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Tax Insights

Unpacking the Alcoa transfer pricing case

Snapshot

On 30 April 2025, the new Administrative Review Tribunal (**ART**) handed down its decision on a transfer pricing case between the Commissioner of Taxation (**Commissioner)** and Alcoa of Australia Ltd (**Alcoa**). The case focuses on historical transactions between Alcoa and an intermediary regarding the supply of alumina to a major customer in Bahrain over the period that predates Australia's current transfer pricing rules in Subdivision 815-B[1], and has therefore been heard under the former transfer pricing rules in Division 13[2].

The Commissioner sought to apply Division 13 to increase Alcoa's taxable sales revenue by approximately AUD 644 million over a period between 1993 and 2009 (**Review Period**).

The ART concluded that while Alcoa did not prove that it was dealing at arm's length with the independent intermediary, it had received no less than arm's length amounts for the sale of alumina during the period. The ART therefore found in favour of Alcoa and the Commissioner's transfer pricing adjustments were dismissed.

The Commissioner has decided not to appeal this case to the Federal Court.

[1] Subdivision 815-B, Income Tax Assessment Act 1997
[2] Division 13, Income Tax Assessment Act 1936

Facts

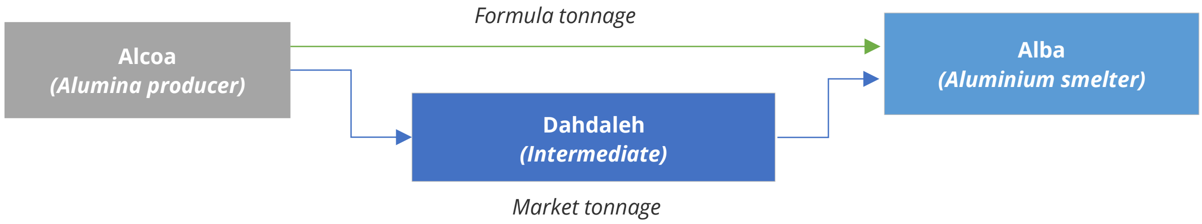
Alcoa is a leading producer of smelter grade alumina, a key component in the production of aluminium. Alcoa sells the majority of its products to aluminium smelters in the global market under long term sales agreements.

The case involves sales of alumina to one of Alcoa's largest customers, Aluminium Bahrain B.S.C (Alba). During the Review Period, Alcoa shipped significant volumes of alumina to Alba, some of which were invoiced via a group of intermediary entities (collectively referred to as **Dahdaleh** herein). While it was accepted that Alcoa and Dahdaleh were independent third parties, the Commissioner maintained that they were not dealing at arm's length with each other, due to allegations of bribery and corruption that were the subject of proceedings brought against Alcoa's parent company and another related party in the United States. Specifically, it was alleged that Dahdaleh marked up its prices when on-selling the alumina to Alba and used a portion of the profits to facilitate bribery and corruption.

Alcoa's sales to Alba during the period can be summarised as follows:

1. **1993 – 1995**: A long term supply agreement entered into between Alcoa and Alba in 1990 had two pricing mechanisms, one applying to alumina sales up to a certain quantity (**Formula Tonnage**), with a price for sales in excess of the specified quantity (**Market Tonnage**). While Formula Tonnage was invoiced directly to Alba, some of the Market Tonnage was invoiced to Dahdaleh and on-sold to Alba.
2. **1997 – 2001**: The invoicing of alumina sales was similar to the arrangements under the 1990 agreement. The key difference during this period was that sales of all Market Tonnage from Alcoa to Alba (via Dahdaleh) were under a separate supply agreement between Alcoa and Dahdaleh.

The supply of alumina between Alcoa and Alba during 1993 - 2001 is illustrated as follows:



3. **2002 – 2009:** During these years, all alumina sales from Alcoa to Alba were via Dahdaleh under a new distribution agreement, as illustrated below:

The Formula Tonnage and the Market Tonnage were co-mingled and shipped directly from Alcoa's refineries to Alba from 1993 to 2009. Dahdaleh never took physical possession of the products.

The Commissioner made transfer pricing adjustments to increase Alcoa's taxable income for its sales of alumina to Dahdaleh during the Review Period.

As with all transfer pricing cases in Australia, the onus was on the taxpayer to prove to the ART that the Commissioner's assessments to increase its taxable income over the Review Period were excessive.

Key issues before the ART

Having regard the requirements for the application of Division 13, the three members in the ART addressed the following key questions:

1. What are the “international agreements” subject to Division 13 and what was the “supply of property”?
2. Were the parties dealing at arm’s length with each other?
3. Did Alcoa receive less than an arm’s length consideration for its sales of alumina?

The ART’s decision on each of these questions is summarised below.

Relevant “international agreement” and property supplied

The parties disagreed on the relevant “international agreement” and the property supplied matters for 1993 to 2001, when Alcoa invoiced both Alba and Dahdaleh for co-mingled cargoes of alumina shipped to Alba’s smelter.

The Commissioner argued that the relevant “international agreement” and “supply” for the purposes of Division 13, in 1993 to 2001, are limited to the sales of Market Tonnage to Dahdaleh. Further, the Commissioner contended that the sales of Formula Tonnage directly to Alba during this period were not relevant to the application of Division 13.

Alcoa argued that the relevant “international agreement” and property supplied in 1993 to 2001 should encompass all of the sales to Alba, including both the Formula Tonnage and the Market Tonnage sold via Dahdaleh.

The ART held that the relevant “international agreement” is a tripartite agreement between Alcoa, Alba and Dahdaleh, which included the sales of Formula Tonnage directly to Alba. Regarding the property supplied, the ART found that since the sales of Market Tonnage are the subject of the decisions under review, the relevant supply of property is limited to the sales of Market Tonnage to Dahdaleh only. However, the ART disagreed with the Commissioner’s view that Alcoa’s direct sales of Formula Tonnage to Alba are not relevant in determining whether the consideration received by Alcoa for its sales to Dahdaleh were less than an arms’ length consideration.

There was no dispute as to the relevant agreement and the property supplied during 2002 to 2009. During this period all of the alumina shipped to Alba was sold via Dahdaleh.

Dealing at arm’s length

Despite there being no common ownership between Alcoa and Dahdaleh, the Commissioner contended that Alcoa and Dahdaleh were not dealing at arm’s length. The Commissioner argued that the contracts for the supply of alumina were structured to facilitate bribery and corruption.

Alcoa argued that it was dealing at arm’s length with Alba and Dahdaleh, and that there was no evidence to suggest that Alcoa colluded with an independent party to achieve lower prices than what it might achieve at arm’s length. It also provided evidence of showing that key negotiations regarding pricing and supply involved both Alcoa and Alba.

The ART held that it is possible for entities that are wholly independent of each other to have non arm’s length dealings, and that collusion for the facilitation of the payment of bribes would not be consistent with arm’s length dealings. The ART confirmed that the onus is on the taxpayer to demonstrate that it was dealing at arm’s length with another party. The ART found that Alcoa has not proven that it was dealing at arm’s length with Dahdaleh.

Arm's length consideration

On the final question, the Commissioner contended that Alcoa received less than arm's length consideration for its sales to Dahdaleh, as supported by Comparable Uncontrolled Price (**CUP**) analyses performed by the Commissioner's expert witnesses.

Consistent with the Commissioner's views on the relevant "international agreement" and "supply of property", discussed above, the Commissioner's expert witness was instructed to consider the sale of Market Tonnage in isolation from the Formula Tonnage sold directly to Alba during the period 1993 to 2001. The expert witness' analysis compared the pricing of Market Tonnage sold to Dahdaleh during this period with comparable transactions between independent parties and index prices.

As noted above, Alcoa provided evidence to support its contention that the Formula Tonnage and Market Tonnage were negotiated with Alba on a holistic basis. Given the more flexible nature of the pricing of the Market Tonnage, the prices for these sales were often adjusted to achieve a negotiated outcome on the overall average price paid by Alba, taking into account movements in the alumina market that were not reflected in the pricing of the Formula Tonnage. Accordingly, Alcoa's expert witnesses performed their analysis by comparing the weighted average price for both Formula Tonnage and Market Tonnage in each year to the arm's length prices identified through an analysis of comparable sales of alumina by Alcoa to other third party customers, along with references to index prices.

The expert witnesses for both parties also undertook CUP analyses for the period 2002 to 2009, each determining a range of arm's length prices. A key difference in the approaches adopted by the expert witnesses for the period relates to the timing of the analyses. While the Commissioner's expert witness undertook an annual analysis based on market conditions in each year, the taxpayer's expert witnesses focused on the market conditions at the time the relevant terms and conditions of the long term contracts were agreed between the parties, including any renegotiation of prices that may be expected during the course of the contracts.

For the period 1993 to 2001, the ART found that the analysis undertaken by Alcoa's expert witnesses were consistent with the appropriate characterisation of the agreement and supply of property, and therefore their opinions were preferred over those of the Commissioner's expert witnesses. In particular, the ART held that the Commissioner's expert witness failed to take into account the commercial circumstances of the transactions during the period 1993 to 2001 and therefore their pricing exercise was flawed. The analysis performed by Alcoa's expert witnesses, which supported the arm's length nature of the combined sales during this period, was accepted by the ART.

While the ART pointed out some flaws in the analysis undertaken by the Commissioner's expert witnesses for the period 2002 to 2009, it was observed that the prices achieved by Alcoa in sales to Dahdaleh during this period were equal or higher than the arm's length prices identified by both the Commissioner's expert witnesses. In fact, one of the Commissioner's expert witnesses determined that Alcoa received USD 203 million more than an arm's length amount during this period. Despite this outcome, the Commissioner persisted with his original transfer pricing adjustments.

The ART accepted the evidence of the Commissioner's expert witnesses (as supported by the expert witnesses of Alcoa) for the period 2002 to 2009 to conclude that Alcoa did not receive less than arm's length consideration.

The ART found that the Commissioner's transfer pricing adjustments for the Review Period were excessive, and that Alcoa's notice of objection to the Commissioner's amended assessments should be allowed in full.

Deloitte Australia's comments

While every case turns on the facts, the ART's decision in this case deals with a number of principles that have broader application to Australian transfer pricing rules, as discussed below.

The application of the transfer pricing rules to third party dealings

To tax professionals outside Australia, it may come as a surprise that the Australian transfer pricing rules are capable of applying to dealings between unrelated parties. By contrast, the transfer pricing rules in most countries include a condition for the parties to the transaction to be 'related parties', 'connected persons' or similar. The definitions of these terms usually require a level of ownership, common ownership or control between the transacting parties, to target inappropriate "profit shifting" within a multinational corporate group. As such, the guidance included in the OECD Transfer Pricing Guidelines[3] also focuses on transactions between "associated enterprises".

Under Division 13, the Australian transfer pricing rules may apply if it is determined that the parties were not dealing at arm's length, irrespective of whether they are members of the same group. It is important to note that Australia's current transfer pricing rules in Subdivision 815-B similarly do not require the relevant entities to be related parties.

Pricing the sales of commodity products

The decision provides useful practical guidance for the economic analysis required to demonstrate the arm's length nature of arrangements involving the sale of commodity products:

- The decision reinforces the use of the CUP method as the most appropriate and reliable transfer pricing method to identify the arm's length pricing for the sale of commodities. The practical application of the CUP method may include a comparability analysis based on comparable contracts between independent third parties or the use of publicly available market indexes.
- The decision is consistent with the judgement in *Glencore*[4], which, *inter alia*, recognised the value of comparable sales contracts as evidence of arm's length terms and conditions. As is often observed in the market, contracts may not be identical in structure or terms but will typically include various terms and pricing mechanisms that can be analysed across a number of third party contracts. In this case, Alcoa's third party contracts with other customers (unrelated to the supplies to Alba) formed a key part of Alcoa's ability to demonstrate that it did not receive less than arm's length consideration.
- In addition to the actual pricing mechanisms adopted in the relevant producer's third party sales contracts, a comparison against an external index prices (e.g., the London Metal Exchange (**LME**) High Grade price for aluminium in this case) was applied in the analysis performed by the expert witnesses in this case. While there are multiple alumna pricing indexes available today, it was noted that pricing alumina as a percentage of the LME price for the end product (aluminium) was a common alumina pricing mechanism during the Review Period.
- Although the CUP method focusses on a direct price comparison of the sales of similar products, it is critical to appropriately characterise the transactions and the parties involved, taking into account the commercial context and looking beyond the legal agreements, to ensure the analysis is "pricing the right transaction". This is illustrated by the fact that the expert witnesses for both parties were instructed to opine on whether the terms and conditions (including, but not limited to the pricing mechanisms) are consistent with those that might be expected between independent parties dealing at arm's length. Further, similar to most Australian transfer pricing cases to date, the appropriate level of "depersonalisation" of the parties when applying the hypothesis required to identify the arm's length consideration was once again a critical factor in this case. Of relevance to the ART's decision was security of supply, specifically Alba's

[3] Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as approved by the Council of the OECD and published on 20 January 2022

[4] *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187 (6 November 2020)

significance to Alcoa as a long term customer with significant volumes of committed alumina purchases, coupled with the preference of alumina suppliers and purchasers to enter long term contracts to provide security of supply. As a result, the ART concluded that the relevant transaction was the totality of purchases by Alba, including both purchases priced according to Formula Tonnage and Market Tonnage.

- The ART concluded that the CUP method could not be reliably applied by reference solely to spot contracts in the circumstances and rejected the analysis of the Commissioner's expert witness as failing to take a holistic view of market conditions. The basis for this decision was that:
  - The spot market represented less than 5 per cent of the alumina market and less than 5 per cent of Alcoa's total alumina sales during the period in question;
  - Refiners and purchasers indicated a clear preference for long term contracts over spot contracts; and
  - There is a rational commercial incentive for large scale refiners and purchasers to enter long term contracts to mitigate supply and price risks.
- While the transfer pricing rules in Division 13 apply on a year-by-year basis (as emphasised in *SingTel*[5]), the pricing exercise for a long term agreement should reflect the terms and conditions that might have been agreed *at the time* the agreement was entered into (taking into account the evidence available of the regularity of price reviews expected between independent parties), rather than merely focussing on the prevailing market prices in each year or assuming that independent parties would include an annual review in all long term contracts.
- The decision also confirmed that a range of arm's length outcomes identified under the CUP method may be equally relevant. In commenting on the approach adopted by the Commissioner's expert witness, the ART referred to *Glencore*[6] which highlighted that the task under the statutory test of Division 13 is not to identify *another* arm's length consideration. Rather, the task is to demonstrate whether the consideration received by the taxpayer was not arm's length consideration, recognising that a range of arm's length considerations may exist for a given arrangement.

Reliance on expert witnesses

As this case ultimately turned on the respective pricing analyses performed by the expert witnesses, the ART's decision provides useful principles for the use of expert witnesses in transfer pricing cases. In particular, the decision emphasised the importance of the way in which expert witnesses are instructed.

In *Chevron*[7], the majority of expert witnesses were dismissed on the basis that they were instructed to address the wrong question. Similarly, much of the ART's criticisms of the Commissioner's expert witnesses relate to the instructions that they received from the Commissioner. This was partly due to the fact that the ART disagreed with the Commissioner's characterisation of the arrangements during the period 1993 to 2001 period (i.e., that the sales of Market Tonnage should be considered in isolation from the remainder of the arrangements between Alcoa and Alba). The ART also criticised the fact that the expert witness was only provided with *"a select sample of contemporaneous business records cherry picked by the Commissioner which omitted many crucial documents"*.

The decision therefore emphasises the importance of expert witnesses and the way they are instructed.

Further, the fact that one of the Commissioner's expert witnesses determined that Alcoa received USD 203 million more than an arm's length amount for the period 2002 to 2009 is an unusual outcome.

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[5] *Singapore Telecom Australia Investments Pty Ltd v Commissioner of Taxation* [2024] FCR 192 (25 October 2024)
[6] *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187 (6 November 2020)
[7] *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation* [2017] FCAFC 62 (21 April 2017)

A different outcome under the current transfer pricing rules?

The case was heard under Division 13, this division continued to apply until the 2013 year. A question arises as to whether the application of current transfer pricing rules in Subdivision 815-B may have resulted in a different outcome.

As noted above, Subdivision 815-B can also apply if the relevant entities are unrelated, provided that it can be demonstrated that the "actual conditions" are different from "arm's length conditions". Therefore, it is possible that Subdivision 815-B may apply to dealings similar to those between Alcoa and Dahdaleh, if it is determined that those dealings involved conditions that are not "arm's length conditions".

Subdivision 815-B requires taxpayers and the Commissioner to take into account the "commercial and financial relations" that create the commercial context for the relevant transactions when applying the arm's length principle. While this is not specifically stated in Division 13, this case confirms the approach taken by the Federal Court in Chevron, Glencore and SingTel where the broader arrangements between the parties were also taken into account in the application of Division 13, rather than simply applying a "market valuation" approach to price the transactions. In this sense, it is likely that a decision under Subdivision 815-B would also have taken into account the broader "tripartite agreement" between Alcoa, Alba and Dahdaleh, rather than focusing on the sales of the Market Tonnage in isolation.

A key difference between the current and former transfer pricing rules is the inclusion of specific "reconstruction provisions" in Subdivision 815-B. Under these provisions, if, for example, it is determined that independent parties would not have entered into an arrangement and would have entered into an alternative arrangement, then the arm's length principle should be applied based on that alternative arrangement.

Under Subdivision 815-B, the Commissioner may have sought to apply the 'reconstruction provisions' to the dealings in this case (e.g., by reconstructing the arrangements to exclude Dahdaleh from the arrangement). However, some of the evidence referred to in the judgement (e.g., the importance of the use of intermediaries in the specific market and the recognition of the special role played by Dahdaleh in the overall arrangement between Alcoa and Alba) indicates that it may have been difficult for the Commissioner to meet the "would" test for these provisions to apply in this case. It also noted that the ART rejected the opinion of the Commissioner's expert witness that "the use of an intermediary was inappropriate for such a large customer".

The potential burden for multinationals operating in Australia

Finally, this case demonstrates the Commissioner's resolve to continue to pursue matters under Division 13 going back many years.

The absence of a period of review allows the Commissioner to test the application of Division 13 to historical arrangements within limitation. This once again calls for a practical approach for the resolution of transfer pricing disputes. As noted by the judges in *Glencore*[8]:

> "… the Court must take care not to make the task of compliance with Australia's transfer pricing laws an impossible burden when a revenue authority may, years after the controlled transaction was struck, find someone, somewhere, to disagree with a taxpayer's attempt to pay or receive arm's length consideration."

[8] *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187 (6 November 2020)

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