved a scheme that had the effect and a purpose, although not the sole purpose, of avoiding income tax. This view raises doubts about the appropriateness of traditional methods of legal analysis, and in particular, what is seen as an excessive reliance on literalism.

These issues were debated in the judgments of Barwick CJ and Murphy J in the case of *Federal Commissioner of Taxation* v. *Westraders Pty. Limited*, handed down in the High Court of Australia shortly before the decision in the *Commonwealth Aluminium* case.

Westraders came to the High Court as an appeal from the Federal Court; that court had upheld the claim of the taxpayer to a deduction. In the Federal Court, Deane J., speaking of the result of his decision to uphold this claim, which was admittedly based on a tax avoidance scheme, said -:

> "That result may seem both contrary to the general policy of the Act (if it be possible to discern any general policy other than that people pay income tax) and unfair to the ordinary taxpayer who willingly or reluctantly contributes, without resort to tax avoidance, the share of his net income which the Parliament has determined is required by the nation for the common good. If there be, in truth, such contrariety or unfairness, the fault lies with the form of the legislation at the relevant time and not with the court whose duty is to apply the words which the Parliament has enacted. For a court to arrogate to itself, without legislative warrant, the function of overriding the plain words of the Act in any case where it considers that overall considerations of fairness or some general policy of the Act would be best served by a decision against the taxpayer would be to substitute arbitrary taxation for taxation under the rule of law and indeed to subvert the rule of law itself."[19]

In the High Court, Barwick C. J. referred to this passage from the

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18 80 A.T.C. 4357

19 80 A.T.C. 4358-9

judgment of Deane J., and said: -

> "The principle to which his Honour calls attention is basic to the maintenance of a free society. Parliament having prescribed the circumstances which will attract tax, or provide occasion for its reduction or elimination, the citizen has every right to mold the transaction into which he is about to enter into a form which satisfies the requirements of the statute. It is nothing to the point that he might have attained the same or a similar result as that achieved by the transaction into which he in fact entered by some other transactions, which, if he had entered into it, would or might have involved him in a liability to tax, or to more tax than that attracted by the transaction into which he in fact entered. Nor can it matter that his choice of transaction was influenced wholly or in part by its effect upon his obligation to pay tax. Of course, the transaction must not be a pretence obscuring or attempting to supplant some other transaction into which in fact the taxpayer had earlier entered. Again, the freedom to choose the form of transaction into which he shall enter is basic to the maintenance of a free society." [20]

Murphy J. was not slow to respond to this affirmation of the principles in the I.R.C. v. Duke of Westminster. [21] In a forthright reply, he drew attention to the evilts that flow from literalism. He said:-

> "The transactions in this case are conceded to be a major tax avoidance scheme. The supporters of the scheme seize upon the bare words of Section 36A and claim that these should be applied literally even if for purposes not contemplated by Parliament. The history of interpretation shows the existence of two schools, the literalists who insist that only the words of an Act should be looked at, and those who insist that the judicial duty is to interpret Acts in the way Parliament must have

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20 80 A.T.C. 4359

21 (1936) A.C. 1

intended even if this means a departure from the strict literal meaning (see the somewhat acid debate by the House of Lords 13 February 1980). It is an error to think that the only acceptable method of interpretation is strict literalism. On the contrary, legal history suggests that strict literal interpretation is an extreme, which has generally been rejected as unworkable and a less than ideal performance of the judicial function."

"It is universally accepted that in the general language, it is wrong to take a sentence or statement out of context and treat it literally so that it has a meaning not intended by author. It is just as wrong to take a section of a tax Act out of context, treat it literally and apply it in a way which Parliament could not have intended. The nature of language is such that it is impossible to express without bewildering complexity provisions which preclude the abuse of a strict literalistic approach."

"It has been suggested, in the present case, that insistence on a strictly literal interpretation is basic to the maintenance of a free society. In tax cases, the prevailing trend in Australia is now so absolutely literalistic that it has become a disquieting phenomenon. But because of it, scorn on tax decisions is being expressed constantly, not only by legislators who consider that their Acts are being mocked, but even by those who benefit. In my opinion, strictly literal interpretation of a tax Act is an open invitation to artificial and contrived tax avoidance. Progress towards a free society will not be advanced by attributing to Parliament meanings which no one believes it intended so that income tax becomes optional for the rich while remaining compulsory for most income earners. If strict literalism continues to prevail, the legislature may have no practical alternative but to vest tax officials with more and more discretion. This may well lead to tax laws capable, if unchecked, of great oppression."[22]

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22 80 A.T.C. 4370

The Legislative Reaction

In 1981, the Australian government introduced in the Federal Parliament measures designed to free the courts from their adherence to rules the literal rule of statutory interpretation, [23] and also to amend Section 136 of the Income Tax Assessment Act.

On 27th May 1981, amendments to the Acts Interpretations Act 1901 were introduced into the Australian Senate by the Attorney-General.

Clause 15 AA of the bill provided as follows:

> 'In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose of the Act.'

This provision may be compared with Section 109(4) of the Papua New Guinea Constitution which reads: -

> 'Each law made by the Parliament shall receive such a fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the law according to its true intent, meaning and spirit, and there is no presumption against extra-territoriality.'

When introducing the bill to the Australian Senate the Attorney-General remarked cautiously: -

> 'Our problems are not unique. They are shared, for example, by the British Parliament, to which proposals have been made along lines now proposed by this Bill. The British proposals, I should add, have been initiated and supported by very distinguished law lords, including

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23 Recently in Cooper Brookes (Wollongong) Pty. Limited v. FCT 1981 ATC 4592 the Court has shown some willingness to depart from strict literalism, but see the commentary of Dr. Spry: 'The Cooper Brookes case and statutory construction' 1981 December A.T.R., 208.

> Lord Scarman and Lord Wilberforce. The effect of the provision to be inserted in the Act ... will be to confirm that in interpreting provisions regard has to be had to the object or purpose underlying that Act in question. I am not among those who would say that the general approach of our Court is at present overly legalistic, but I do think that there is scope for expressly stating that statutes we make are to be interpreted in a purposive manner. Tax decisions constitute a topical and important example that will come readily to all Senators' minds, but the matter has wider implications that extend to many other statutes.' [24]

On the same day, 27th May 1981, the Treasurer made a statement to the Australian House of Representatives: -

> 'Mr. Speaker, I would like now to spell out what is involved in the Government's decision to introduce in the next Sittings of the Parliament further anti-avoidance measures complementary to those I have just explained and which deal with what might be described as the transfer pricing problem. The further measures will apply in relation to income derived and expenses incurred after today. I have previously informed the House that the existing Section 136 [24A] which was designed decades ago to deal with tax avoidance arrangements under which profits that should be taxed in Australia would be shifted out tax free - was being reviewed because it was proving inadequate to meet modern conditions. The point has been driven home by the decision of the High Court in the Commonwealth Aluminium Corporation case.'

The Treasurer then described a new provision to control transfer pricing. He stated that the defect exposed in Section 136, by the Commonwealth Aluminium case would be rectified. An 'arms length' criterion would be introduced to measure the value of transactions where markets conditions prevailed. Where market conditions did not exist, the Commissioner would be 'empowered to assess tax on a taxable income of such amount as he determines to be appropriate in the circumstances.

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24 AFTR 61.611

24A PNG Income Tax Act 1951, Section 197

Implications for Papua New Guinea

In Papua New Guinea, Section 197 of the Income Tax Act, is cast in similar terms to Section 136 of the Income Tax Assessment Act. The defects in Section 136 revealed by the Commonwealth Aluminium Act case, considering current trends in statutory interpretation, could well result in the defeat of Section 1977 of the Income Tax Act in Papua New Guinea, and steps need to be taken to review the Australian amendments to Section 136, and recast Section 197 in Papua New Guinea.

The Commonwealth Aluminium case shows the need for governments to constantly review taxation legislation, particularly where it applies to international investment, and to introduce reforms where changing circumstances make a provision unworkable or obsolete. Section 136 of the Income Tax Assessment Act was by 1980 completely outdated. It had been incorporated in the 1936 Income Tax Assessment Act after the present paragraphs (b) and (c) were added to Section 28 of the Income Tax Assessment Act 1922. In turn, Section 28 was based on Section 23 of the 1915-21 Act, which had its origins in, and was in the same terms as Section 31 of the Finance (No. 2) Act 1915 (U.K.). All this early legislation and the 1936 reenactment had effect in the context of "no tax" or "low tax" rates on companies. After World War II, when income tax rates on companies were raised, general pressure was felt on Income Tax legislation as corporate taxpayers sought to avoid the payment of the high rates.

One feature of the Commonwealth Aluminium case should be noted in Papua New Guinea. It is the time that the government took to rectify the discrepancies in Section 136 of the Act. Comalco claimed that it had made a voluntary disclosure of the arrangements involving the Hong Kong subsidiary to the Australian Taxation Office in 1969. It can be fairly presumed that Comalco tax advisers would have formed the opinion that Section 136 would not be an impediment to this arrangement sometime in the early 1960s. If the limited application of Section 136 was known to Comalco at this time, it might well be asked why was it not perceived by those who advise the government? Why was action not taken in 1969 when voluntary disclosure was made? Or in 1974 when the special assessment was made? [25]

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25 C. O'Faircheallaigh has written: -

"The Australian Taxation Commissioner was aware of transfer pricing in the aluminium industry as early as 1967, but was

The complete answers to these questions are not known in Papua New Guinea, but they draw attention to the possibility of either poor advice available to the government or a lack of political will to reform the statute. In the circumstances, merely to do nothing, and to wait seven years for a High Court ruling, does not appear to be a responsible way of protecting the tax base.

In Papua New Guinea, where much defective legislation has been reenacted at Independence, there simply has not been the time or the resources to reform or replace all the out-dated statutory material that has survived from colonial times.

This factor points to a need for flexibility in the judicial approach to staturory interpretation in Papua New Guinea.

Since independence, the Supreme Court has not had an opportunity to authoritatively determine the rules of interpretation as they relate to taxing statutes, although there are cases in other fields which indicate possible trends in construction.

The Supreme Court Reference PLAR No. 1 of 1980 contains some guidance. In his judgment in that case, Wilson J., in a lenghty analysis of the constitutional responsibility of the Supreme Court to develop the Underlying Law, and of the common law cases on staturory interpretation, concluded that the literal rule had no place in the law of Papua New Guinea. [26] The other majority judge in that case, Andrew J., was not prepared to go so far as Wilson J. Andrew J. Said: -

> "I agree with the judgment of Wilson J. that it is inappropriate to apply a 'literal rule of statutory

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> unable to act because it proved impossible to obtain the information required to place an open market value on transactions between affiliates, in this case bauxite sales". This explanation is not entirely convincing as Showa Denko and Sumitomo Chemical were not affiliates and presumably would not pay more than a market price.
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> C. O'Faircheallaigh, 'Submission to the Law Reform Commission on Transfer Pricing Manipulations in Papua New Guinea'. History Department, UPNG (Unpublished) November 1981.

26 PLAR No. 1 of 1980. Unreported Judgment SC 181, 4-10.

interpretation in the circumstances of this reference". [27]

These words do not totally banish the literal rule from Papua New Guinea, but merely included it from the ambit of the particular case. PLAR No. 1 of 1980 concerned a question of the applicability of the defence of provocation to the crime of manslaughter as defined by the Criminal Code.

It would seem that the majority decision to reject the literal rule could well be limited to the circumstances of that case. Had PLAR No. 1 of 1980 dealt with the interpretation of a provision defining an offence, as distinct from the application of a defence, the trend may be thought to have been different, because the literal rule has been associated with both the interpretation of offences and taxing provisions. But there are other judgments of the Supreme Court which indicate that some judges at least are not prepared to concede the court wide powers of interpretation. Kapi, J., as he then was, made this clear in Avia Aihi. In His Honour's view, there was no judicial power to interpret a statute in such a way as to disregard or override its clear provisions. Kapi J. said: -

> "This, in effect, would amount to amendment or repeal of legislation by judicial power. Such an interpretation would put this court above the legislature and it could make orders against the clear provisions of legislation if it thought the legislation was unfair or did not do justice. Such an interpretation would violate the doctrine of separation of powers". [28]

It may well be thought too, that this passage is confined to the particular point of constitutional interpretation that was dealt with at that point in the case. On the other hand, it does also indicate generally, that the principle of separation of powers in Section 99 of the Constitution is a restraint on the power of the judiciary when construing an Act of Parliament.

There are other definite indications in the Constitution that a literal reading of a statute is inapplicable in Papua New Guinea. Section 109 (4) has already been quoted in full. It states that statutes 'shall

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27 SC. 181, 22

28 Avia Aihi v. The State, SC. 195, 31

receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the law according to its true intent'.

The effect of Section 41 of the *Constitution* on the rules of interpretation is also unknown at this point in time. Section 41 makes unlawful an otherwise lawful act, done under a valid law, when it is done in a harsh, oppressive, unwarranted, disproportionate manner, or in circumstances which are not warranted in a democratic society. It may well be that this provision has no effect whatsoever on the construction of a statute, but should that construction result in any of the conditions described in the Section, the construction itself may well constitute an unlawful act.

There have been some dicta on the meaning of the word 'justice' in Section 158(2) of the *Constitution*. This Section states: -

> "In interpreting the law, the courts shall give paramount consideration to the dispensation of justice."

Kapi, J. in *Avia Aihi* said that 'justice' under Section 155(4), meant 'justice according to law', but it is unlikely that the court heard argument to the contrary on this point. Both Sections 158(2) and 155(4) contain the word "justice", and there is some support for the view that it is indicative of a value system based upon broad principles of justice and equity, rather than founded in positivism.[29]

The *Commonwealth Aluminium* case involved complex economic issues. At one level, the case was about the apportionment of profits between the taxpayer and the state. Yet it was also about the submergence of foreign capital into a national economy, and its transformation under a cloak of corporate personality and indigenous management into a domestic industry. It was about a mode of commercial activity that transcends national boundaries and obscures the true identity of the interests who own, control and operate it.

When dealing with cases that involve matters of international business courts that rely solely on technical legal analysis, and ignore economic reality are not in a position to competently deal with the issues. Further, to selectively rely on legal analysis, and to ignore economic analysis is irrational. Finally, a tribunal which

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29 J. Goldring, The Constitution of PNG, L.B.C. Sydney 1978, 126-7.

consciously adopts perimeters to its investigation in a selective manner may well be thought to be less than impartial.