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RELATIONSHIP BETWEEN CAMECO AND GLENCORE TRANSFER PRICING CASES

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OVERVIEW

A note in the December 2019 issue (Report #109)[25] considered the relationship between the 2019 transfer pricing decision rendered by one judge (herein the trial division) of the Federal Court of Australia in *Glencore Investment Pty Ltd.*[26] and the 2018 transfer pricing decision of the Tax Court of Canada ("**TCC**") in *Cameco*,[27] which has since been affirmed by the Federal Court of Appeal[28] ("**FCA**"). The Crown is now seeking leave to appeal the 2020 FCA decision to the Supreme Court of Canada ("**SCC**"). The relationship between the TCC decision in *Cameco* and the 2019 decision in *Glencore* was that both decisions considered whether tax authorities can recast taxpayer transactions or pricing procedures.[29] Now with a November 6 decision of the Federal Court of Australia Full Court ("**FCAFC**") affirming the trial division,[30] this follow-up report reviews last year's discussion as background and then considers whether anything in the FCAFC judgement in Glencore is likely to affect either the SCC's decision on the leave application in *Cameco* or, if granted, on the decision on the merits.

BACKGROUND

In 2018, the TCC had rejected a three-pronged attack by the Canada Revenue Agency ("CRA") on the tax results of sales of uranium by Cameco Canada to Luxembourg/Swiss subsidiaries that was resold into the market as well as arrangements involving the purchase and resale of Russian uranium. One prong asserted that the intercompany transactions were shams, the second invoked the provisions of paragraphs 247(2)(*b*) and (*d*) of the *Income Tax Act*[31] on the basis that the transactions lacked commercial reality, were irrational and lacked business purpose, and the third relied on the arm's length pricing requirements of paragraph 247(2)(*a*) and (*c*). The singular issue in *Glencore* was the pricing sales of crude copper (more precisely copper concentrate) to Glencore of Switzerland by its wholly owned Australian subsidiary that produced copper concentrate (all of which was sold to the Swiss parent under renewing supply contracts, for resale into the market).

The December 2019 article examined the competing formulas and procedures to price the sales (see below) and expressed surprise that there was anything in *Cameco* that would be relevant to the decision in Glencore. That reaction is consistent with the fact that the FCAFC November 6 decision (see below) does not make any reference to either the 2018 TCC or 2020 FCA decisions in *Cameco*.

In rejecting the Australian government positions on pricing the sales, the trial division in *Glencore* cited paragraphs 305, 327–332, and 360 of the TCC decision in *Cameco*. Given the Canadian government's direct and indirect focus in *Cameco* on sham and commercial irrationality, which was ultimately rejected by both the TCC and FCA, and given that according to the FCAFC the trial judge made the unchallenged findings that "Miners may sell copper concentrate to either smelters or traders. … A miner may enter into a long term contract with a trader to sell specified quantities of its concentrate or the whole of a particular mine's production"[32] and given that there was the usual contest in both cases over facts and circumstances-driven pricing, it is not clear why the trial division of the Federal Court of Australia considered *Cameco* to be relevant to the *Glencore* dispute. It has already been noted the FCAFC did not (see the next section).

THE DECISION OF THE FCAFC

As detailed in last December's article, the Australian government contended that the "price sharing" formula used by the parties to arrive at the price for the crude copper sold by the Australian subsidiary—being the excess of the market price for refined copper over an allowance for the cost the buyer would incur to treat and refine the crude ("**TC/RCs**"), calculated as 23% of the price for refined crude—led to prices for the crude that were below an arm's length price ("**ALP**"). Instead, the government contended that the parties should have either used a 7% factor, not 23%, or an entirely different way of calculating the allowance (such as spot TC/RCs) and calculated the net intercompany price on that basis. The parties also disagreed over the manner in which the dates or periods (whether a day or longer) were chosen for determining the price or average price of the refined copper (referred to as the quotational period).

In Canadian tax terms this was a paragraph 247(2)(*a*) arm's length pricing inquiry—with two potentially major differences. The Canadian ALP rule is briefly and simply worded and is not supported by any specific statutory or regulatory rules. In this regard, the SCC in *Glaxo*[33] made clear that the OECD Transfer Pricing Guidelines ("**TPG**") do not govern like a statute. In contrast, the relevant Australian rules (Div.13 of the *Income Tax Assessment Act 1936* and Subdivision 815-A of the *Income Tax Assessment Act 1997*) are elaborate and dense and, with one possible exception, are intended to arrive at an ALP that is understood internationally. The one and possibly startling exception is section 136AD(4) of Div. 13 which provides:

> [where] "it is not possible or practical for the Commissioner to ascertain the arm's length consideration... (it) ..shall be deemed to be such amount as the Commissioner determines."

How is this to be viewed? It is not clarified in Glencore because it was not relevant to the decision. Another difference is that contrary to the above-noted non-binding status in Canada of the OECD TPG, section 815-20 of the Australian statute incorporates both the OECD TPG and the OECD Model tax treaty.

Against that legal background, the FCAFC reviewed the facts found by the trial division, the relevant legal documents and testimony of the witnesses for the parties and considered the question of which "should be

preferred." The 62-page discussion of that review is highlighted below.

Pricing among unaffiliated parties for sales of copper concentrate took a wide variety of forms and utilized a number of different formulas:

> Whilst the copper industry has developed a pricing structure for its contracts which follows a reasonably well established framework, each contract nonetheless is individually negotiated and the detail and pricing of individual contracts varies greatly.[34]

There was unprecedented price movement and volatility in the year (2006) prior to those in dispute. Paragraph 19(*f*) noted the following:

> The market conditions for the price of copper in 2006 were unique. The copper price had risen by more than 80% as compared to the previous year price reaching a point that was four times the average copper price over the 1998 to 2003 period." Paragraph 19(*h*) "Spot [TC/RCs] were unknown for 2007. All experts agreed that spot pricing was very volatile and inherently difficult to predict.

As far as the essence of the statutory provisions is concerned, the bottom line is said, in paragraph 49, to be following statement in the leading *Chevron* decision:[35]

> [T]he ultimate purpose is to determine the consideration that would have been given ... had there not been a lack of independence in the transaction. How one comes to that assessment ... depends upon the circumstances at hand and a judgement as to the most appropriate rational and commercially practical way of approaching the task consistently with the words of the statutory provision, on the evidence available.

As may be expected, the expert witnesses totally disagreed with each other. The taxpayer relied on comparables—to some effect. Paragraph 193 of the FCAFC decision reasonates as a balanced approach to comparables that is of interest beyond this case.

> In our view many of the differences identified by the Commissioner are relatively important. They diminish the probative value of the contracts said to be comparable. But they do not negate the value entirely. The Contracts were valid reference points (referring to specific issues). (Parenthetical words added).

At paragraph 154, the FCAFC criticizes the trial division for thinking the case involved anything more than pricing and, thereby, explains why the FCAFC, unlike the trial division, makes no reference to *Cameco*. The FCAFC goes on to reject any applicability of sections 1.37 and 1.38 of the OECD TPG that discuss recasting transactions. It was those sections that underlied the formulation of paragraph 247(2)(*b*) that was featured in *Cameco*.[36]

The Court notes at paragraphs 183 *et seq*. that there can be a range of arm's length outcomes and their relevance is not diminished by the fact that *Glencore* Australia may have made more profit under the terms of its contract with its Swiss parent that was in effect in the tax years (1997–2006) before the tax years than it did under the revised terms in effect for the years in dispute (2007–2009).

The Court noted in paragraph 185 that the Commissioner erred in claiming that:

> the taxpayer had to prove what Independent parties WOULD have agreed to be the arm's length consideration, rather than what Independent parties MIGHT reasonably be expected to have paid or receive.

Then in paragraph 186 the Court states:

> … in applying the foregoing a degree of flexibility and pragmatism is required ... Predicting how Independent parties dealing at arm's length with each other would price a wholly controlled transaction is a difficult and complex issue ... (And that that is particularly so where a factor that) ... affects the consideration payable is the formation of a commercial judgment about risk taking. The court should acknowledge and take into account the practical difficulties faced by both the taxpayer and the Commissioner in finding evidence that grounds what is sufficiently reliable, or which demonstrates that something is insufficiently reliable. The answer is not always to be found in overly lengthy and complex expert reports. Common sense is required." (parenthetical words and underscore added).[37]

As far as the irrelevance of the pre 2007 results – (which could be termed, "it's not what could have been, it's what was")—paragraph 188 captured the Commissioner's error as follows:

> Something should be said at this point about the focus of ... the Commissioner's case upon the proposition that if CMPL had been dealing independently and at arm's length with GIAG, it would never have agreed to the amendments made to the pricing formula in February 2007 ... But in our respectful opinion the ultimate issue for determination is not whether an arm's length party would have agreed to the amendments, given the pre-existing terms of trade ... Rather the relevant issue is whether the consideration received by CMPL in the 2007 to 2009 years was less than the arm's length consideration ... for the copper concentrate in fact supplied. The answer to that question does not turn upon whether the amendments made in February 2007 were in CMPL's interests.

The importance of that statement cannot be over emphasized. The Court goes on to note that it is not saying that the pre-existing terms were irrelevant to the overall issue, but they did not govern.

The FCAFC had no trouble upholding the trial judge's decision save for an ancillary issue for the 2009 year respecting an allowance for freight charges. It saw no reason to overturn the trial judge's preference for the testimony of the taxpayer's expert witnesses that supported the arm's length price and methodologies used for the years in question.

EFFECT ON CAMECO?

It is ironic that the December 2019 article on the 2019 decision of the trial division of the Federal Court of Australia in Glencore was inspired by the question of why the trial judge thought the 2018 TCC decision in *Cameco* was relevant to her 2019 decision in *Glencore*, while this December 2020 article now concludes with the question of whether the FCAFC decision confirming the trial judge—BUT without referring to *Cameco*—may be relevant to how *Cameco* plays out, namely whether leave is granted by the SCC and, if it is, how they might decide the appeal.

The short answer, in this writer's view, is negative: the *Glencore* appeal decision should not be relevant because of fundamental differences in the facts and circumstances of the two cases (and potential differences in the architecture of the arm's length standard in the two countries).

However, the foregoing seems to point to several factors that may be generally favourable to Canadian taxpayers in transfer pricing disputes with the government. In particular, the comments on comparables and acceptable ranges (see paragraphs 183, 185, 186, and 193 noted above) and those comments as to the effect of prior years (see paragraph 188 noted above).