

Significant Transfer Pricing Disputes – III Cameco-Canada Federal Court of Appeal Decision

On 26 June 2020, Canada’s Federal Court of Appeal released its decision in the case of *The Queen v. Cameco Corporation*, an appeal of the September 2018 Tax Court of Canada decision in *Cameco Corporation v. The Queen*. The Federal Court of Appeal upheld the Tax Court’s decision in favor of the taxpayer, and in doing so issued a detailed interpretation of the transfer pricing recharacterization provisions in the Income Tax Act.

1. Facts

During the taxation years in issue (2003, 2005 and 2006), Cameco Corporation was one of the world’s largest uranium producers and suppliers of conversion services. In the late 1990s, Cameco’s European subsidiary Cameco Europe S.A entered into an agreement with the Russian Government to purchase certain amounts of highly enriched uranium (the Tenex Agreement) and an agreement with Urenco Limited to purchase a certain amount of natural uranium (the Urenco Agreement).

During that period, Cameco reorganized itself. Following the reorganization, the Cameco group had three main entities: the Canadian entity, which continued to operate uranium mines and conversion facilities in Canada along with providing administrative support services to other Cameco entities; CESA/CEL, a Swiss entity that was the trader for the group, purchasing and selling uranium from Russia and from the Canadian and US affiliates; and Cameco US, which was the marketing arm responsible for selling the uranium to third parties for use in nuclear reactors.

From 1999 to 2001, CESA/CEL entered into nine long-term agreements with Cameco which used a base escalated pricing model. In addition, from 1999 to 2006, CESA/CEL and Cameco entered into twenty-two agreements to deliver uranium to Cameco on a specific date or short-term delivery period that used a fixed or market-based price.

The Canadian Tax Administration reassessed Cameco’s revenue for taxation years of 2003, 2005, and 2006 and decided to increase Cameco’s income to include all of the profits from CESA/CEL. The Administration relied i) on the legal doctrine of sham, and ii) on paragraphs 247(2)(b) and (d) of the Income Act to recharacterize the transactions. The administration claimed that Cameco, as an arm’s-length person, would not have entered into the transactions with CESA/CEL. Lastly, Canadian Tax Administration relied on paragraphs 247(2)(a) and (c) of the Income Act to re-evaluate the transactions. The reassessments increased Cameco’s income by approximately 483 million CAD for the three years in dispute.

2. Tax Court of Canada

On September 2018 The Tax Court of Canada decided in favor of Cameco. The Tax Court concluded that none of the transactions, arrangements or events in issue was a sham, finding that there was no evidence to suggest that the contracts entered into by the parties did not represent the parties’ true intentions. The decision also reversed the Administration’s transfer pricing adjustments under section 247 of the Act for each of the taxation years in question, concluding that transactions were not commercially irrational, thus the criteria in subparagraph 247(2)(b)(i) had not been met and therefore recharacterization rule in paragraph 247(2)(d) did not apply. The Tax Court also found that

prices charged by the taxpayer in the relevant taxation years were within an arm's length range of prices and concluded that transfer pricing adjustment was not justified under paragraphs 247(2)(a) and (c).

3. Federal Court of Appeal

The Federal Court of Appeal dismissed the Administration's appeal of the Tax Court's decision. In its appeal, the Administration challenged the Tax Court's findings regarding the recharacterization provisions in paragraphs 247(2)(b) and (d) of the Income Act.

The Federal Court of Appeal reaffirmed the Tax Court's decision. There is no evidence that parties dealing with each other at arm's length would not have bought and sold uranium or transferred between them the rights to buy uranium from Tenex or Urenco. In reaching its decision, the Federal Court of Appeal referenced the Organisation for Economic Co-operation and Development's (OECD) 2010 Transfer Pricing Guidelines.

The Federal Court of Appeal also considered the application of paragraph 247(2)(d). Paragraph 247(2)(d) of the Act requires the Court to replace the transactions realized between the participants with the transactions that would have been realized between persons dealing with each other at arm's length. It does not consider disregarding the existing transactions, which is the result proposed by the Administration.

Finally the Federal Court of Appeal asserted that the rules in paragraph 247(2)(b) and (d) of the Act are not as broad as the Administration suggests. They do not allow the Administration to reallocate all of the profit of a foreign subsidiary to its Canadian parent company with the claim that the Canadian corporation would not have realized transactions with its foreign subsidiary if they had been dealing with each other at arm's length.

4. Supreme Court of Canada

On 18 February 2021, The Supreme Court of Canada (Case 39368) has denied the Administration to appeal the Federal Court of Appeal's decision in *The Queen v. Cameco Corporation*. As a result, the Tax Court of Canada's decision to reverse the tax authorities' transfer pricing adjustments stands.

5. Conclusion

The Cameco decision of the Tax Court of Canada and Federal Court of Appeal concluded that:

- Canada's foreign affiliate regime has a legitimate purpose to allow Canadian companies to conduct business outside of Canada on a tax-effective basis, and taxpayers are entitled to structure their affairs within this regime without triggering adverse consequences.
- The recharacterization provisions of paragraphs 247(2)(b) and (d) will not apply where the taxpayer's arrangements are commercially rational and especially where transfer prices are determined in accordance with the arm's length principle, even if the taxpayer utilizes a tax-oriented structure.
- Determining whether arm's-length parties would have entered into a transaction under paragraph 247(2)(b), the reference should be made to arm's-length persons rather than to the particular participants to a transaction.

- In cases where paragraph 247(2)(d) applies, the Administration has to substitute arm's-length terms and conditions based on transactions realized between arm's length parties, rather than substituting the terms and conditions with nothing on the presumption that the no transaction would have occurred.

https://www.ey.com/en_gl/tax-alerts/canada-federal-court-of-appeal-rejects-crown-appeal-of-tax-court-decision-in-cameco-transfer-pricing-case

Canada - Supreme Court of Canada Denies Tax Authorities Leave to Appeal Federal Court of Appeal Cameco Decision Regarding Transfer Pricing Adjustments (26 Feb. 2021), News IBFD (accessed 17 July 2021).

https://research.ibfd.org/#/doc?url=/document/tns_2021-02-26_ca_1

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