

Federal Court of Appeal dismisses Crown's appeal in Cameco



JUNE 29, 2020 7 MIN READ

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In a unanimous decision, the Federal Court of Appeal upheld the Tax Court's decision that Cameco's transactions with its Swiss subsidiary were on arm's length terms and, therefore, compliant with Canada's transfer pricing rules and their underlying policy.

The overarching theme of the Court's decision is that the goal of Canada's transfer pricing provisions is to ensure that transactions between related parties are priced on arm's length terms and conditions. As all the transactions between Cameco and its subsidiary were done on market terms, the government's allegation that there was "profit shifting" was unfounded. The profits in issue properly belonged to Cameco's subsidiary. The Minister cannot rely on the transfer pricing provisions to arbitrarily reallocate profits from a subsidiary to its parent.

The Court also emphasized that the government was not challenging any of the findings of fact made by the trial judge in allowing Cameco's appeal against the reassessments. The Court also observed that the Crown was no longer alleging that any of the transactions in issue were a sham.

Key Takeaways

Our key takeaways from the decision respecting the appropriate interpretation of section 247 are:

- Canada's transfer pricing rules operate to ensure related parties transact on arm's length terms. The provisions do not allow the Minister to pierce the corporate veil and reallocate profits.
- Transfer pricing is fundamentally a factual exercise. The Court characterized many of the Crown's arguments as indirect attacks on the trial judge's factual findings, for which no palpable and overriding error was present.
- The "recharacterization" branch of the transfer pricing rules contains an objective test: would any hypothetical arm's length persons have entered into the relevant transactions? The Court rejected the Crown's subjective test based on the idiosyncrasies of the parties to the transactions.

Background

In 1999, Cameco incorporated a subsidiary operating in Switzerland to pursue foreign business opportunities of acquiring Russian uranium from third parties for resale. In addition, Cameco agreed to sell a substantial amount of its uranium production to its subsidiary for resale. Years after these transactions were entered into, the price of uranium unexpectedly spiked, resulting in the subsidiary realizing significant profits. The Minister reallocated all of the subsidiary's profits to Cameco in Canada.

At trial, the Crown's primary argument was that Cameco's transactions were a sham and, in the alternative, that the transfer pricing provisions in section 247 applied. The Tax Court dismissed the suggestion that there was any sham and found that neither branch of the transfer pricing provisions supported an adjustment, as the transactions were commercially rational and undertaken on arm's length terms and conditions. The Crown did not pursue its argument concerning sham before the Federal Court of Appeal and only relied on transfer pricing arguments, primarily the "recharacterization" branch of the provisions.

For our analysis of the Tax Court's September 2018 decision, see [Taxpayer prevails in landmark transfer-pricing dispute](#)

“Recharacterization” is only available if arm's length parties would not enter the transactions under any terms or conditions

The Federal Court of Appeal held that the condition in subparagraph 247(2)(b)(i) asks an objective question: would hypothetical persons dealing with each other at arm's length have entered the transaction (or series)? Like the Tax Court, the Federal Court of Appeal rejected the Crown's subjective test asking whether the *particular* taxpayer would have entered the transaction (or series) with an arm's length party.

The Court began with a textual analysis of subparagraph 247(2)(b)(i), which asks whether “the transaction or series ...would not have been entered into between *persons* dealing at arm's length”. Had Parliament intended a subjective test it would have used the phrase “between *the participants* if they had been at arm's length”. The Court also noted that subparagraph 247(2)(b)(i) must be read consistently with paragraph 247(2)(d), which uses the phrase “*persons* dealing at arm's length” in circumstances where it is clear the provision is not referring to the actual participants.

The Court held that the test is satisfied only when no arm's length persons would have entered into the transaction (or series) in question, under any terms and conditions. In other words, if the transaction (or series) can be priced (e.g. market pricing exists), it should be analyzed under paragraphs 247(2)(a) and (c), not paragraphs 247(2)(b) and (d).

The Crown's proposed interpretation of the recharacterization rule was too broad according to the Court as it could lead to the section inappropriately applying whenever a corporation in Canada decided to carry on business in a foreign country (with a lower tax rate) through a foreign subsidiary. This result would be inconsistent with the foreign affiliate rules in the Act which encourage Canadian multinationals to use foreign affiliates to expand globally.

The Court also held that the Crown's requested relief under paragraphs 247(2)(d), effectively ignoring the separate existence of the subsidiary and instead treating Cameco as if it stood in the subsidiary's place, was flawed. The Court noted that if the conditions in paragraph 247(2)(b) are satisfied, paragraph 247(2)(d) contemplates replacing the existing transactions with some other transaction, not replacing it with no transaction as the Crown was

proposing.

The Court relied on several contextual factors to support its interpretation of section 247, including the Transfer Pricing Guidelines published by the OECD. The Guidelines advocate ignoring the actual transactions and substituting other transactions only in exceptional cases, such as where the transactions practically impede the tax administration from determining an appropriate transfer price. The Court held that no such exceptional circumstances existed, finding there was nothing to suggest Cameco's structure impeded the Minister's (or the Tax Court's) ability to determine whether the transactions had arm's length prices.

Similarly, the Court held that the "Transfer Pricing" and "Transfer Pricing Adjustment" headings in the Act and the Department of Finance's Technical Notes both suggest the transfer pricing provisions are intended to allow for adjustments in pricing, not to pierce the corporate veil to reallocate profits.

The Court confirmed prices should be tested based on the circumstances existing when the agreements were entered into, without the benefit of hindsight to take into account, for example, the spike in uranium prices which occurred several years later.

The Court concluded by noting that "[e]ssentially, the profits in question in this case arose from buying and selling uranium" and there was no basis to find that parties dealing with each other at arm's length would not have entered into the transactions.

Traditional pricing rule – No reason to interfere with trial judge's factual findings

The Court's decision with respect to the traditional transfer pricing rule in paragraphs 247(2)(a) and (c) demonstrates the importance of effectively marshaling evidence, including expert evidence at the trial level.

The Court characterized the Crown's submissions with respect to paragraphs 247(2)(a) and (c) as relitigating which party's experts should be preferred and indirectly challenging the trial judge's findings of fact. The Court reaffirmed this was the trial judge's role: weighing the expert evidence and determining which expert to prefer, and making findings of fact. Absent a palpable and overriding error (which the Crown did not allege), a trial judge is entitled to deference.

Consequently, the Court held there was no reason to interfere with the Tax Court's decision.

Conclusion

The Minister sought to disregard Cameco's *bona fide* corporate structure and to tax Cameco on the profits of its subsidiary. The principal argument in support of this was that the corporate structure and virtually all the intercompany transactions were a sham. This argument was rejected by the trial judge on the basis that the facts and the law simply did not support that narrative. At the Court of Appeal the Crown abandoned the sham allegations but pressed on with its transfer pricing arguments to achieve the same objective of piercing the corporate veil and taxing Cameco on its subsidiary's profits. The Federal Court of Appeal rejected the Minister's overreach and found that consistent with the OECD Guidelines and statements of the Department of Finance, the transfer pricing rules have one objective – to ensure that related party transactions are carried out on arm's length terms

and conditions. The Court held this objective was satisfied in this case and for that reason the assessments in issue are unfounded in law.

If you have any questions about transfer pricing matters or tax litigation, please contact one of the authors above or a member of the National Tax Group.