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The Cameco Transfer Pricing Decision: A Victory for the Rule of Law And the Canadian Taxpayer

by Steve Suarez

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COMMENTARY & ANALYSIS

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The *Cameco* Transfer Pricing Decision: A Victory for the Rule of Law and the Canadian Taxpayer

by Steve Suarez

Steve Suarez

Steve Suarez is with Borden Ladner Gervais LLP in Toronto.

In this article, the author discusses *Cameco*, a long-awaited transfer pricing decision from the Tax Court of Canada that criticizes the Canada Revenue Agency's aggressive use of the sham doctrine and its strained interpretation of Canada's transfer pricing rules. The court opts to focus on the parties' actual actions and commercial realities, rather than advance a hypothetical alternative. The ruling is also consistent with Canadian precedent, which takes a notably different approach to transfer pricing than the OECD.

Table of Contents

I. **Facts** 878
A. The Cameco Group and the Uranium Market 879
B. The HEU Feed Agreement 880
C. The Urenco Agreement 880
D. The Cameco Group Reorganization . . 880
E. The Operation of CESA/CEL 882
F. Sales by Cameco to CESA/CEL 884
G. Sales by CESA/CEL to Cameco US . . . 885
H. The CC Contracts 885
II. **The Judgment** 885
A. Sham Transactions 886
B. Transfer Pricing 889
III. **Discussion** 892
A. Sham Transactions and the ITA 893
B. Transfer Pricing 898

On September 26 the Tax Court of Canada released its long-awaited transfer pricing decision in *Cameco Corporation v. The Queen*, 2018 TCC 195. The case involved the application of the transfer pricing rules contained in the Income Tax Act (Canada), rules that govern transactions between Canadian residents and non-arm's-length nonresidents. For example, the rules would apply to dealings between a Canadian subsidiary and a foreign parent company or vice versa. The *Cameco* case is almost certainly the most important Canadian judicial decision on taxes that has been — or will be — released in 2018.

In this case, Cameco Corporation, a Canadian taxpayer and one of the world's largest uranium producers, entered into long-term contracts to sell uranium to a European subsidiary and guaranteed long-term contracts that its European subsidiary entered into to purchase uranium from two non-Canadian third parties. After the parties entered into these supply contracts, the price of uranium rose significantly. The result was that profits from sales by the European subsidiary to customers outside Canada were realized largely in Switzerland rather than Canada.

The Canada Revenue Agency reassessed Cameco, attributing to Cameco the profits that its European subsidiary had earned and arguing before the Tax Court of Canada that the purchase and sales contracts involving the European subsidiary:

- were a "sham" that the court should simply look through; and
- did not meet the arm's-length standard in Canada's transfer pricing rules, thus allowing the CRA to either completely ignore the actual contracts or revise their terms to reflect what arm's-length parties would have agreed to.

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While the case before the court only involved Cameco's 2003, 2005, and 2006 tax years, the CRA also challenged the taxpayer's later years as well. Cameco estimated C $2.5 billion in taxes, interest, and penalties was potentially at stake for 2003 through 2017.

Following a 65-day trial featuring extensive evidence and numerous expert witnesses, Justice John R. Owen of the Tax Court of Canada found in favor of Cameco in a lengthy, detailed judgment spanning 293 pages. After examining all the evidence and reviewing the relevant legal principles, the Tax Court decisively rejected the Crown's arguments on both the sham and transfer pricing issues. It found no evidence that: (1) Cameco had tried to deceive the tax authorities; (2) the relevant transactions were anything other than what they appeared to be; or (3) the relevant transactions were commercially irrational or priced outside the range of what arm's-length persons would have agreed to under similar circumstances. In particular, the court found that the facts fell far short of what would be necessary to deem a transaction to be a sham. The Tax Court ordered the CRA to reassess accordingly: a complete and convincing win for the taxpayer.

The CRA has filed a notice of appeal before the Federal Court of Appeal, albeit only on transfer pricing grounds (the sham argument has been dropped). Unless reversed on appeal — which seems highly unlikely — the *Cameco* decision will serve as important guidance to taxpayers and tax authorities on transfer pricing in Canada. In particular, the decision represents a stern rebuke of both the CRA's aggressive use of the sham doctrine to reassess transactions that are legally effective and fully disclosed, and the tax authority's use of hindsight when assessing taxpayers' transfer pricing. Owen's ruling also stresses the importance of carefully defining the scope of the relevant transaction (or series of transactions) to which Canada's transfer pricing rules are to be applied. In particular, he cautions against using an overly broad scope that would make it difficult to find comparable third-party transactions — transactions that are at the heart of the arm's-length principle in Canada's transfer pricing rules. In considering for the first time the recharacterization rule element of Canada's transfer pricing legislation, the Court establishes "commercial irrationality" (objectively determined) as the applicable threshold. This ruling also makes clear that the arm's-length standard does not require members of a multinational enterprise to act as if they are completely independent entities. Normal collaborative MNE practices such as shared services, entity specialization, and the allocation of business opportunities within the MNE are perfectly acceptable if properly implemented and priced appropriately.

Finally, the *Cameco* decision is an important reminder that OECD pronouncements — including the transfer pricing guidelines emanating from the OECD's base erosion and profit-shifting project — are not the law in Canada. Thus, the Tax Court rejected the CRA's attempt to use the OECD's rules to shift profits away from the entity that bore the risk (the Swiss subsidiary) and toward the entity that the Crown alleged was managing the risk (Cameco). Post-*Cameco*, it seems likely that the courts will continue to apply Canada's transfer pricing rules based on the taxpayer's substantive legal relationships and the actual risks borne by different entities, rather than using the "value-creating activities" principles advanced in the OECD's latest transfer pricing guidelines. Taken as a whole, *Cameco* firmly reinforces the primacy in Canadian law of taxing on the basis the legal rights and obligations that a person has in fact created, even if they are tax-motivated, which are generally those expressed in the relevant documentation unless the facts show otherwise. Except in those rare instances when a specific provision of the ITA explicitly deems otherwise or transfer pricing transactions are found to be commercially irrational, Canada will tax taxpayers on the basis of what they have actually done as a matter of law — not something else the taxpayer could have done, not what a less sophisticated taxpayer might have done, not what the CRA thinks the taxpayer should have done, not what the OECD would do, and not something different that has a similar economic result.

I. Facts

In this case, the relevant transactions involved numerous parties (some arm's length, some non-arm's length) and occurred over several years. As

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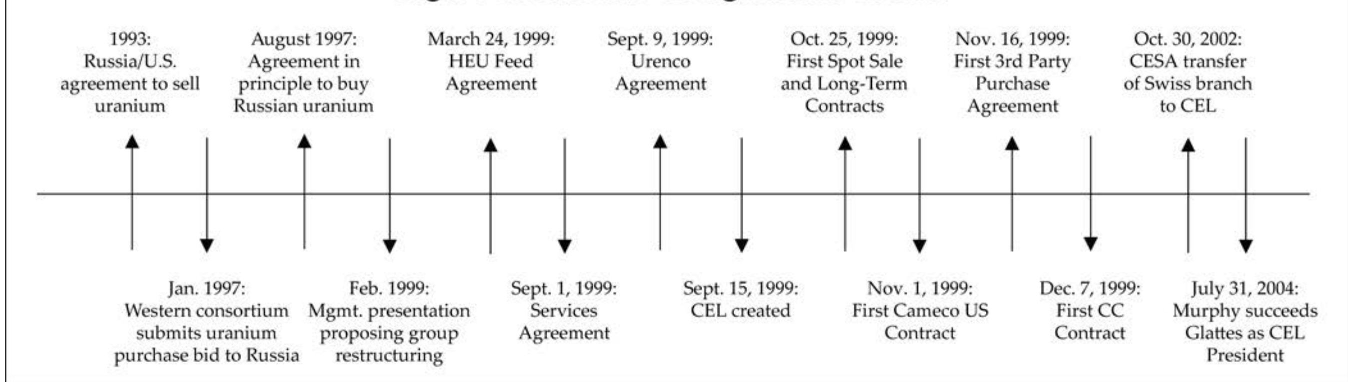

a result, the Tax Court spent quite some time identifying and describing the relevant transactions and how they interrelate. Figure 1 depicts a timeline of these significant events. While reading the factual summary, it may also be useful to consult Figure 2, which appears after the discussion of some of the initial facts, as it illustrates the various parties and the interrelated contracts that are all important to understanding the case and the judgment.

A. The Cameco Group and the Uranium Market

Cameco is a Canadian corporation engaged in exploring, developing, mining, and milling uranium ore to produce uranium concentrates (U_3O_8), which are either sold in that form or further refined and processed (that is, converted) into UO_3 (used in heavy water nuclear reactors) or, more commonly, UF_6 (used in light water nuclear reactors). Parties could contract separately for the conversion services to change U_3O_8 into UF_6, if they so desired.

The uranium market consists of producers, traders, and end-users (generally, nuclear power utilities). Uranium is not traded on a commodity exchange. Instead, it is bought and sold via bilateral contracts that are not publicly disclosed, although two companies did publish price indicators during the tax years at issue. The place of origin also affects the price of uranium. During the relevant period, uranium from some sources (for example, Russia) could not be sold to some markets or faced import quotas, while uranium from other sources (for example, Canada) could be sold without restriction.

Uranium contracts generally include the following key elements:

- term of the contract (that is, how long it runs);
- quantity of uranium purchased;
- degree of flexibility allowing the purchaser to change the quantity purchased;
- details of uranium delivery (place, method, notice, and so forth); and
- pricing and payment terms.

The Court heard expert testimony stating that reliability of supply and price are the two most important considerations for purchasers that are nuclear utilities (as opposed to traders in uranium).

Purchase contracts may be for "spot delivery" (delivery within 12 months) or "long-term delivery" (delivery beyond 12 months). Spot contracts are typically priced based on a fixed price agreed to at the time of the contract or market-related pricing. Pricing methodology on long-term contracts is more varied: It may involve a fixed price (with or without increases to account for inflation), a price based on future spot market indicative prices (that is, market-related pricing), or a combination of the two (that is, hybrid pricing).

During the relevant years, Cameco and its subsidiaries (collectively, the Cameco Group) had uranium mines in Canada and the United States. While historically Cameco focused its business activities in North America, by the mid-1990s the Cameco Group was pursuing opportunities elsewhere.

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B. The HEU Feed Agreement

A significant development occurred in the uranium market during the 1990s, after the dissolution of the USSR: The U.S. government reached an agreement with the export agency for the Russian state-owned nuclear entity (Tenex) for the sale of highly enriched uranium (HEU) that had been used in the Soviet nuclear arsenal. As a result, the potential for millions of pounds of additional uranium to be dumped onto the market created the risk of serious downward pressure on uranium prices.

In 1996 and 1997 Cameco explored the possibility of obtaining the HEU feed from Tenex, a stream that the Russian government needed to monetize and that Cameco, along with other producers, was concerned would push down uranium prices dramatically. Ultimately, in 1997 Tenex entered into an agreement in principle for Cameco's Barbados subsidiary and two entities unrelated to Cameco — Cogema and Nukem — to purchase HEU from Tenex. However, discussions between Tenex and a Cameco-led buyers' group about the terms of the arrangement continued for another 18 months, finally resulting in a formal agreement between Tenex and the Western consortium — that is, Cameco Europe SA (CESA),[1] Cogema, and Nukem — on March 24, 1999 (the HEU Feed Agreement). At Tenex's request, Cameco guaranteed CESA's obligations under the HEU Feed Agreement. Shortly thereafter, the president of CESA, Gerhard Glattes, secured the agreement of the European regulatory agency to allow the unrestricted sale of the uranium from the HEU feed to European utilities. The Western consortium members also concluded an administration agreement among themselves, appointing Cameco's primary U.S. subsidiary (Cameco US) to administer the HEU Feed Agreement in accordance with their instructions.

CESA entered into the HEU Feed Agreement largely as a defensive measure to prevent a decline in uranium prices in an already weak market. It expected the HEU Feed Agreement to be marginally profitable, in the order of 4 percent to 6 percent. In fact, during 2000 and 2001 the floor price under the HEU Feed Agreement was greater than the uranium market's spot price, leading the Western consortium to decline its purchase option for 2001. The parties' unhappiness with the situation led them to amend the HEU Feed Agreement — in exchange for lower pricing, the amendment required the Western consortium to exercise its purchase options for delivery of UF_6 in 2002 through 2013. The amendments also provided reduced pricing for 2001. A senior executive of Cameco led the negotiations of these revised terms. Glattes was involved in preliminary discussions to set out a framework for the negotiations and participated in meetings with Cogema and Nukem, as well as various discussions within the Cameco Group.

C. The Urenco Agreement

In September 1999 CESA entered into an agreement (the Urenco Agreement) to purchase UF_6 from Urenco, a uranium enricher that had previously struck a deal with Tenex to have the tails resulting from its enrichment activities re-enriched to the level of natural uranium. The purpose of the Urenco Agreement was to prevent Urenco from dumping the UF_6 into the market, further depressing prices, and potentially to profit from a subsequent sale of the material if and when prices improved.

Senior executives of Cameco US led the negotiations with Urenco, with Glattes involved in discussions regarding the agreement, related regulatory issues, and the development of the proposal to Urenco. Testimony established that Glattes had extensive knowledge of the uranium market generally and was well connected with European regulators and utilities, as well as with key personnel at Urenco.

D. The Cameco Group Reorganization

In 1999 a senior Cameco executive, O. Kim Goheen, suggested restructuring the activities of various members of the Cameco Group. According to testimony recorded in paragraph 109 of the Tax Court's judgment,[2] the change was

[1] A Luxembourg subsidiary with a Swiss branch that it would eventually transfer to Cameco Europe AG.

[2] Unless otherwise noted, all paragraph references are to paragraphs in the Tax Court's *Cameco* decision.

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largely a result of the expected supply of non-North American uranium from the HEU Feed Agreement and the desire for greater tax efficiency. The possibility of securing significant amounts of uranium from outside Canada created the potential for tax planning opportunities within the parameters of the ITA's rules involving foreign subsidiaries of Canadian taxpayers. Moreover, Cameco would not need the uranium to meet the needs of its Canadian customers.

In general terms, the Canadian tax system imputes some income — that is, foreign accrual property income — that controlled foreign affiliates (CFAs) of a Canadian taxpayer earn back to the Canadian taxpayer. FAPI is generally limited to: (1) passive income earned by the CFA; and (2) business income that the CFA earns that, despite being earned outside Canada, is sufficiently connected to Canada, so that it would erode the Canadian tax base unless the income was imputed back to the Canadian taxpayer, namely income:

- from the sale of property — including income from performing services as an agent for the purchase or sale of property — to the Canadian taxpayer, another non-arm's-length Canadian resident, or a non-arm's-length nonresident carrying on a Canadian business, subject to certain exceptions described below;
- from the insurance of Canadian risks;
- derived (directly or indirectly) from indebtedness and lease obligations of Canadian residents; and
- from the provision of services that are deductible in computing (i) the Canadian business income of the Canadian taxpayer (or another non-arm's-length person), or (ii) the FAPI of any foreign affiliate of the Canadian taxpayer or non-arm's-length person.[3]

The "sale of property" rule in section 95(2)(a.1) ITA is of particular interest since the government enacted it in response to a case in which the CRA (as in the *Cameco* case) unsuccessfully claimed that the taxpayer's arrangements constituted a sham: *Irving Oil Limited v. The Queen*, 88 DTC 6138 (FCTD), *aff'd* 91 DTC 5106 (FCA). In that case, the Canadian taxpayer acquired crude oil at market prices from a foreign affiliate that had purchased the oil at a materially lower cost, thereby leaving significant profits in the foreign affiliate. The Department of Finance responded by enacting section 95(2)(a.1) ITA, which provides explicit permissive exceptions for, *inter alia*:

- Sales of property manufactured, produced, grown, extracted, or processed in the selling foreign affiliate's home country.
- Sales of property by what is effectively an export sales foreign affiliate to nonresidents of Canada. The statute sets out various circumstances in which this exception applies:
  - When the Canadian taxpayer (or a non-arm's-length Canadian) manufactures, produces, grows, extracts, or processes the property in Canada.
  - When the Canadian taxpayer (or a non-arm's-length Canadian) purchases the property from an arm's-length vendor. For example, if Canco acquires the property from an arm's-length vendor and sells it to the export sales foreign affiliate to be sold on to nonresidents of Canada.
  - When the Canadian taxpayer (or a non-arm's-length Canadian) purchases the property from a vendor that is a foreign affiliate of such a purchaser, and the foreign affiliate manufactures, produces, grows, extracts, or processes the property in its home country. For example, if Canco acquires the property from Foreign Affiliate 1 and sells it to Foreign Affiliate 2 to be sold on to nonresidents of Canada.
- Certain intragroup toll manufacturing arrangements described in section 95(3.1) ITA.

The key point is that the statute explicitly describes the circumstances in which business income that a Canadian taxpayer's CFA earns should be simply imputed back to — and taxed in the hands of — that Canadian taxpayer. Outside

[3] *See* ITA sections 95(2)(a.1)-(a.4) and 95(2)(b). These and other elements of the Canadian foreign affiliate system are ably explained in Drew Morier and Raj Juneja, "Foreign Affiliates: An Updated Primer," in *Report of Proceedings of the Sixty-Fourth Tax Conference*, 2012 Canadian Tax Foundation Conference Report (2013).

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of those situations, it is clear that Parliament does not consider the use of a CFA to earn income that the Canadian taxpayer could otherwise earn directly to be objectionable or that the arrangement should be looked through. Instead, those arrangements are governed by Canada's transfer pricing rules on the basis of adherence to the arm's-length standard.

Against this backdrop, it is not surprising that a Canadian multinational would have carefully reviewed the ITA and concluded that no good reason existed to bring profits from the sale of goods sourced from outside Canada to customers outside Canada into the Canadian tax system. Paragraph 112 quotes Goheen's testimony about the HEU feed:

> It's equivalent over the life of it to about 80 million pounds for Cameco, which is a very substantial uranium mine. It had no connection to Canada. Why bring it here, subject that uranium to Canadian tax when it never was from Canada in the first place?

Further consideration of the matter indicated to Cameco that the Canadian tax system also specifically envisioned and permitted the use of a foreign sales affiliate to market Canadian-source uranium to nonresidents as long as the sale of that uranium by the Canadian taxpayer to its foreign sales affiliate occurred at fair market value. Again, in Goheen's words, quoted in paragraph 113:

> The driver there was that, under all circumstances, the uranium coming out of Canada to [the wholly owned offshore subsidiary] had to be sold across at fair market value. That was an absolute unviolatable [sic] principle.

Given these principles, the Cameco Group decided to segregate the different business activities into three primary group entities:

- Cameco, which would continue to mine uranium and carry out the head-office functions typical of a multinational group's parent corporation.
- Cameco US, which would act as the marketing arm of the Cameco Group, finding and negotiating sales contracts with arm's-length customers. The United States was a logical location for the group's sales force since, as reported in paragraph 114, "two-thirds of our customers are in the U.S."
- CESA, with the Swiss branch acting as the trader of the Cameco Group, buying and selling uranium and carrying the risk of profit and loss on its inventory. In October 2002, as described in paragraph 132, CESA transferred all the assets and liabilities of its Swiss branch to Cameco Europe AG, a Swiss subsidiary of Cameco incorporated on September 15, 1999 (CEL). Thereafter, CEL carried on the activities previously undertaken by CESA.[4]

Thus, as Goheen explains in paragraph 115, the three main functions of the trading role that CESA/CEL undertook involved understanding the uranium market, deciding when to buy and sell uranium (and on what terms), and entering into contracts to fulfill those purchases and sales.

To implement this reorganization, the group incorporated CESA in Luxembourg during March 1999, and Cameco's board of directors approved the reorganization on April 30, 1999. The Cameco board understood that any resulting tax savings would occur only if uranium prices rose — thus, the plan did entail business risk that could result in CESA/CEL experiencing losses rather than gains in a lower-tax jurisdiction. If prices fell, CESA/CEL would incur the ensuing losses, which would result in Cameco overpaying its tax in Canada relative to what would have been the case if CESA/CEL had not existed. Cameco's board understood and accepted this risk.

E. The Operation of CESA/CEL

CESA/CEL effectively had one full-time employee: Glattes. He retired in July 2004, and William Murphy succeeded him as president and chairman. Both men were extremely knowledgeable about the uranium market, and their primary duties involved making decisions about when and on what terms to buy and sell uranium (roughly 20-25 contracts per year according to paragraph 135). CESA/CEL benefited from on-site administrative services

[4] The term "CESA/CEL" refers to CESA before this transfer and to CEL thereafter.

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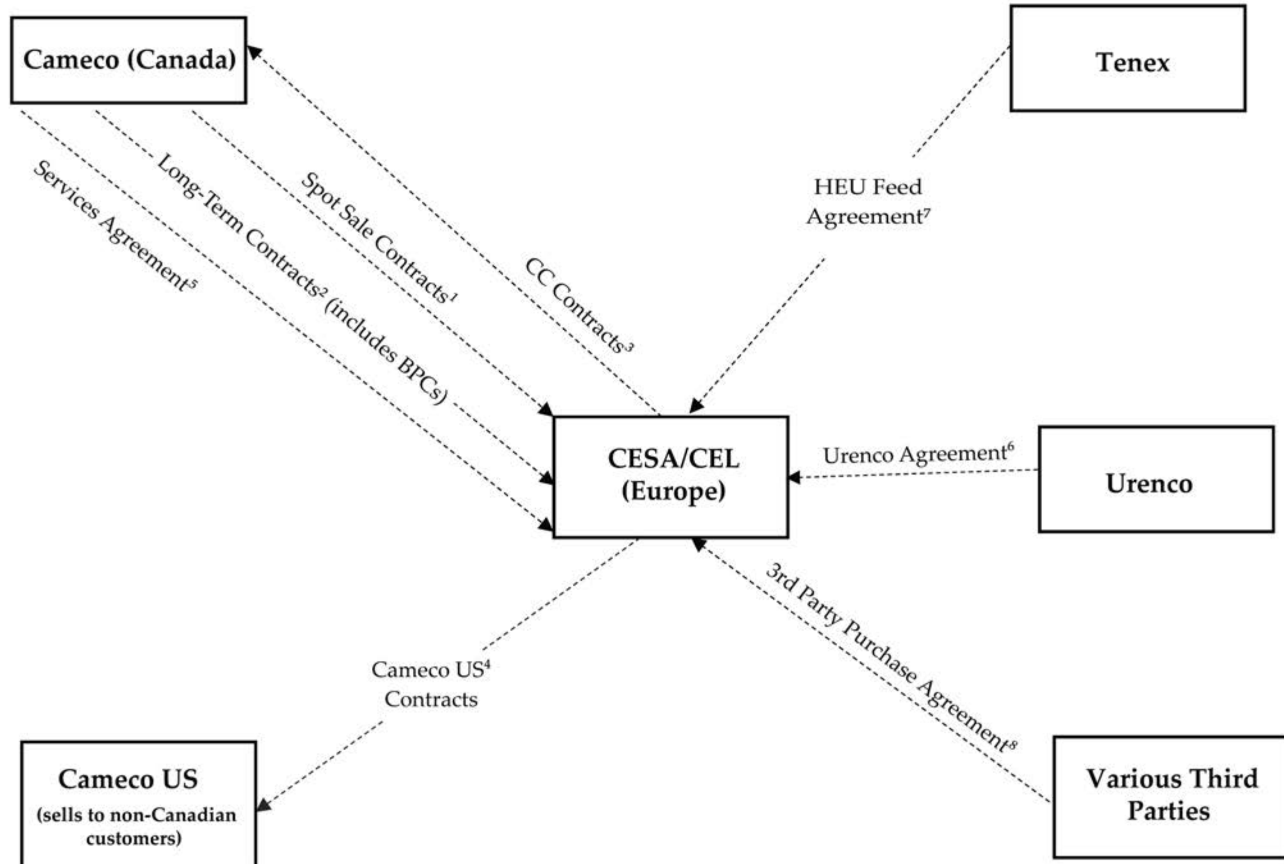
Figure 2. Summary of Key Contracts



[1]Ten Spot Sales contracts between October 25, 1999, and November 22, 2002, for sale of uranium by Cameco to CESA/CEL (para. 227).

[2]Thirteen long-term agreements between October 25, 1999, to August 20, 2004, for sale of uranium by Cameco to CESA/CEL; nine of these (the BPCs) provide for deliveries during tax years (para. 234).

[3]Twenty-two agreements between December 7, 1999, and December 6, 2006, for sale of uranium by CESA/CEL to Cameco (para. 317).

[4]Ninety agreements between November 1, 1999, to December 15, 2006, for sale of uranium by CESA/CEL to Cameco US (para. 301).

[5]Agreement effective September 1, 1999, for Cameco to provide back-office and administrative services to CESA/CEL (para. 170).

[6]Agreement of September 9, 1999, for CESA to purchase Russian-source UF6 from Urenco (uranium enricher); guaranteed by Cameco (para. 89).

[7]Agreement of March 24, 1999, for purchase of highly-enriched uranium (HEU) by Western consortium (including CESA/CEL) from Russian nuclear authority (Tenex); guaranteed by Cameco (para. 53).

[8]Forty-three agreements between November 16, 1991, and July 15, 2006, for purchase of uranium by CESA/CEL from third parties (para. 327).

provided by a third-party trust company (one of its employees eventually became an employee of CESA/CEL) and retained two other third-party consultants for specific projects.

CESA/CEL also received substantial back-office and administrative services from Cameco under a services agreement entered into effective September 1, 1999, although the parties actually signed it later since they were still negotiating the contract language. Under the terms of this agreement (the services agreement) and as the court recounts in paragraphs 175 and 176, Cameco agreed to do the following for CESA/CEL:

- provide assistance administering CESA/CEL's contracts, which included monitoring adherence to contract terms, ensuring that products and services were delivered to customers, obtaining necessary regulatory approvals, maintaining inventory balances,

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assistance in drafting legal agreements, and ensuring timely and accurate invoicing and collections;
- assist with market forecasting and research;
- provide legal services on contract matters, under the direction of CESA/CEL;
- assist with human resource matters including employee placement services — up to, but not including, the hiring decision — at CESA/CEL's request;
- prepare monthly payroll and related information reports to satisfy compliance requirements;
- prepare and maintain all customary financial and accounting books in the appropriate form and with sufficient detail to support an annual independent audit of the financial condition of CESA/CEL, in accordance with instructions that CESA/CEL provided;
- make books and records available to audit and answering questions regarding the same;
- use accounting records to calculate the fees and expenses of the supervisory directors in connection with attending meetings, non-Canadian taxes, non-Canadian filing fees, and other costs or expenses incurred on behalf of CESA/CEL; and
- prepare quarterly and annual financial statements for CESA/CEL.

Critically, after listing the covered services, the services agreement specifically states that Cameco's services "shall not include the conclusion of any contractual terms on behalf of [CESA/CEL]."

While Cameco's contract administrators performed routine services under the services agreement, the parties were fairly diligent in ensuring that final decisions about purchasing and selling uranium were made by CESA/CEL's president and that this individual in fact executed the related contracts.[5] CESA/CEL was financed largely by another Cameco subsidiary based in Ireland.

As part of its role as the marketing arm of the Cameco Group, Cameco US held twice-weekly sales meetings to discuss matters involving the marketing, purchase, and sale of uranium. Glattes and Murphy attended by phone when their schedules permitted. Glattes and Murphy also actively participated in monthly strategy meetings for senior members of the Cameco Group to discuss market directions and potential opportunities, usually by phone but sometimes in person.

F. Sales by Cameco to CESA/CEL

Shortly after the formation of CESA in 1999, Cameco considered selling both its existing uranium inventory and its uncommitted future production (except uranium that Cameco's Canadian customers needed) to CESA/CEL. The parties effectuated the sale of existing inventory through a series of 10 spot sale contracts dating from October 25, 1999, through November 22, 2002 (the spot sale contracts, referenced in paragraph 227). The parties completed all deliveries under these contracts by the end of 2002.

The sale of Cameco's uncommitted uranium production involved a series of 13 long-term contracts entered into between October 25, 1999, and August 20, 2004 (the long-term contracts, referenced in paragraph 234). Nine of these contracts (the BPCs) provided for delivery within the tax years. The parties negotiated and settled the terms of those contracts during Cameco Group sales meetings. Pricing under the BPCs varied from contract to contract: One contract used a fixed price; four used base-escalated pricing; two relied on market-based pricing; and the final two involved hybrid pricing. The contract terms provided for delivery from 2001 through 2008, with an option to extend for one to three years. CESA/CEL also had the option to acquire increased or decreased amounts of uranium representing up to 20 percent to 30 percent of the contract volume in each year (flex options).

As a result of flood-related production difficulties at one of Cameco's Canadian mines in 2003 that reduced its ability to produce uranium

[5] In contrast, the Tax Court heard evidence that the parties applied somewhat less rigor regarding the timely administration of subsidiary documentation (such as delivery notices). However, in paragraph 385, the Tax Court ultimately determined those problems were of little practical impact on the issues before it.

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and delays in starting up another mine, the parties amended eight of the nine BPCs in 2004 and again in 2007 following extended negotiations. These amendments deferred the expiry date of these eight contracts by between two to five years, causing CESA/CEL to receive the same quantities in later years (and, hopefully, at a time of higher spot prices) under the same pricing formula. To some extent, CESA/CEL dealt with the shortfall in production and delivery of Canadian uranium by drawing down its existing inventories and keeping its regular inventory on hand at lower levels (that is, a four-month forward supply rather than six), and in part by Cameco US negotiating corresponding deferrals for its customer contracts.

G. Sales by CESA/CEL to Cameco US

Between November 1, 1999, and December 15, 2006, CESA/CEL entered into 90 agreements to sell uranium to Cameco US (the Cameco US contracts, referenced in paragraph 301). Each of these contracts mirrored a contract that Cameco US had with an arm's-length customer, except that Cameco US purchased uranium at 98 percent of the price to be paid by the arm's-length customer. Cameco US was effectively compensated for its marketing services with a 2 percent commission.

CESA/CEL was essentially Cameco US's sole supplier. Thus, for obvious reasons, Cameco US would not put a proposal in front of a customer unless CESA/CEL had agreed to sell on those terms. The process between CESA/CEL and Cameco US was described as "very collaborative," as would be expected between the group's trading and marketing arms. Glattes and Murphy participated in Cameco US sales meetings at which proposals for Cameco US's customers were discussed. CESA/CEL would, of course, have to manage its inventory of uranium to be able to decide when and on what terms it could undertake to support a sale to the customers with whom Cameco US was negotiating.

During the relevant tax years — that is, 2003, 2005, and 2006 — CESA/CEL acquired uranium from various sources:

- from Cameco in accordance with the spot sale contracts and long-term contracts;
- from Urenco in accordance with the Urenco Agreement;
- from Tenex in accordance with the HEU Feed Agreement; and
- from various third parties under 43 contracts that CESA/CEL entered into between November 16, 1999, and July 16, 2006 (the third-party purchase agreements).

H. The CC Contracts

Between December 7, 1999, and December 6, 2006, CESA/CEL entered into 22 agreements to sell uranium to Cameco (the CC contracts, referenced in paragraph 317). The terms of these contracts were negotiated at Cameco Group sales meetings. These contracts were largely discontinued after 2004, and thereafter the parties amended existing contracts to provide only for the conversion of uranium rather than sales to avoid creating FAPI.

II. The Judgment

The relevant legal questions before the court were as follows:

1. Was the uranium trading business carried on by CESA/CEL in fact a sham, such as would entitle the CRA to ignore the existence of CESA/CEL and simply attribute its profits to Cameco?

2. Did the transfer pricing recharacterization rule (TPRR) in section 247(2)(b) ITA apply to CESA/CEL's uranium business? If so, was the result that the CRA could reallocate all the profits actually earned by CESA/CEL to Cameco? The TPRR applies when a Canadian taxpayer (here, Cameco) and a non-arm's-length nonresident (here, CESA/CEL) participate in a transaction or a series of transactions that:

   (i) parties dealing at arm's-length would not have entered into; and

   (ii) can reasonably be considered to not have been entered into for any primary bona fide purposes other than to obtain a tax benefit?

3. If the TPRR did not apply, did the more general transfer pricing rule (GTPR) in section 247(2)(a) ITA apply to CESA/CEL's uranium business? If so, was the result

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that the CRA could reallocate all the profits actually earned by CESA/CEL to Cameco? The GTPR applies when a Canadian taxpayer (here, Cameco) and a non-arm's-length nonresident (here, CESA/CEL) participate in a transaction or a series of transactions and the terms or conditions made or imposed between any of the participants differ from those that would have been made between persons dealing at arm's length.

A. Sham Transactions

In *Cameco*, the Crown took the position that an MNE setting up a new business in a foreign subsidiary must:

- in fact transfer significant functions and activities relating to the business to that foreign subsidiary for it to perform, not just have the foreign subsidiary sign the relevant contracts; and
- ensure that any transfer of goods and services to the foreign subsidiary occurs on an arm's-length basis.

In the Crown's view, CESA/CEL's purported uranium trading business was a sham because the transactions it undertook were — and were known by Cameco to be — presented in a manner other than what they truly were. In particular, the Crown asserted that Cameco itself continued to perform all important functions and make all strategic decisions regarding CESA/CEL's uranium trading business, with CESA/CEL simply rubber-stamping the agreements.

For its part, Cameco's position was that CESA/CEL generated its profits from its own bona fide uranium trading activities in accordance with legally effective, commercially normal contracts that were, in fact, exactly what they purported to be on their face. As such, Cameco asserted that there was no deception or sham.

The Court began its analysis on this issue by citing the classic legal definition of a "sham" from English jurisprudence:

> It means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.[6]

Canadian courts have adopted this definition and, as in *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298, interpreted it to require "an element of deceit in the way the transaction was either constructed or conducted."

Justice Owen also cites *Antle v. The Queen*, 2010 FCA 280 — one of relatively few cases in which the CRA successfully applied the sham doctrine — to offer an example of when a Canadian court has found a sham existed. In that case, the court found that a trust deed between the taxpayer and a trustee purporting to give the trustee discretion to act as he saw fit with the trust property was, in fact, a sham because both parties "knew with absolute certainty that the [trustee] had no discretion or control over the [trust property, yet] both signed a document saying the opposite."

In paragraph 598 of the *Cameco* ruling, Justice Owen states:

> As observed in *Continental Bank*, the factual presentation of the legal rights and obligations of parties to a transaction is not the same as the legal characterization of that transaction. Consequently, a sham does not exist if the parties present the legal rights and obligations to the outside world in a factually accurate manner (i.e., in a manner that reflects the true intentions of the parties) but identify the legal character of the transaction incorrectly. For example, calling a contract a lease when its actual legal effect is a sale is not evidence of a sham provided the terms and conditions of the contract accurately reflect the legal rights and obligations intended by the parties.

In this regard, the court observed that whether or not the transactions in question were tax motivated is irrelevant, as it is settled law in Canada that "taxpayers are entitled to arrange their affairs for the sole purpose of achieving a favourable position regarding taxation and no distinction is to be made in the application of this

[6] *Snook v. London & West Riding Investments, Ltd.*, [1967] 1 All E.R. 518.

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principle between arm's length and non-arm's length transactions."[7]

Against this backdrop, it is evident that the standard for successfully asserting the existence of a sham is very high indeed. The court quickly concluded that it was not a close call given the facts at hand (paragraphs 603-604):

> In my view, the [Crown]'s position reflects a fundamental misunderstanding of the concept of sham. I have heard no evidence to suggest that the written terms and conditions of the many contracts entered into by [Cameco], Cameco US and CESA/CEL between 1999 and the end of 2006 do not reflect the true intentions of the parties to those contracts, or that the contracts presented the resulting transactions in a manner different from what the parties knew the transactions to be.
>
> Quite the contrary, I find as a fact that [Cameco], Cameco US and CESA/CEL entered into numerous contracts to create the very legal relationships described by those contracts. The arrangements created by the contracts were not a façade but were the legal foundation of the implementation of the Appellant's tax plan.

In a diligent and thoughtful analysis, the Tax Court ruling sets out the key elements in support of its finding that no sham existed:[8]

- The evidence overwhelmingly supported the finding that CESA/CEL in fact bought and sold the uranium described in the purchase and sale contracts.
- CESA/CEL was validly created and fiscally resident in its home country. It had a properly constituted and functioning board of directors that, in fact, met regularly to perform board functions. That the transactions in question happened to be in the best interests of the Cameco Group as a whole did not detract from these points. "No reasonable person would expect a wholly owned subsidiary to act in a manner that is at odds with the interests of the ultimate parent corporation or of the broader corporate group."
- Given how highly regulated uranium transactions are — and that CESA/CEL obtained the required authorizations from Swiss and European nuclear regulatory authorities — it is inconceivable that the authorities would have permitted fictitious transactions.
- At all times, CESA/CEL had at least one employee with extensive uranium industry experience who was well qualified to carry out the essential elements of a uranium trading business. This was sufficient to address the number of purchase and sale contracts executed. In other word, CESA/CEL itself had the resources required to trade uranium.[9]
- Glattes and Murphy "were both experienced participants in the uranium industry and in my view clearly had the knowledge and experience to understand and participate in the sales meetings, and to meaningfully contribute to those meetings," and "did not act as mere figureheads who simply followed the explicit directions of [Cameco]."
- CESA/CEL's employees, not Cameco, did in fact make the actual decisions as to when and on what terms to buy and sell uranium — the key elements of CESA/CEL's uranium trading business. The services agreement explicitly stated that concluding contracts on behalf of CESA/CEL was outside the scope of the services Cameco provided.
- The twice-weekly sales meetings in which Glattes and Murphy usually participated were a reasonable way of ensuring that all members of the Cameco Group were working together in a mutually beneficial manner. The collaborative decision-making process, commercial integration, and

[7] Para. 599 (quoting the Supreme Court of Canada in *Neuman v. Minister of National Revenue*, [1998] 1 S.C.R. 770).

[8] *See* paras. 604-622.

[9] Justice Owen noted that this distinguished these facts from those in *Dominion Bridge Co. v. Canada*, [1975] F.C.J. No. 316 (QL) (FCTD), which the Crown cited on the sham issue. In paragraph 669, Justice Owen described the earlier case as involving a foreign corporation that "was literally an empty shell corporation, and its parent corporation, which was its only client, directed, controlled and carried out all its activities."

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centralized/shared administrative services were typical of MNEs (as expert evidence attested) and in no way indicative of a sham; and

- While CESA/CEL outsourced various elements of its business to third parties — most notably Cameco under the services agreement:

  Canadian law has long recognized that a corporation may undertake activities through its own employees or through independent contractors acting on its behalf," and "[t]here is no evidence to support the conclusion that the Appellant was performing the services for its own account rather than for the benefit of CESA/CEL.

The court found that, as a general rule, the parties to the various contracts (including those between members of the Cameco Group) did act in a manner consistent with their terms. However, there were irregularities in some documentation and cases in which officers of Cameco or Cameco US had taken the lead in negotiating contract terms with third parties. It was on these that the Crown rested its hopes of convincing the court to deem the arrangement a sham.

The court reviewed these instances and found as follows:

- The parties did not sign the services agreement until 2001 and did not pay fees thereunder until the same year, even though Cameco provided the services in question during 1999 and 2000. The court accepted Glattes' explanation that between the time of his initial request for services and Cameco's initial proposal to provide them in August or September 1999 and the time the parties actually signed the final version of the services agreement in 2001, CESA/CEL and Cameco were settling the terms of the agreement.
- In a few instances, Cameco personnel administering CESA/CEL's contracts under the services agreement overstepped the bounds of their authority. The court observed that these were exceptions, and no one in authority condoned or tolerated these transgressions.
- On "a few occasions," the date on CESA/CEL contracts did not reflect the actual date of signature. The court determined that there were explainable reasons for these instances, such as a time lag between the legal agreement and the documentation evidencing it or people being unavailable to sign on the effective date because of being in transit. The court thus concluded that they did not indicate any intent to deceive.
- Personnel administering CESA/CEL's contracts frequently backdated various notices (for example, delivery notices) referred to in the contracts. The court found that these notices had no practical effect beyond redundantly papering events largely dictated by Cameco US's customers on which nothing turned. Again, the court held these did not evidence any intent to deceive, but rather the failure of the contract administrators to follow set instructions and procedures.
- In some instances, contract administrators issued notices involving flex options late or backdated the documents. Witnesses explained that these were (again) situations when the company made the actual decision to exercise in a timely manner, but preparation was untimely. The court heard further evidence that these notices were not particularly important, amounting to the contract administrators formally notifying themselves. While there was evidence of "carelessness or incompetence" on the part of the contract administrators, the evidence did not show any intention on the part of Cameco to deceive.

Ultimately, the Court concluded that "the *de minimis* examples" put forward by the CRA did not support a finding of sham or suggest that Cameco routinely concluded contracts on behalf of CESA/CEL and treated CESA/CEL's inventory as its own.[10]

[10] *See* para. 616. Stated the Court:
I am not aware of any principle that states that the chief executive officer of the parent of a multinational group of corporations is precluded from holding high-level discussions on behalf of members of the multinational group.

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As such, the Court soundly rejected the CRA's assertion of a "sham":[11]

> [631] As in *Stubart*, the parties to the transactions in issue in these appeals, by their various agreements, created precisely the legal relations that they wished to create and presented those relations to the Minister for a determination of the tax consequence according to the law, including the transfer pricing provisions in the ITA.

B. Transfer Pricing

Next, the court turned to analyze the potential application of section 247(2) ITA, Canada's transfer pricing rules. As noted earlier, the CRA's primary argument was that the TPRR in section 247(2)(b) applied. Specifically, the CRA contended that: (1) the relevant transaction or series of transactions would not have been entered into by arm's-length parties; and (2) can reasonably be considered *not* to have been entered into primarily for bona fide reasons other than to obtain a tax benefit. Justice Owen observed that this case marked the first judicial interpretation of the TPRR.

1. The Relevant Transaction or Series

Both the TPRR and the GTPR (that is, section 247(2)(a) ITA) require the court to define a transaction or series of transactions in which the taxpayer and one or more non-arm's-length nonresidents participated. It is this relevant transaction or series that the court will test either transfer pricing rule against. As such, defining that "relevant transaction or series" is critically important, since it frames the scope of the analysis regarding whether arm's-length persons would have entered into the transaction or series.

The Crown took the broadest interpretation of the relevant transaction or series possible arguing that *all* of the transactions that Cameco and CESA/CEL entered into from the reorganization onwards were part of a single series of transactions, which was the relevant series to be tested. It contended that arm's-length persons would not have entered into that single series of transactions and that the series was not "commercially rational." The result, in its view, was that the TPRR applied and permitted the CRA to disregard CESA/CEL entirely and tax all its profits in Cameco's hands.

Justice Owen concluded that interpreting the relevant transaction or series so broadly was incompatible with the essence of the arm's-length principle inherent in both the Canadian transfer pricing rules and their OECD counterpart, which seek to determine what members of an MNE would do if they were independent entities by identifying reasonably comparable transactions involving arm's-length parties and comparing the two. Specifically, at paragraphs 704 and 705:

> To allow for a meaningful comparative or substitutive analysis, the transaction or the series identified in the preamble must be susceptible of such an analysis. An overly broad series renders the analysis required by the transfer pricing rules impractical or even impossible by unduly narrowing (possibly to zero) the set of comparable circumstances and substitutable terms and conditions.
>
> The series identified by the [Crown] includes a wide range of transactions, some of which are between a taxpayer and a non-arm's length non-resident (e.g., [Cameco] and CESA/CEL), some of which are between non-resident persons dealing at arm's length (e.g., CESA/CEL and Tenex and CESA/CEL and Urenco) and some of which are between non-arm's length non-residents that are not taxpayers (e.g., CESA/CEL and Cameco US and CESA/CEL and [other U.S. subsidiaries of Cameco]). How does one apply the analysis required by the transfer pricing rules to such a series?

Instead, Justice Owen identified two transactions and two series of transactions to test in accordance with the transfer pricing rules in section 247:

[11] Further at para. 670:
In summary, I find as a fact that [Cameco], Cameco US and CESA/CEL did not factually represent the numerous legal arrangements that they entered into in a manner different from what they knew those arrangements to be, nor did they factually represent the transactions created by those arrangements in a manner different from what they knew those arrangements to be, consequently, the element of deceit required to find sham is simply not present.

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- the BPCs between Cameco and CESA/CEL;
- the CC contracts;
- the series of transactions including the incorporation of CESA, the designation of CESA as the Cameco Group signatory for the HEU Feed Agreement, CESA's execution of the HEU Feed Agreement, and Cameco's guarantee of CESA's obligations thereunder (collectively, the Tenex Series); and
- the series of transactions including the incorporation of CESA, the designation of CESA as the Cameco Group signatory for the Urenco Agreement, CESA's execution of the Urenco Agreement, and Cameco's guarantee of CESA's obligations thereunder (collectively, the Urenco Series).

2. The TPRR

The *Cameco* decision notes that the TPRR rests on an implicit assumption that non-arm's-length parties might choose to enter into transactions (or a series thereof) that arm's-length parties would not. This commercial reality frequently has little or nothing to do with tax avoidance: It is simply a feature of how MNEs rationally operate.

In paragraphs 714 and 715, Justice Owen presents the TPRR as a test of "commercial rationality" that asks: Taking into account all relevant circumstances and determined objectively, would arm's-length parties acting in a commercially rational manner have entered into the transaction or series at issue? If so, then the TPRR rule cannot apply; if not, then the TPRR will apply if the entering into of the relevant transaction or series can reasonably be considered not to have been entered into for bona fide purposes other than to obtain a tax benefit.

As to the Tenex series and the Urenco series, the court considered whether it was commercially rational for Cameco to have given up the business opportunity of entering into the HEU Feed Agreement and the Urenco Agreement itself. The court cited evidence from Cameco's experts to conclude that the answer was yes, as long as Cameco was fairly compensated for doing so. The court also noted that Canada's foreign affiliate regime specifically envisions Canadian taxpayers setting up subsidiaries in foreign countries to conduct businesses there, with the purpose being to allow Canadian multinationals to compete in international markets via the foreign subsidiaries without attracting Canadian tax (beyond FAPI).

Therefore, the court found it eminently reasonable to infer that the ITA intends to allow Canadian parent corporations to direct foreign business opportunities to foreign subsidiaries. Justice Owen went so far as to characterize this use of subsidiaries as "a core function of the parent of a multinational enterprise" (paragraph 722). There was nothing exceptional, unusual, or inappropriate about Cameco incorporating CESA and having it execute both the HEU Feed Agreement and the Urenco Agreement. Thus, the Tax Court found that the TPRR did not apply to the Tenex Series or the Urenco Series.

Turning to the BPCs, the court found that the terms and conditions of Cameco's sale of uranium to CESA/CEL under these agreements were, as noted in paragraph 734, "generally consistent with practices in the uranium industry." Similarly, nothing about the terms and conditions of the CC contracts was inconsistent with what would be found in arm's-length sales. As such, these contracts were all commercially rational, and the TPRR could not apply to them either.

Although he concluded that the TPRR did not apply without needing to consider the purpose test — that is, the "commercial irrationality" factor alone sufficed to render the TPRR inapplicable — Justice Owen nonetheless commented on whether the purpose test would have been met. While he found that the purpose of the Tenex Series and the Urenco Series was to avoid the tax that would have been payable if Cameco itself entered into the HEU Feed Agreement and the Urenco Agreement, the BPCs and the CC contracts were a different matter. The court found that the parties carried out the BPC and CC transactions for the bona fide purpose of earning a profit.

3. The GTPR

Applying the GTPR to the relevant transactions or series, Justice Owen framed the questions before him as:

- As to the Tenex series and the Urenco series, would an arm's-length person in the same position as Cameco have attributed value to the business opportunity that these transactions made available to CESA/CEL?

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- As to the BPCs and the CC contracts, did their pricing come within the range of what arm's-length parties would pay or be paid in light of all the circumstances?

In answering both questions, the court referenced the voluminous expert evidence that both parties put before it.

Justice Owen found Cameco's primary expert, Thomas Horst, had performed an appropriate transfer pricing analysis consistent with Canadian jurisprudence and the 1995 OECD guidelines. Horst determined that the comparable uncontrolled price method was the most reliable method for determining arm's-length prices.[12]

Other experts put forward by Cameco, Atulya Sarin and Alan Shapiro, supported Horst's approach. They concluded that the substantial price risks that CESA/CEL bore in terms of fluctuations in the price of uranium supported Horst's analysis (paragraphs 439-447).

In contrast, the court made a number of adverse findings regarding the evidence that the CRA's primary expert witnesses, Anthony Barbera and Deloris Wright offered. As set forth in paragraphs 757 et seq., the court found that:

- They did not undertake the transfer pricing analysis required by traditional transfer pricing rules.
- They unduly based their expert evidence on hindsight, thereby improperly focusing on the profit or loss that ultimately resulted from the relevant transactions or series, instead of the situation at the time of the agreements.
- Their expert evidence was tainted by reliance on the subjective views of Cameco and Tenex at the time the parties entered into the relevant transactions or series, rather than objective benchmarks.
- Barbera's analysis essentially replaced the legal substance of the actual transactions with notional transactions in which Cameco bore all the risk associated with the uranium that CESA/CEL actually purchased and sold.
- Barbera's reasons for excluding the HEU Feed Agreement as a comparable were based on "pure speculation."
- Wright's analysis of hypothetical scenarios involving the performance of various functions failed to recognize the economic significance of the core marketing and buy/sell functions that Cameco US and CESA/CEL performed, as opposed to the relatively low-value functions performed by Cameco. Further, Wright's analysis did not produce any actual transfer prices, and thus were of no practical value when considering the GTPR.
- Similarly, Barbera's calculations could not be reconciled with the quantitative adjustments in the Crown's pleadings. Thus, in substance, they were relevant only to the TPRR analysis, not the GTPR issue.

Turning specifically to the Tenex series and the Urenco series, the court reviewed the conflicting expert evidence and said that, because the HEU Feed Agreement and the Urenco Agreement were arm's-length agreements, they should be assumed to have no inherent value upon execution. Paragraph 773 explains:

> In the case of an arm's length bilateral agreement to purchase and sell a commodity with a market-determined value, absent evidence to the contrary, it is reasonable to assume that at the inception of the agreement the consideration agreed to be given by one of the parties to the agreement is equal to the consideration agreed to be given by the other party to the agreement. Otherwise, one party would be transferring value to the other party for no consideration, which is inconsistent with the behaviour of persons dealing at arm's length.

Justice Owen accepted the expert evidence that Shapiro and Sarin presented, namely, that although these agreements eventually became quite valuable, the value resulted from increases in uranium prices that occurred after the execution of these agreements — an event the parties could not have known would occur. The

[12] Paras. 410 and 754. Horst also used the resale price method to test the reasonableness of the CUP method's results. The Tax Court noted that the OECD's most recent work on transfer pricing in the BEPS initiative deemed this an appropriate method for determining an arm's-length pricing for commodities.

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downside price risk that CESA/CEL took on when signing the contracts justified the upside that it enjoyed when prices eventually rose. For this reason, the court held that no pricing adjustment under the GTPR was warranted.

Next, the court turned to the BPCs. The Crown's expert (Barbera) concluded these should be priced on a cost-plus basis — a method that Cameco's experts, Shapiro and Sarin, characterized as the equivalent of treating CESA/CEL as a risk-free distributor. Once again, Justice Owen found the Crown's expert witnesses unconvincing:

- A number of the contracts that Barbera used as comparables effectively constituted the use of hindsight.
- Barbera's valuation analysis relied on Cameco's subjective price forecasts, which are not objective pricing benchmarks that can support a transfer pricing analysis.
- CESA/CEL clearly bore virtually all the risk that uranium prices might fluctuate, and thereby also bore the resulting risk of profit and loss associated with the legal obligation to buy and sell a commodity when it had no control over the price.
- While Cameco provided market forecasting, research, and administrative services in its capacity as a service provider under the services agreement — and received a fee that the CRA had not challenged — the value of those services could not possibly support the CRA's proposal to shift all of CESA/CEL's profit to Cameco.

That Cameco had in fact incurred losses was not evidence of non-arm's-length pricing in and of itself (particularly in the case of a commodity), and the evidence did not show that Cameco knew at the time it entered into the BPCs that losses would eventually occur.

The court also rejected the Crown's contention that Cameco unilaterally made decisions regarding when CESA/CEL would buy or sell uranium. This conclusion was not changed by the presence of a collaborative decision-making process, which Cameco's corporate governance expert, Carol Hansell, said was typical and normal within an MNE.

As such, Justice Owen accepted Horst's CUP methodology as the most reliable and objectively reasonable assessment for pricing the BPCs and the CC contracts, concluding (at paragraph 856) that the actual pricing of the contracts fell "well within an arm's length range of prices and that consequently no transfer pricing adjustment was warranted."

III. Discussion

Without actually attending the trial (which lasted 65 days) to hear the full presentation of the evidence and each side's oral argument, one cannot be absolutely certain of having a full and complete understanding of the Crown's case. Justice Owen's judgment is lengthy, detailed, organized, and gives every impression of being comprehensive. Before ascending to the bench, he was a well-respected practitioner with extensive transactional and litigation experience; he would certainly have the ability to work through and understand the voluminous documents and filings. One would therefore have every reason to believe that his description of the Crown's arguments fairly reflects its submissions before the court.

Operating from that premise, the Crown's arguments on both the sham and, to a lesser degree, transfer pricing issues are surprising and somewhat difficult to understand. Put bluntly, the findings of fact summarized in the judgment are simply nowhere near what would be required to support the existence of a sham and, given the seriousness of the assertion and the paucity of support for it on the facts, the sham argument should not have been put before the court.

The Crown's transfer pricing arguments are also not what one might have expected for a case of this magnitude, both in the abstract and in the apparent disconnect between those arguments and the evidence of the CRA's expert witnesses on this issue. Overall, after working through the Tax Court's judgment, one's immediate reaction could easily be, "Is that really all the Crown had to work with in this case, and if so, why did it take so long to get this result?"

Given the Tax Court's findings of fact, the Crown's prospects on appeal appear bleak. Cameco management has said that it has incurred roughly C $57 million in costs to date litigating this matter, and it will petition the court to recover

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those costs from the CRA.[13] If the taxpayers of Canada are ultimately required to fund most or all of that bill — on top of whatever costs the Crown itself incurred in arguing the CRA's position — for a dispute in which the CRA's case was as thin as this judgment makes it appear to be, they will not have received a good return for their money.

A. Sham Transactions and the ITA

1. Basic Principles of the ITA

There are several basic principles that the courts use when interpreting and applying the ITA that are so fundamental as to be beyond discussion. While it is surprising how often tax authorities and others seem to need to be reminded of them, they form the basis for how a Canadian tax court will analyze any given case. Unless those involved approach the problem from the right starting point — something the Crown does not appear to have done in *Cameco* — they are unlikely to arrive at the correct result.

Perhaps the most fundamental principle is that the ITA is a taxation overlay on top of the commercial transactions into which taxpayers have entered. An analysis starts with what the taxpayer has in fact done — the actual legal rights and obligations that have been created — and applies the ITA to that. As the Supreme Court explained in *Jean Coutu Group Inc. v. Canada*, 2016 SCC 55, "One of the fundamental principles of our tax system [is] that tax consequences flow from the legal relationships or transactions established by taxpayers." Similarly, in *Quebec (Agence du Revenu) v. Services Environnementaux AES Inc.*, 2013 SCC 65, the Court notes that "tax law applies to transactions governed by, and the nature and legal consequences of which are determined by reference to, the common law or the civil law." Lawyers (including judges) must recognize legally effective agreements for what they are and respect the legal rights and obligations they create.

Over the years, the Crown has tried using various extrastatutory doctrines to convince the courts to tax in a way that ignores what the taxpayer has in fact done, including the "business purpose test"[14] and the "absence of legal reality"[15] doctrine. In *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622, the Supreme Court responded thus to yet another such attempt:

> Inquiring into the "economic realities" of a particular situation, instead of simply applying clear and unambiguous provisions of the Act to the taxpayer's legal transactions, has an unfortunate practical effect. This approach wrongly invites a rule that where there are two ways to structure a transaction with the same economic effect, the court must have regard only to the one without tax advantages.

In each of these cases, the Supreme Court of Canada rejected the argument as an attempt to make an end-run around the expressed view of Parliament as enacted in the governing legislation. The Court has refused to depart from the bedrock of certainty derived by applying the statute to the actual legal substance of the taxpayer's actions by creating what would amount to an arbitrary smell test out of thin air. A useful statement of this policy by the Supreme Court appears in *Canada v. Antosko*, [1994] 2 S.C.R. 312:

> In this appeal, despite conceding that these factual elements are present, the respondent is asking the Court to examine and evaluate the transaction in and of itself, and to conclude that the transaction is somehow outside the scope of the section in issue. In the absence of evidence that the transaction was a sham or an abuse of the provisions of the Act, it is not the role of the court to determine whether the transaction in question is one which renders the taxpayer deserving of a deduction. If the terms of the section are met, the taxpayer may rely on it, and it is the option of Parliament specifically to preclude further reliance in such situations.

[13] *See* "Cameco Says Tax Court Has Ruled in Its Favour in Dispute With CRA," CTV News (Sept. 27, 2018). In Canada, successful litigants are usually entitled to receive more than half their expenses from the unsuccessful party.

[14] *Stubart Investments*, [1984] 1 S.C.R. 536.

[15] *Continental Bank*, 2 S.C.R. 298.

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As a corollary to this principle, Canada taxes on the basis of what the taxpayer did — not what the taxpayer could have done. Tax authorities sometimes seem to believe that what a taxpayer has in fact done could and should be ignored because the relevant transactions "should" have been done differently and with different effect, such as would incur a higher tax. There is simply no legal basis in Canada for this approach. To the contrary, the Supreme Court has repeatedly stated that "taxpayers have the right to order their affairs to minimize tax payable."[16] Whatever transactions a taxpayer has undertaken must be assessed from the starting point that the taxpayer has every right to do so, even if tax motivated. *Shell Canada* explains:

> This Court has made it clear in more recent decisions that, absent a specific provision to the contrary, it is not the courts' role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way. . . . Unless the Act provides otherwise, a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done.

This principle cuts both ways — taxpayers must live with the legal rights and obligations that they have in fact created, even when it is to their disadvantage or the tax consequences are contrary to their intentions. Again, *Jean Coutu* is instructive:

> Equally, if taxpayers agree to and execute an agreement that produce[s] unintended tax consequences, they must still be taxed on the basis of that agreement and not on the basis of what they "could have done" to achieve their intended tax consequences, had they been better informed. Tax consequences do not flow from contracting parties' motivations or tax objectives.

Therefore, the logical first step in any analysis is to determine what legal rights and obligations the parties have created under the relevant commercial law. The relevant documentation shows the parties' intentions and agreement, and it is therefore taken as prima facie evidence of their legal relationships.[17]

There is no evidence in the *Cameco* judgment that the CRA challenged the legal effectiveness or sufficiency of the relevant agreements as somehow not achieving the desired commercial results that they purported to create. That approach was attempted — unsuccessfully — by the Crown using an "incomplete transaction" argument in *Stubart*. Presumably, the CRA did not make the argument here because there was no viable legal basis for doing so. In an industry as heavily regulated as nuclear power, it would have been astonishing if the contracts entered into between the parties (some of which were at arm's length) were ineffective or incomplete in some material way as to cause them not to establish the legal rights and obligations they purported to create.

This being so, and given how solidly rooted the taxpayer's legal relationships are as forming the basis for applying the ITA, the Crown's options for somehow convincing the Court to ignore the relevant documentation without a specific statutory basis for so doing were very limited indeed, to the point of calling into question the decision to litigate the case on any basis other than the transfer pricing rules in section 247(2) ITA.

2. The Sham Doctrine

Had Cameco and CESA/CEL deviated in a significant and substantial manner from the terms and conditions of the relevant contracts, the court

[16] *Jean Coutu Group Inc.*, 2016 SCC 55, at para. 41.

[17] *See, e.g.*, *Continental Bank*, 2 S.C.R. 298, at para. 45 (citing *Orion Finance Ltd. v. Crown Financial Management Ltd.*, [1996] 2 B.C.L.C. 78 (C.A.)):

> Unless the documents taken as a whole compel a different conclusion, the transaction which they embody should be categorized in conformity with the intention which the parties have expressed in them.

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might have been convinced that the written agreements did not correspond with the legal rights and obligations created by the parties (as evidenced by their conduct). As described in Section II, the court examined the relevant evidence on the documentary irregularities the Crown advanced at length, and it concluded that they could not support any such finding by a reasonable trier of fact. Courts must apply the ITA to real-world situations. For obvious reasons, the standard of documentary compliance is not perfection. Rather, it requires demonstrating that any discrepancies between the agreements and actual practice are the exception rather than the rule and do not go to the heart of the parties' commercial relationship in a way that legitimately calls into question the parties' true intentions. The facts in this case were nowhere near the level that would compel the court to disregard the taxpayers' legal agreements and find they do not reflect the parties' true legal rights and obligations. The Court expressed this conclusion in fairly strong terms, and it is entirely proper that sham has been excluded as a basis for the CRA's appeal.

The Crown's assertion of sham was essentially a non-starter as it not only requires a substantial discrepancy between the parties' legal rights and obligations and their presentation — which the court emphatically stated did not exist[18] — but also an element of intentional deceit on the part of the taxpayer.[19] Essentially, the Crown pointed to the totality of the arrangements in question — noting that they appeared to be tax motivated — cited some relatively minor documentary discrepancies, observed that CESA/CEL was not operating as a completely independent entity because it outsourced some nonessential business functions to third parties and to other members of the Cameco Group, and then invited the court to infer deception from these facts, even though the parties documented and disclosed all of the relevant legal arrangements.

No Canadian court would ever find deception on facts such as these. All of the Cameco Group's arrangements were documented and validly entered into by the appropriate personnel at each entity. CESA/CEL had the resources required to genuinely carry on its uranium trading business — its own employees, the services agreement, arrangements with other third-party service providers, and financing — and the court found that it did so. That it did so as a member of an MNE, operating in a way that may be different than how a completely independent entity would by taking advantage of shared services, group strategy and sales meetings, and outsourced back-office functions, was not hidden from tax authorities or anyone else and was irrelevant. The evidence that the judgment describes as the factual basis for the Crown's assertion of deceit does not come remotely close to meeting the standard required for that finding. It cannot be surprising that, at paragraph 670, Justice Owen found that "the element of deceit required to find sham is simply not present."

Frankly, it is astonishing that the Crown advanced the sham argument (apparently as its primary argument, no less) in these circumstances, involving a large public corporation (with the related securities law disclosure obligations and concomitant potential for liability resulting from inaccuracies), operating in a highly regulated industry, and audited annually by a Big 4 accounting firm. The standard required to establish a sham is quite high, as it should be given the cataclysmic nature of the results from the finding. On these facts, it is simply inconceivable that so many reputable parties with so much to lose by being party to a sham would have involved themselves in one. Indeed, in paragraph 608 of his ruling, Justice

[18] At para. 604:

> Quite the contrary, I find as a fact that [Cameco], Cameco US and CESA/CEL entered into numerous contracts to create the very legal relationships described by those contracts. The arrangements created by the contracts were not a façade but were the legal foundation of the implementation of the Appellant's tax plan.

[19] Despite the suggestion in obiter dicta by the Federal Court of Appeal in *Antle*, 2010 FCA 280, that a sham could exist without the court necessarily finding that the deception was intentional, it is fairly clear from the previous Supreme Court jurisprudence on "sham" that a conscious intention to deceive is required. For example, *Stubart*, [1984] 1 S.C.R. 536, adopts the description of a sham used in English law as "acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create." Justice Owen states this in *Cameco* at para. 592: "The deceit is the factual representation of the existence of legal rights when the parties know those legal rights either do not exist or are different from the representation thereof."

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Owen characterized the assertion to be "beyond belief."[20]

The CRA's decision to put forward the sham argument on these facts is particularly baffling because the Supreme Court of Canada in *Stubart* completely dismissed the very same argument on comparable facts. In that case, the taxpayer disposed of a business to a non-arm's-length corporation and the recipient concurrently appointed the taxpayer to continue operating the same business as its agent. If a complete outsourcing of all business functions to a sister company was found to constitute "a total absence of the element of deceit" in *Stubart*, how were the facts in *Cameco* ever going to support a finding of sham?

The Crown advances the sham concept as a basis for reassessment far too often and with relatively infrequent success. Perhaps the relevant people at the CRA and the Department of Justice genuinely do not appreciate how deeply offensive and potentially devastating it is for a senior officer of a public company or a private practitioner (particularly at a large law firm or accounting firm) to be accused of participating or being complicit in transactions involving conscious dishonesty. It is one thing to be accused of tax planning that interprets the ITA incorrectly; it is quite another to be accused of intentionally deceiving tax authorities. Unless there is some further factual basis supporting an assertion of a sham that is not apparent from the Tax Court's judgment, the Crown was very wide of the mark in this case and should not have advanced this argument before the court. The CRA and Department of Justice should seriously rethink the circumstances under which they make reassessments that rest on accusations of intentional deceit by the taxpayer.

3. Other Quasi-Legal Doctrines

In addition to the concept of a sham, there are other quasi-legal doctrines outside the ITA itself that the CRA puts forward on occasion as a basis for recharacterizing or ignoring legally effective transactions. Agency is one example. Here, the Crown argues that the party ostensibly involved in a transaction is merely the agent for another (the principal) to whom the actual rights, obligations, and tax consequences of the transaction should attach. The Crown (unsuccessfully) advanced the agency argument in *Continental Bank*, 94 DTC 1858, and the Tax Court's ruling illustrates the extremely high standard for establishing agency: "Generally speaking it requires extremely compelling evidence for one company — even a subsidiary — to be regarded as an agent of another." There is simply no plausible basis for the CRA to assert that CESA/CEL was acting as Cameco's agent in entering into the various contracts in this case since all the legal documentation, regulatory obligations, and dealings with third parties establish that CESA/CEL acted on its own behalf.[21] The Tax Court's findings of fact at trial leave nothing for the Crown to work with here.

Recently, the CRA advanced a new doctrine that it labeled "conduit," a theory apparently fashioned out of whole cloth without prior jurisprudential basis. In *Alta Energy Luxembourg SARL v. The Queen*, 2018 TCC 152, the Tax Court of Canada suggested that this was merely "agency" cloaked in another name:

> I am uncertain what the Respondent means when it uses the term "conduit" to describe the circumstances of the Appellant's holding and disposition of the Shares and the distribution of the sales proceeds to the Appellant's shareholders. A corporation is often referred to as a "conduit" when it holds property for a principal. In that case, the principal is the "beneficial owner" of the [property and the] property's legal title [is] in the name of the corporation which holds title as an agent or nominee for the principal.

[20]"Trading in uranium is a serious business that is subject to worldwide regulation and scrutiny and it is beyond belief that this regulatory authority would authorize what the Respondent in substance alleges are fictitious transactions."

[21]Relevant findings include:

- in paragraph 606: "The evidence overwhelmingly supports my finding that CESA/CEL did in fact buy or sell uranium in accordance with the terms of the contracts";
- in paragraph 833: "The general and contract administration services provided by [Cameco] to CESA/CEL under the Services Agreement cannot be viewed as functions performed by [Cameco] for its own account"; and
- in paragraph 613: "There is no evidence to support the conclusion that [Cameco] was performing the services for its own account rather than for the benefit of CESA/CEL."

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There are other examples of these devices in earlier jurisprudence. They all essentially amount to the CRA stating: "We don't like what you've done, but we can't find anything in the ITA that causes it not to achieve the result you intended." The courts generally have little time for this sophistry, particularly when — as in *Cameco* — the taxpayer's transactions are fully disclosed and their legal efficacy is not disputed.[22]

4. The GAAR and the ITA

This then leaves the ITA itself as a basis for ignoring or recharacterizing what the taxpayer actually did as a matter of commercial law. In some instances, explicitly laid out in the statute, the ITA deems what in fact happened as a commercial law matter not to have happened or not to have had the effect that it would otherwise have had for the purposes of applying specific rules in the ITA. In a small number of cases, the taxpayer's purpose for doing what it did is sufficient to trigger the deeming rule.[23] None of these provisions apply to Cameco's situation.

The general antiavoidance rule in section 245 ITA is the primary statutory basis in the CRA for levying tax based on something other than what the taxpayer in fact did. It was enacted in 1988, largely in response to what the government perceived to be the insufficiency of the kind of extrastatutory antiavoidance doctrines described above.[24] The Explanatory Notes to Legislation Relating to Income Tax, issued by the Honourable Michael H. Wilson, Minister of Finance (June 1988), accompanying the provision's enactment described it thus:

> New section 245 of the Act is a general anti-avoidance rule which is intended to prevent abusive tax avoidance transactions or arrangements but at the same time is not intended to interfere with legitimate commercial and family transactions. Consequently, the new rule seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs.

There are three essential requirements needed in order for the GAAR to apply:

- the presence of a "tax benefit";
- the carrying out of one or more transactions that are primarily tax motivated; and
- a conclusion that the result of the foregoing is a misuse of one or more provisions of the ITA or a tax treaty, or the abuse of the ITA or a tax treaty read as a whole.

When applicable, the GAAR entitles the CRA to "redetermine the tax consequences to a person as is reasonable in the circumstances" (section 245 ITA) and deny a tax benefit that would otherwise result.

The power of the GAAR to allow the CRA to tax based on an altered reality makes it an extremely potent tool, and for this reason, it is meant to be applied as an extraordinary provision of last resort. Nonetheless, it is critical to understand that a determination of whether or not the GAAR applies is still based on what the

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[22] As colorfully stated by Justice Donald Bowman in *Continental Bank*, *supra* note 15:

> [D]id the appellants enter into the various transactions that they purported to, or was the elaborate series of steps envisioned by the master agreement a mere camouflage for what was in substance a single event, i.e., a direct sale of assets by CBL to CC? In cases of this type expressions such as sham, cloak, alias, artificiality, incomplete transaction, simulacrum, unreasonableness, object and spirit, substance over form, bona fide business purpose, step transaction, tax avoidance scheme and, no doubt, other emotive and, in some cases, pejorative terms are bandied about with a certain abandon. Whatever they may add, if anything, to a rational analysis of the problem, apart from a touch of colour in an otherwise desiccated landscape, they do not exist in separate watertight compartments. They are all merely aspects of an attempt to articulate and to determine where "acceptable" tax planning stops and fiscal gimmickry starts.

[23] For example, section 191(3)(a) ITA states:

> Notwithstanding subsection 191(2), where it can reasonably be considered that the principal purpose for a person acquiring an interest that would, but for this subsection, be a substantial interest in a corporation is to avoid or limit the application of Part I or IV.1 or this Part, the person shall be deemed not to have a substantial interest in the corporation.

[24] *See The Queen v. Canada Trustco Mortgage Company*, 2005 SCC 54, at para. 14:

> The GAAR was enacted in 1988, principally in response to *Stubart Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536, which rejected a literal approach to interpreting the Act. At the same time, the Court rejected the business purpose test, which would have restricted tax reduction to transactions with a real business purpose. Instead of the business purpose test, the Court proposed guidelines to limit unacceptable tax avoidance arrangements. Parliament deemed the decision in *Stubart* an inadequate response to the problem and enacted the GAAR.

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taxpayer in fact did, as the explanatory notes from 1988 state:

> Subsection 245(3) does not permit the "recharacterization" of a transaction for the purposes of determining whether or not it is an avoidance transaction. In other words, it does not permit a transaction to be considered to be an avoidance transaction because some alternative transaction that might have achieved an equivalent result would have resulted in higher taxes.

The CRA's conceptual starting point in *Cameco* is clearly a belief that Cameco "should" have structured its affairs so as to earn the relevant income directly, rather than having CESA/CEL earning that income. No doubt the CRA considered applying the GAAR to Cameco and concluded — correctly — that there was no reasonable basis for doing so. As noted in Section I.D., Canada's foreign affiliate regime sets out a detailed set of rules governing (*inter alia*) when and under what circumstances a Canadian corporation can use a foreign subsidiary to perform activities and earn income without the income being imputed back to the Canadian taxpayer. Notably, imputation back to the Canadian taxpayer was exactly the result that the Crown sought to achieve in *Cameco*. Since the reassessed transactions stayed on the proper side of these rules, there was no chance of convincing the court that setting up CESA/CEL to act as the group trading entity and (through sales to Cameco US) sell uranium to third-party customers outside Canada was remotely abusive. This left Canada's transfer pricing rules in section 247 ITA as the CRA's only genuine hope for challenging what Cameco had done — and the case should have been limited to interpreting and applying that provision alone.

B. Transfer Pricing

The Crown framed its reassessment under section 247(2) ITA as primarily based on the TPRR (section 247(2)(b)) and secondarily based on the GTPR (section 247(2)(a)). As noted above, *Cameco* is the first time a court has considered the TPRR.

On multiple occasions, the Supreme Court of Canada has commented on the generally accepted approach for interpreting the ITA. The comments of Justice Louis LeBel in *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, are one useful summary:

> The interpretive approach is thus informed by the level of precision and clarity with which a taxing provision is drafted. Where such a provision admits of no ambiguity in its meaning or in its application to the facts, it must simply be applied. Reference to the purpose of the provision "cannot be used to create an unexpressed exception to clear language" . . . . Where, as in this case, the provision admits of more than one reasonable interpretation, greater emphasis must be placed on the context, scheme and purpose of the Act. Thus, legislative purpose may not be used to supplant clear statutory language, but to arrive at the most plausible interpretation of an ambiguous statutory provision. Although there is a residual presumption in favour of the taxpayer, it is residual only and applies in the exceptional case where application of the ordinary principles of interpretation does not resolve the issue.

Thus, in cases like *Cameco* when the relevant provision is anything but "clear and unambiguous," the required analysis will necessarily go beyond the text of the actual provision.

The result, as seen here, is that context matters. Courts will interpret and apply specific provisions — here, section 247(2) ITA — to the taxpayer's transactions within the context of both the ITA as a whole and the commercial reality in which the relevant actors — here, MNEs — function.[25] This principle is evident throughout the court's analysis in *Cameco*:

- in paragraphs 723 to 726, the foreign affiliate regime informs the court as to the issue of parent corporations creating foreign

[25] A recent example of this approach is *Alta Energy Luxembourg SARL*, 2018 TCC 152, at paras. 64 and 68, in which the Tax Court interpreted a tax treaty provision and the intentions of the signatories "in accordance with the industry's best practices."

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subsidiaries to pursue business opportunities outside Canada;

- in paragraphs 561 and 837, the court applies its understanding of the highly integrated, interdependent manner in which MNEs function to the Crown's attempt to use the parties' collaborative decision-making as a basis for challenging Cameco's transfer pricing;
- in paragraph 608, the strict regulatory environment in which CESA/CEL operated is one of the determining factors in the court's consideration of the sham doctrine; and
- in paragraphs 704 and 705, the court cites the objectives of the transfer pricing rules when determining how broadly or narrowly to read the phrase "relevant transaction or series" in the preamble to section 247(2) ITA.

The CRA's proposed interpretation of section 247(2) ITA was so rigid and incompatible with both how the commercial world operates and what the transfer pricing rules are trying to achieve that Justice Owen dismissed it as simply unworkable in practice and hence highly unlikely to plausibly reflect what Parliament intended. This is stated multiple times in his opinion:

- "I do not accept that members of a multinational group cannot share such information without triggering a transfer pricing issue" (paragraph 826);
- "No reasonable person would expect a wholly owned subsidiary to act in a manner that is at odds with the interests of the ultimate parent corporation or of the broader corporate group" (paragraph 607);
- "There is nothing exceptional, unusual or inappropriate about [Cameco]'s decision to incorporate CESA and have CESA execute the HEU Feed Agreement" (paragraph 726);
- "The fact that decisions may have been collaborative rather than adversarial does not support the shift of substantive contractual price risk from CESA/CEL to [Cameco]" (paragraph 837); and
- "An overly broad series renders the analysis required by the transfer pricing rules impractical or even impossible by unduly narrowing (possibly to zero) the set of comparable circumstances and substitutable terms and conditions" (paragraph 704).

The Crown's interpretation of the law seemed to not only require that an MNE group's members adhere to the arm's-length principle, but also that a subsidiary conduct itself as if it were in fact an independent entity that is not part of an MNE. That is neither commercially realistic nor what Parliament could reasonably have intended, and thus the Crown's strategy was unlikely to succeed.

The CRA's apparent decision to adopt an all-or-nothing approach to reassessing Cameco under section 247(2) ITA is also unusual. One might have expected at least the GTPR proposal (which involves adjusting the relevant pricing to what arm's-length parties would have charged) to produce a result other than: "Zero to CESA/CEL, everything to Cameco." This is even more true in light of the apparent disconnect that Justice Owen observed between that proposed result and the Crown's own expert evidence in paragraphs 764 and 765. The expert evidence was what it was; without actually working through all the transfer pricing reports, it is difficult to know exactly what the Crown had to work with as a practical matter, but the apparent absence of a lesser adjustment as a fallback position is an interesting risk management decision.

In any event, the *Cameco* decision obviously stands for several important propositions regarding the interpretation and application of section 247 ITA, many of which will affect other transfer pricing cases that have yet to be decided. These include the following:

- A preference for using the CUP method relative to profit splits, particularly in pricing commodities.
- The rejection of the tax authorities' use of hindsight.
- The importance of selecting the appropriate, relevant transaction or series to test under section 247(2) ITA such that it be sufficiently narrow as to afford the court a reasonable opportunity to identify comparables. As paragraph 707 states, this permits "a meaningful, predictable and practical application of the arm's length principle embodied in subsection 247(2), which in turn promotes certainty, predictability and fairness."
- The express endorsement of the "commercially rational" standard as the

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basis for applying the TPRR, determined objectively and taking into consideration all relevant circumstances.

- The importance of the foreign subsidiary having one or more employees with the requisite experience and knowledge to enable the subsidiary to make the decisions that are essential to the core functions of its business.
- The validation of normal commercial MNE practices, such as creating foreign subsidiaries to carry on new business ventures or sharing information or services within the group. Ideally, expert evidence can be used to support and establish the specific practices, as Hansell's testimony did here.
- The acceptance of outsourcing — at least of non-core business functions — as a normal and permissible commercial practice so long as the agreement obeys the arm's-length principle (paragraph 833).
- The acknowledgement that it is reasonable to assume that arm's-length contracts have neither positive nor negative value at the time of execution unless the facts demonstrate otherwise, at least in the case of commodities with a "market-determined value" (paragraph 773).

Most importantly, *Cameco* represents the primacy of the taxpayer's actual legal rights and obligations — and the actual entitlements and risks they create — over an economic analysis based on "value-creating activities" such as the OECD has created and advanced. Anyone who thinks Canadian courts are likely to import these OECD concepts into the country's existing transfer pricing law will be in for a shock after reading Justice Owen's judgment in *Cameco*.

Canadian tax courts have, for many good and valid reasons, cast a wary eye on the OECD and its pronouncements. The Supreme Court in paragraph 20 of *The Queen v. GlaxoSmithKline Inc.*, 2012 SCC 52, made it clear that OECD guidelines are "not controlling as if they were a Canadian statute, and the test of any set of transactions or prices ultimately must be determined according to [the ITA] rather than any particular methodology or commentary set out in the Guidelines." In *McKesson Canada Corporation v. The Queen*, 2013 TCC 404, at paragraph 120, Justice Patrick Boyle astutely observed that the OECD's guidelines reflect a viewpoint that is different from that of the legislators who write the actual rules by which the game is to be played:

> The transfer pricing provisions of the Act govern and are determinative, not any particular methodology or commentary from the OECD Guidelines, or any source other than the Act. I would add the observation that OECD Commentaries and Guidelines are written not only by persons who are not legislators, but in fact are the tax collection authorities of the world. Their thoughts should be considered accordingly. For tax administrators, it may make sense to identify transactions to be detected for further audit by the use of economists and their models, formulae and algorithms. But none of that is ultimately determinative in an appeal to the Courts. The legal provisions of the Act govern and they do not mandate any such tests or approaches. The issue is to be determined through a fact finding and evaluation mission by the Court, as it is in any factually based issue on appeal, having regard to all of the evidence relating to the relevant facts and circumstances.

Likewise, Justice Owen noted in paragraph 699 that the wording of Canada's transfer pricing rules is simply "quite different from the text in Article 9 of the [OECD] Model Convention."

This variance between Canadian law and the OECD's path is not new. For example, the OECD's 2008 discussion paper on "Transfer Pricing Aspects of Business Restructurings"[26] proposed ignoring or recharacterizing a taxpayer's legally binding arrangements in an alarmingly wide range of circumstances (dubiously described as "exceptional"). Then, as now, Canada's transfer pricing rules in section 247 ITA simply do not provide a legal basis for taking that step except in

[26] OECD Committee on Fiscal Affairs, "Transfer Pricing Aspects of Business Restructurings: Public Discussion Draft" (Sept. 19, 2008).

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the limited circumstances of the TPRR — that is, based on the "commercial rationality" standard.[27]

In 2012 the OECD's Secretary-General, José Ángel Gurría, said that:

> the time has come to simplify the rules and alleviate the compliance burden for both tax authorities and taxpayers. Because complicated rules can be a barrier to cross-border trade and investment and place a heavy burden on tax administrations and businesses, we are making our approach simpler without making it arbitrary.[28]

The world is still waiting. Little that has come out of the OECD since then can fairly be said to have advanced either objective. To the contrary, the amended 2017 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, an outgrowth of the BEPS project, have moved transfer pricing further away from certainty and simplicity by encouraging tax administrators to ignore the legal substance of actual commercial transactions in favor of a quixotic search for "economic realities."[29] Compliance costs have increased significantly, as have the costs of dispute resolution, as the OECD continues to move the goalposts further away from the substantive legal relationships that govern parties' conduct in the real world.

Taken at face value, it seems like the Crown in *Cameco* would have felt better about the taxation in Switzerland of income that could have been taxed in Canada (and at a higher rate) had Cameco opted to receive the income directly if CESA/CEL had more employees outside Canada who performed the administrative functions that Cameco personnel performed in Canada under the services agreement.[30] Why Canada's tax policy would encourage Canadian multinationals to move head-office employees, along with their various contributions to the Canadian tax base, out of Canada is something of a mystery, though perhaps no more so than various other elements of the CRA's approach in this case. But that is a question for another day. If Canada truly believes that transfer pricing should be based on the location of employees and the functions they perform instead of focusing on which entity has the legal rights and bears the business risk, why not change the rules to say so? Why continue to try to administer the existing text of section 247 ITA by reference to OECD guidelines that are increasingly disconnected from legal reality and, in any event, not supported by the text of the statute?

The BEPS project purportedly represented an effort by OECD members and other interested countries to agree on new principles — or, as we are told, "reinterpret" existing principles — to prevent international tax avoidance and a race to the bottom. More than 100 countries are now working to develop a consensus-based approach to the challenges arising from digitalization.[31] Why not continue the journey — at least among those who are willing; participation need not be universal to be effective — saving the time and expense associated with compliance and the litigation of transfer pricing disputes by moving to formulary apportionment or something similar? If Canadian tax authorities really believe what they appear to be advocating for in *Cameco*, then by all means, they should change the statute to reflect the result they want — but do so in a straightforward, compliance-friendly way. The Canadian experience in using formulary apportionment to allocate income amongst provinces for provincial tax purposes has been described by one of this country's preeminent minds as at least "promising."[32] Some have wondered whether the ongoing dismissal of formulary apportionment by the OECD, a position reiterated in paragraph 1.16 et seq. of the 2017 guidelines, and others within the "transfer

[27] *See* Richard Tremblay and Steve Suarez, "The OECD Discussion Draft on Transfer Pricing Aspects of Business Restructurings — Canadian Considerations," 38 *Tax Man. Int'l J.* 98 (2009).

[28] OECD, "Tax: OECD to Simplify Transfer Pricing Rules" (Mar. 28, 2012).

[29] OECD, "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" (July 10, 2017), at 1.14.

[30] This is evident in paragraph 577, which describes the Crown's assertion that "the significant functions and activities relating to that business must also be transferred and performed by the foreign subsidiary."

[31] *See* OECD, "Tax Challenges Arising From Digitalisation: More Than 110 Countries Agree to Work Towards a Consensus-Based Solution" (Mar. 16, 2018).

[32] Robert Couzin, "The End of Transfer Pricing?" 61(1) *Canadian Tax Journal* 159 (2013), at 177.

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pricing establishment"[33] is driven more by the inherent (and perfectly human) bias of those whose livelihood is best served by the continuation of the existing rules — "reinterpreted" from time to time, as necessary, of course. Allocating tax among countries based on payroll, sales, or some other readily ascertainable measurement of "value-added functions" is at least a plausible alternative to the status quo. Why not bite the bullet and achieve the result in the most cost-efficient way possible?

For now, *Cameco* serves as a notice to Canadian tax authorities that the rule of law will prevail, and a reminder that they either need to administer the transfer pricing rules they have written within their statutory limits or enact new ones that achieve the desired results — whatever they may be. ■

[33] *Id*. at 161.

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