INSIGHTS

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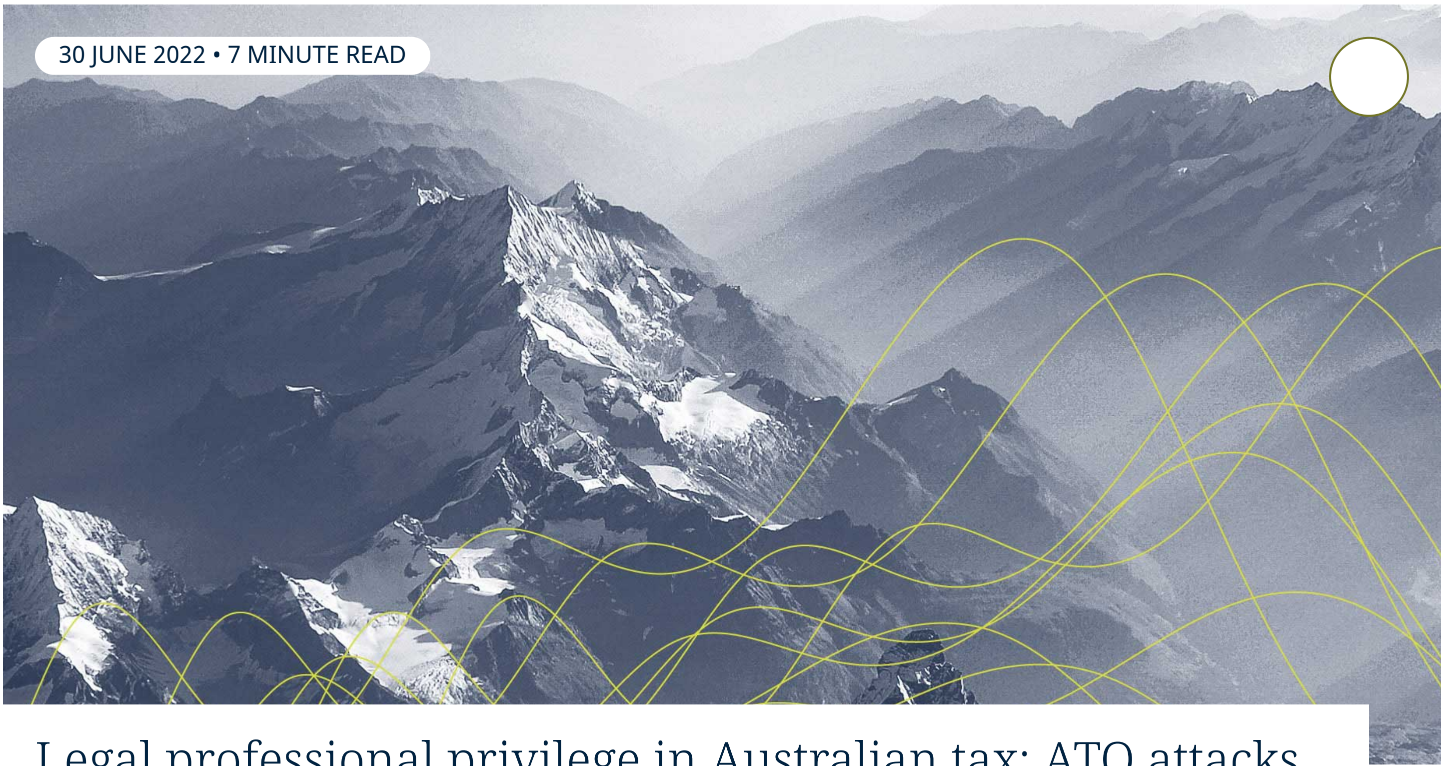

Legal professional privilege in Australian tax: ATO attacks Mylan debt push down

On the 22nd of June 2022, the ATO has released an updated version of its voluntary "protocol" for taxpayers who wish to claim legal professional privilege (LPP) when they are asked for certain documents. The ATO and professions have been working for at least 4 years to try to reduce disputes about whether legal professional privilege applies to documents sought by the ATO, especially those sought by statutory notices using coercive powers. It is believed the Law Council initially hoped that a joint protocol might be released, but the final document is that of the ATO.

The document is to be commended as helpful guidance, designed in consultation with the professions, which may avoid some disputes where the Commissioner pushes to see documents that a taxpayer says are privileged. It aims to explain to taxpayers the information which, the Commissioner says, may convince him that a claim is likely to be well founded, and convince him that disputing the claim is unlikely to be successful.

Taxpayers and their lawyers will need to work through it carefully and thoughtfully adopt those parts of it that are appropriate to their circumstances, in and effort to reduce disputes as far as possible.

It is, however, unlikely to prevent major disputes (especially with multidisciplinary practices "MDPs" where lawyers are in the minority, like the "Big 4" professional services firms) such as the two matters involving PricewaterhouseCoopers clients AB InBev and JBS meats (*CUB Australia Holding Pty Ltd v Commissioner of Taxation* [2021] FCAFC 171 and *Commissioner of Taxation v PricewaterhouseCoopers* [2022] FCA 278).

This is because the protocol really focusses on how to inform the ATO of the circumstances of a claim, rather than attempt to present a consensus on all the circumstances when privilege does or does not attach to a document. In particular the Commissioner clearly retains many of his original concerns about the risk that LPP may not attach to many communications in an MDP. Those were first publicly set out in the National Tax Liaison Committee meeting minutes of 30 November 2018. And many of the key points were raised in the PwC decision, where the Commissioner had considerable success. They are repeated from paragraph 11 of the protocol, and following paragraphs.`

It also does not preclude the Commissioner from demanding the information suggested by the protocol by way of a statutory notice, after a taxpayer has declined to participate in the voluntary protocol.

As a result, many extremely difficult issues remain for taxpayers and their advisors. For instance, one of the risks for clients and their lawyers in a privilege dispute with the ATO concerns the risk of prosecution for failing to produce a document in response to a section 353 TAA notice (a “statutory subpeona” as it might be referred to in some jurisdictions). If it is actually privileged, there is no offence. If it turns out later to actually not be privileged, is there a risk of prosecution. This consequence of the notice itself pressures the parties. This is one of the key differences in a privilege dispute involving regulators and one occurring in civil litigation. The Law Institute of Victoria has also suggested that in pressing for documents over which privilege is claimed, some parties believed that in their particular circumstances improper pressure to drop claims has been applied, and questions whether this could give rise to a breach (presumably argued to be committed by individual ATO officers) of the Legal Profession Uniform Law. The same risk exists for partners in firms who personally receive such notices, and who wish clients would simply waive their privilege claim. And who may be personally liable if the claims are not waived, but the privilege they advised a client may exist, in fact does not. It was interesting to see how these issues played out in the PwC matter.

Another extremely current issue which remains unresolved is the question of whether a finding that the “promotor penalty” provisions have been breached prevents a successful claim for privilege.

“DEBT PUSH DOWN” DISPUTE FOR VIATRIS GROUP IN AUSTRALIA

In February this year Mylan Australia Holdings Pty Ltd (now believed to be a subsidiary of the Viatris group, after a merger in 2020 of the Mylan group and the Upjohn division of Pfizer) filed an appeal in the Federal Court of Australia against tax assessments in Australia.

Financial information is not disclosed in the publicly available information available from the Court. But there is some information in the public domain that lets us get a sense of the possible scale of the dispute. The transaction in dispute, relates to Mylan Inc’s acquisition of the Merck group’s global generics business, Alphapharm in October 2007 for a total price globally of USD6.6bn.

In July 2007, the AFR estimated that Alphapharm controlled 40% of the Australian generic pharmaceuticals market. In its US8K filing in 1 November 2007, Mylan Inc identified the Australian generics market as having total sales of approximately USD800million in 2006 and said it had a market share of 60% in 2006. A 60% share of the 2006 market would be sales of USD480million. This would be approximately 18% of the sales of the total global Alphapharm generics business. If we use “percentage of sales” to apportion value, then the value attributed to the Australian business as a percentage of total price would be in the order of USD1.2bn. Assuming a standard debt/equity of 3:1 in 2007, then debt could have been US$904m. At end of 2007 the Cash Rate in Australia was 6.7% and the exchange rates during the period varied between about .75 and .85. Giving an annual interest bill in the order of AUD60m. Which would be a not insubstantial number.

Clearly the above valuation is simplistic and doesn’t acknowledge differences in regulatory regimes or profitability by jurisdiction. And the debt/equity ratio may have been different, the interest rate may have been higher or lower. But it seems likely we are talking a substantial amount in each year in dispute.

All of that interest bill, across several years (2007 and 2009 to 2013), is now in dispute under our General Anti Avoidance Rule, Part IVA. In addition there is a dispute under our transfer pricing provisions in relation to the same period and also the 2014.

The Commissioner’s opening position is that no interest should have been claimed, with fall back positions that a lower amount or an amount at a lower rate would have been borrowed.

What is surprising about the dispute is that it appears to relate to a “debt push down”. It is common, in a global acquisition, for the acquirer to wish to ensure that part of the total interest cost for the acquisition is reflected against the individual P&L’s of the subsidiaries in each market. This can be done in a number of ways. Capital or profits in the country subsidiaries may be transferred up the group, and that transfer may be funded by debt. Or assets may be transferred into the market (relevant entities for the market, or business assets in the market for instance) and paid for by the local entity raising debt. Australia has not had a history of attacking debt raised in this manner. In this case it appears that an Australian Mylan entity acquired an Australian Alphapharm entity from Merck KgaA. That acquisition step was at least party funded by debt.

In the Singtel case (*Singtel v C of T* [2021] FCA 1597, now on appeal to the Full Federal Court) the Commissioner did not attack the steps that introduced debt into Australia, but attacked the rate of interest charged.

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