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Cameco decision a serious blow to the CRA's aggressive transfer pricing audits

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In his decision rendered at the Tax Court of Canada in favour of the taxpayer in *Cameco Corporation v. The Queen*, Justice John R. Owen rejected the audit positions relied on by the Minister and dealt a serious blow to the Canada Revenue Agency's (CRA) efforts to use the 2017 edition of the OECD's Transfer Pricing Guidelines to curb the base erosion and profit shifting (BEPS) activities of multinationals.

At issue in these proceedings were the transfer prices used by Cameco's mining operations in Canada (Cameco Canada) during its 2003, 2005 and 2006 taxation years for uranium sold to Cameco Europe S.A. (CESA), a Luxembourg subsidiary with a Swiss branch that was later transferred to a Swiss subsidiary, Cameco Europe AG (SA, Ltd.) (CEL) (collectively, CESA/CEL). In total, the transfer pricing adjustments reassessed by the CRA would have added $484.4 million to Cameco Canada's income. Related reassessments of future taxation years could have added an additional $8 billion to Cameco Canada's income.

In the appeals, the Minister relied first on sham, second on the transfer pricing recharacterization rules (paragraphs 247(2)(b) and (d)) and lastly on the traditional transfer pricing rules (paragraphs 247(2)(a) and (c)). This was the first transfer pricing case in which the Minister relied on the recharacterization rules.

In rejecting the Minister's positions, Justice Owen concluded that:

- There had been no deception or sham; the related parties did not factually represent the 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. That CESA/CEL had been expressly authorized by the Swiss and European nuclear regulatory authorities to carry out the transactions certainly helped to support the taxpayer's position that the transactions were not a sham.
- There was nothing exceptional, unusual or inappropriate about Cameco Canada's decision to incorporate CESA/CEL and have the foreign affiliates execute certain arm's length transactions. To the extent this decision raises transfer pricing concerns, the traditional transfer pricing rules should address those concerns. Applying the extraordinary remedy of Canada's recharacterization rules was neither warranted nor appropriate in the circumstances.
- The results derived from applying the comparable uncontrolled price (CUP) method provided the most reliable measure of an arm's length price for uranium and did not warrant a transfer pricing adjustment under Canada's traditional transfer pricing rules because the prices charged by Cameco during the taxation years in question were well within an arm's length range.

What does this ruling mean for taxpayers?

For taxpayers, the decision rendered by Justice Owen is the most significant related to Canada's transfer pricing rules since the Supreme Court of Canada ruled on *The Queen v. GlaxoSmithKline*.

In rendering his decision, Justice Owen reaffirmed that:

- Canada's transfer pricing rules trump the guidelines provided by the OECD in its transfer pricing guidelines; consequently, unless the tax laws are changed, the BEPS-inspired 2017 version of the OECD guidelines will continue to be considered guidance and not the law.
- The Duke of Westminster is alive and well; tax planning alone is not sufficient to warrant a transfer pricing adjustment.
- It is important to develop transfer pricing policies that reflect commercial reality, putting proper and timely-executed intercompany agreements in place that reflect commercial terms and conditions, and recording related party transactions in the companies' books and records as they would arm's length transactions.
- It is a range of arm's length prices that matters and not a particular point in that range.
- The Tax Court prefers the CUP method over profit-based methods, such as the transactional net margin method.
- It is important to document the circumstances which led to related party transactions that were inconsistent with the stated transfer pricing policy.
- Relevant commercial and economic circumstances, such as regulatory issues, need to be properly considered.

As it relates to key administrative positions regarding transfer pricing taken by the CRA, Justice Owen's decision also:

- established that the test to determine whether Canada's recharacterization rules apply is based on the commercial reality of the transaction or series of transactions;
- established that the traditional transfer pricing rules must not be used to recast the arrangements actually entered into by the participants in the transaction or series of transactions, except to the limited extent necessary to properly price the transaction or the series of transactions by reference to objective benchmarks;
- rejected the use of hindsight by the CRA and the Respondent's experts to arrive at their conclusions;
- rejected arguments made that because Cameco Canada performed all of the functions, it should earn all of the profit. The services provided by Cameco Canada to CESA/CEL under the Services Agreement cannot be viewed as functions by Cameco Canada for its own account. The proper focus of a transfer pricing analysis of such services under the transfer pricing rules is to determine the arm's length price for those services. As such, the performance of such services by Cameco Canada did not justify shifting the price risk inherent in the core buy-sell functions of CESA/CEL, which the services support, from CESA/CEL to Cameco Canada; and
- rejected the notion that losses reported by one of the related parties in the transaction or series of transactions was sufficient evidence to support the conclusion that the transfer price was not an arm's length price.

The precedents set in this case are a serious blow to the aggressive positions the CRA has taken on several transfer pricing audits in recent years and will make it difficult to implement the OECD's revised version of the arm's length principle, with its focus on the functions that generate value in the relevant transaction or series of transactions. As a result, expect the CRA to appeal this decision to the Federal Court of Appeals and, perhaps, to the Supreme Court of Canada. Also look for the Minister of Finance to introduce specific measures in next spring's Budget to further address the type of tax planning that initiated the OECD's BEPS Action Plan.

Contact us

The transfer pricing specialists at Grant Thornton have been following developments on this case closely and can help you understand its implications for your business. Transfer pricing is more than benchmarking analyses and documentation. As advisors, we provide a personalized and highly-collaborative experience based on a three-step strategy to plan, implement and defend your transfer pricing policies. By executing this strategy with our integrated network of global transfer pricing specialists, as well as local audit and tax advisors, we help multinational corporations create tax-efficient international business structures that hold up to the intense scrutiny of taxing authorities.

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