International Fiscal Association

YIN SESSION *JOINT EVENT*

TRANSFER PRICING JURISPRUDENCE IN AUSTRALIA AND CANADA – AN OCEAN DIVIDE?

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OUTLINE

1. General overview
2. Cross-border financial arrangements
3. Glencore vs Cameco
4. Bundled transactions/series of transactions

GENERAL OVERVIEW

CROSS-BORDER FINANCIAL ARRANGEMENTS

GE ELECTRIC CAPITAL CANADA INC V R 2010 FCA 344

BACKGROUND

- General Electric Capital Corporation (“GECUS”) indirectly owns General Electric Capital Canada Inc. (“GECC”).
- GECUS provided explicit guarantees for GECC, which allowed GECC to borrow from unrelated parties at a lower interest rate.
- GECC paid an annual fee of 100 basis points of the principal amount outstanding during any fiscal year.
- GECUS effectively controlled the issuance and repayment of GECC's debts.
- The explicit guarantee was necessary to GECC's operations.

THE MINISTER'S POSITION

- A Canadian transfer pricing analysis must consider all economically relevant circumstances, including circumstances which arise from the non-arm's length relationship.
- The relationship between the parties created strategic and reputational pressures, which gave GECUS a strong economic incentive to support GECC, even without explicit contractual obligations.
- The guarantee provided no value, as implicit credit support which arose from the parent-subsidiary relationship would have allowed GECC to borrow on equally favourable terms.

THE TAXPAYER'S POSITION

- Since the arm's length principle treats parties as independent entities, benefits which arise from the non-arm's length relationship should not be considered.
- The taxpayer's credit rating prior to the implementation of the explicit guarantee must be determined solely on a stand-alone basis.

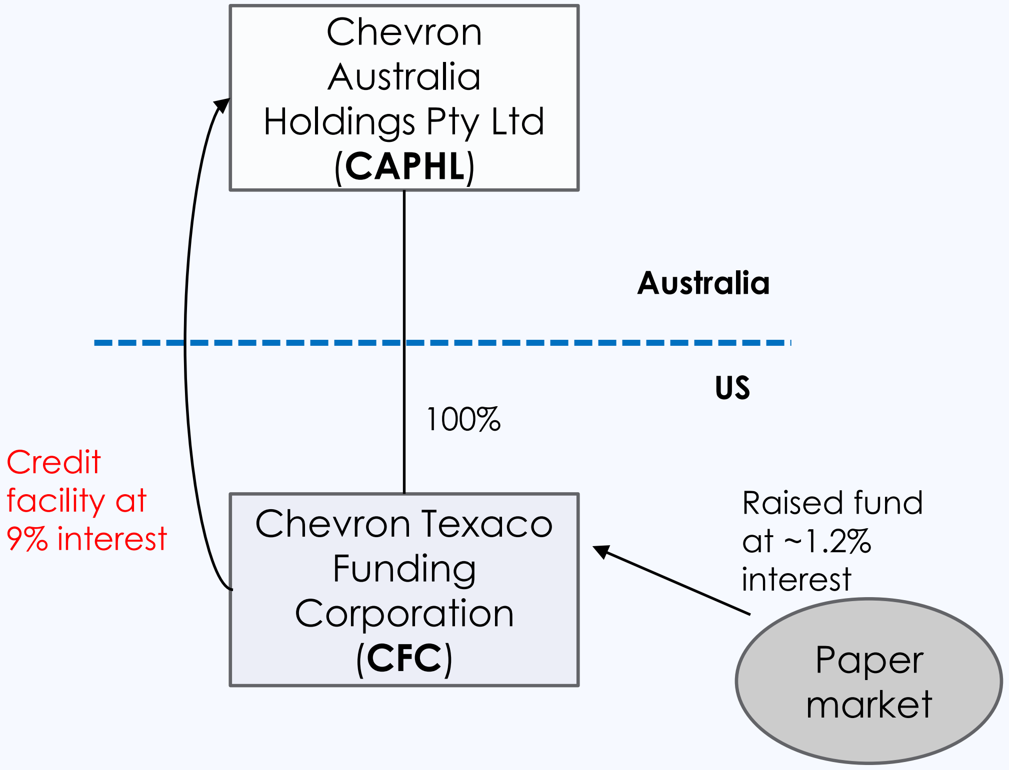
DECISIONS OF THE TAX COURT OF CANADA AND FEDERAL COURT OF APPEAL

- Finding in favour of the taxpayer, the Tax Court agreed with the Minister's pricing method, but disagreed with how this method was applied by the Minister's expert – the explicit guarantee was necessary and raised GECC's credit rating from BBB-BB+ to AAA.
- The Federal Court of Appeal dismissed the Minister's appeal and agreed with the Tax Court that implicit support was a clearly relevant circumstance.

CHEVRON AUSTRALIA HOLDINGS PTY LTD (CAHPL) V COT [2017] FCAFC 62

BACKGROUND FACTS

- Chevron Australia Holdings Pty Ltd ("CAPHL") was ultimately owned by Chevron Corporation ("CVX") in the US. CAPHL needed funds to acquire Australian assets under a global merger.
- Chevron Texaco Funding Corporation ("CFC") was a US subsidiary of CAPHL.
- 2003 - Credit Facility Agreement for US$ 2.4B at ~9% interest, unsecured with no guarantee.



POSITIONS OF THE PARTIES

Commissioner

- Application of Division 13 and 815-A.
- Treating the entities as independent does not mean that the ownership of the borrower needs to be disregarded.
- Implied parental support.

Taxpayer

- 815-A provisions were "unconstitutional".
- The relevant conditions should be determined on a stand-alone basis, i.e. exclude common ownership as a condition operating between CAHPL and CFC.
- The "profits" argument: There must be a causal relationship between the conditions and the non-accrual of profits.

DECISION OF THE COURT

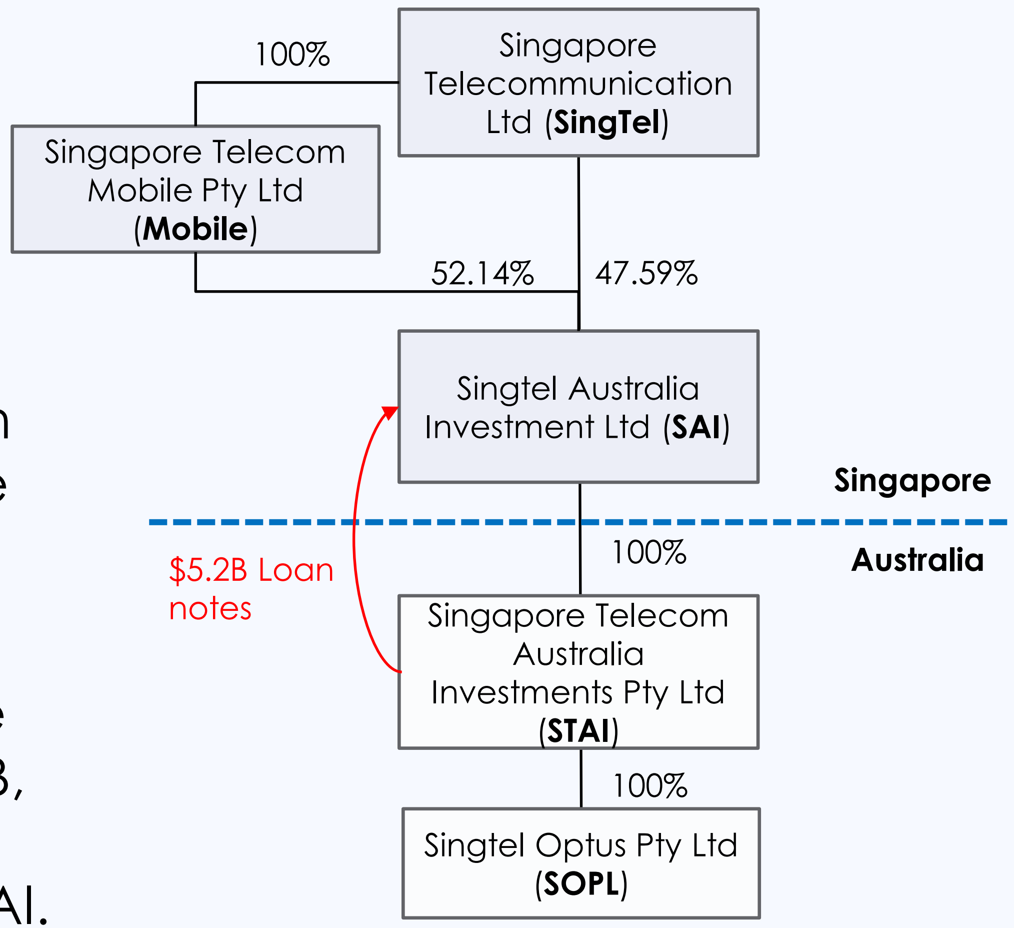
Full Federal Court: *For the Commissioner*

- Identify the conditions affecting their "financial or commercial relations" – means a broad and wide-ranging inquiry.
- Includes consideration of the parent – subsidiary relationship.
- Hypothetical exercise:
  - Parties in the hypothetical will generally have the characteristics and attributes of the actual enterprise in question.
  - What independent parties like CAPHL and CFC would have entered into.
  - Independent parties would only have entered into the credit facility on a secured basis with covenants in favour of the lender.

SINGAPORE TELECOM AUSTRALIA INVESTMENTS PTY LTD V COT [2024] FCAFC 29

BACKGROUND FACTS

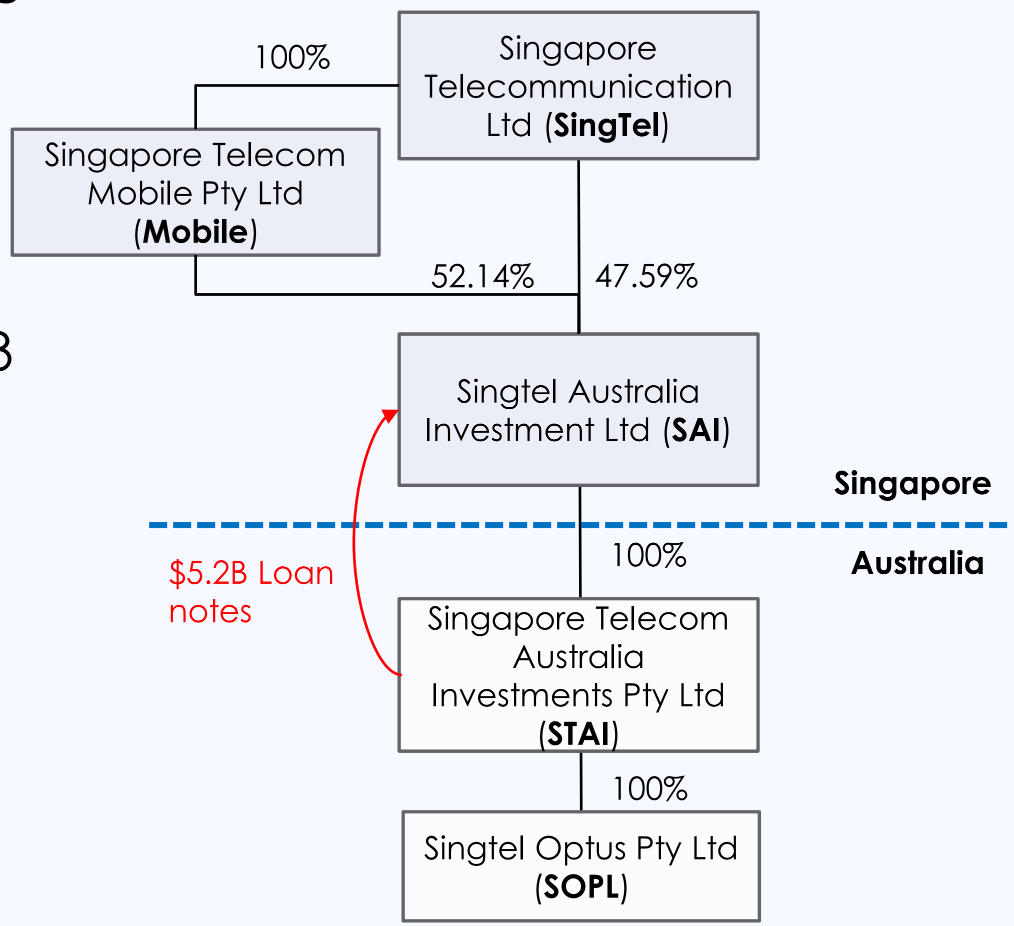
- Prior – Singtel Australia Investment Ltd ("SAI") acquired Singtel Optus Pty Ltd ("SOPL") from Optus funded by A$10.5B in equity and A$3.5B in debt from Singapore Telecommunication Ltd ("SingTel").
- Singapore Telecom Australia Investments Pty Ltd ("STAI") then acquired 100% of the issued capital in SOPL from SAI for A$14.2B, funded by A$9B of scrip (i.e. entitlement certificate) and A$5.2B of loan notes to SAI.



BACKGROUND FACTS (CONT'D)

Loan note issuance agreement ("LNIA") on 28 June 2002

- Denominated in AUD, term: 10 years.
- Interest: Floating rate of 1-year BBSW + 1.00%.
- Subject to three amendments in 2002, 2003 and 2009:
  - 2002: Changed the maturity date.
  - 2003: Accrual and payment of interest contingent on profitability benchmarks, and added a 4.552% "interest premium".
  - 2009: Replaced the floating rate with a fixed rate of 6.835% plus 1% margin (with WHT gross-up).



POSITIONS OF THE PARTIES

Commissioner

- Independent financiers would not have agreed to the amendments without parental guarantee.
- The change in the interest rate under the amendments did not represent arm's length rates.

Taxpayer

- Relationship between lender and taxpayer was not dissimilar to arrangements between independent parties.
- Loan notes was *economically equivalent* to a traditional debt capital market instrument.
  - Relied on certain rates in the debt capital markets and no parental guarantee.

DECISION OF THE COURT

Full Federal Court: *For the Commissioner*

- Court concluded on the basis of the no amendment model.
- Independent parties would have obtained parental guarantee.
- Independent parties would not have agreed to the 2003 and 2009 amendments, **even though** the overall result in interest actually paid was within the range arm's-length parties might have paid.

CROSS-BORDER FINANCIAL ARRANGEMENTS

1. Orphan theory.
2. Credit ratings and what this means for understanding implicit support and explicit guarantees.

GLENCORE VS CAMECO

CANADA V CAMECO CORPORATION 2020 FCA 112

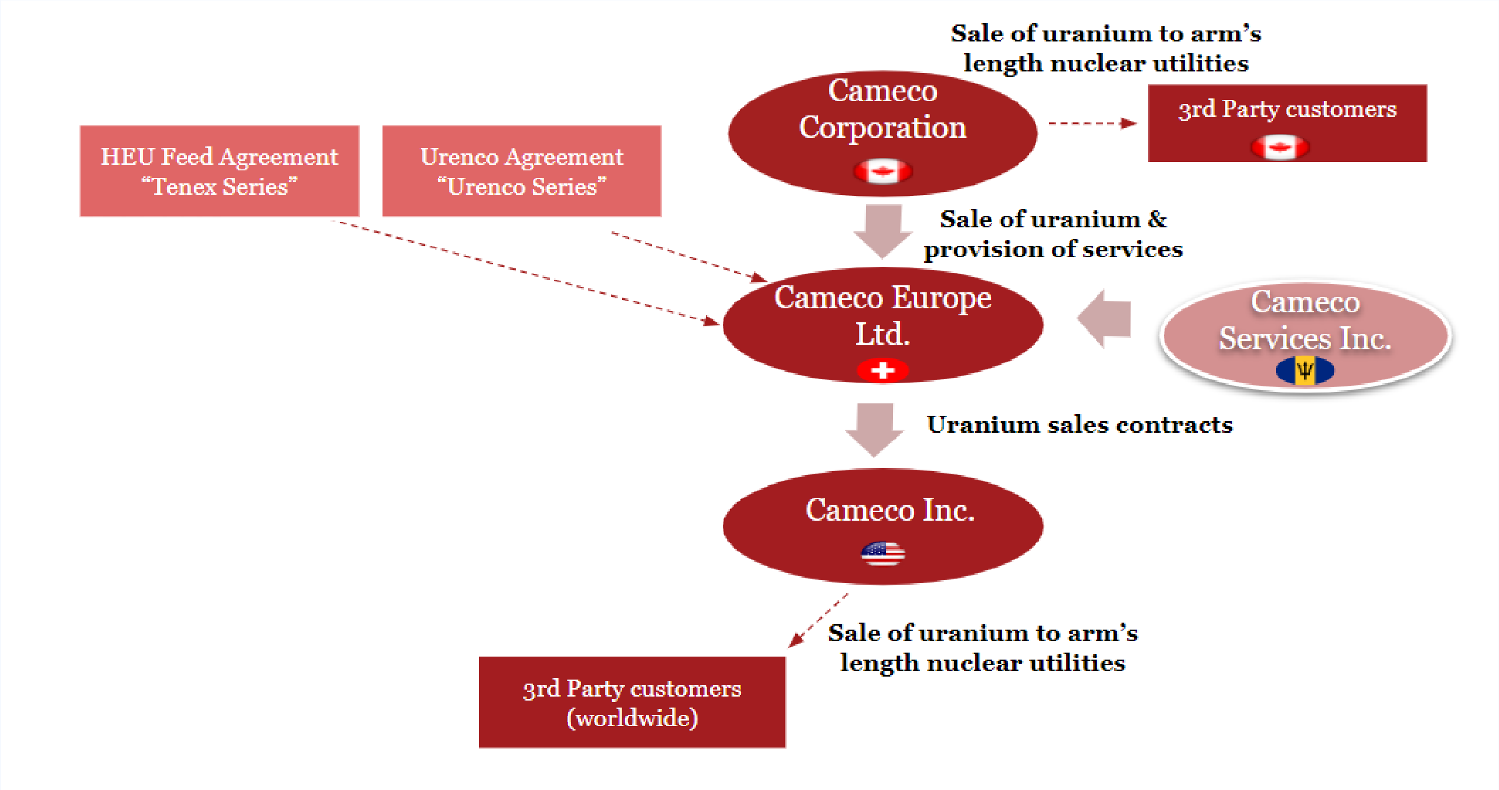
BACKGROUND

- Cameco is one of the world's largest uranium producers and suppliers of conversion services.
- In the 1990s, the Russian government began a program to sell its supply of uranium.
- To mitigate concerns of a flooded market and depressed uranium prices, Cameco and other industry participants coordinated to purchase highly enriched uranium ("HEU") from the Russian government (the "Tenex Agreement").
- Following the Tenex Agreement, Cameco's European subsidiary concluded an agreement with Urenco Limited to purchase a certain amount of natural uranium (the "Urenco Agreement").

BACKGROUND (CONT'D)

- During the same period, Cameco undertook a reorganization, including the formation of a Swiss subsidiary.
- Pre-restructuring, Cameco sold directly to third party customers worldwide.
- Cameco Europe Ltd. (Switzerland) employed 2 people during the years under audit.
- Per the request of the Russian government, the agreement between Cameco Europe Ltd. and the Russian government was guaranteed by a Cameco parent company guarantee.

BACKGROUND (CONT'D)



THE MINISTER'S POSITION

- Cameco's structure, specifically the 1999 reorganization, was a sham – Cameco's Swiss subsidiary performed few, if any, valuable functions.
- The recharacterization rule applies if the taxpayer would not have entered into the transaction or series that it did with an arm's length party (i.e., the test is subjective and applies to the transactions at issue).
- In the alternative, the traditional transfer pricing rules apply to adjust the transfer prices under the Tenex Agreement and the Urenco Agreement.

THE TAXPAYER'S POSITION

- The Swiss entity's profits are the result of commercially normal transactions for the purchase and sale of a fungible commodity – a tax element does not transform the arrangements into a sham.
- The recharacterization rule only applies if *no* arm's length parties would have entered into the same transaction or series (i.e., the test if objective based on hypothetical parties & applies when the transactions are not commercially rational).
- With respect to the traditional transfer pricing rules, the key point is that it is the owners of the asset who bear the risk, not the managers of that risk.

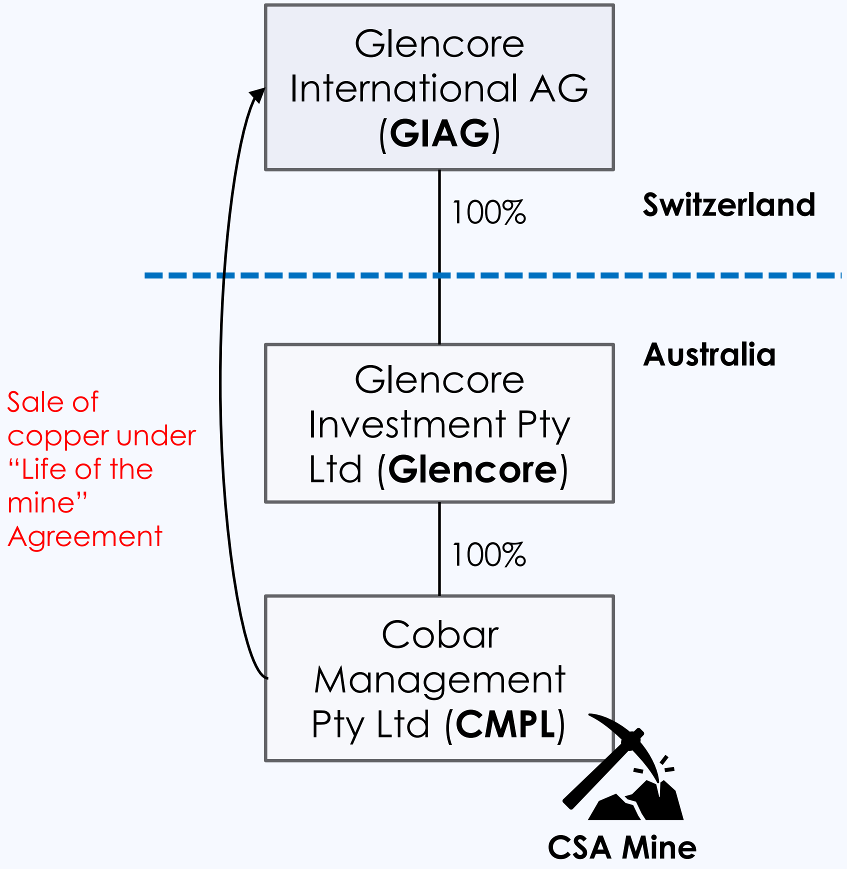
DECISIONS OF THE TAX COURT OF CANADA AND FEDERAL COURT OF APPEAL

- The recharacterization rules did not apply:
  - The recharacterization rules are objective – they only apply if, among other things, no arm’s length parties would enter into the transaction or series in question.
  - The recharacterization rules are not intended to allow the CRA to effectively ignore the existence of a foreign subsidiary.
- The traditional transfer pricing rules did not apply: The prices adopted, absent hindsight, were well within an arm’s length range

COT V GLENCORE INVESTMENT PTY LTD [2019] FCA 1432

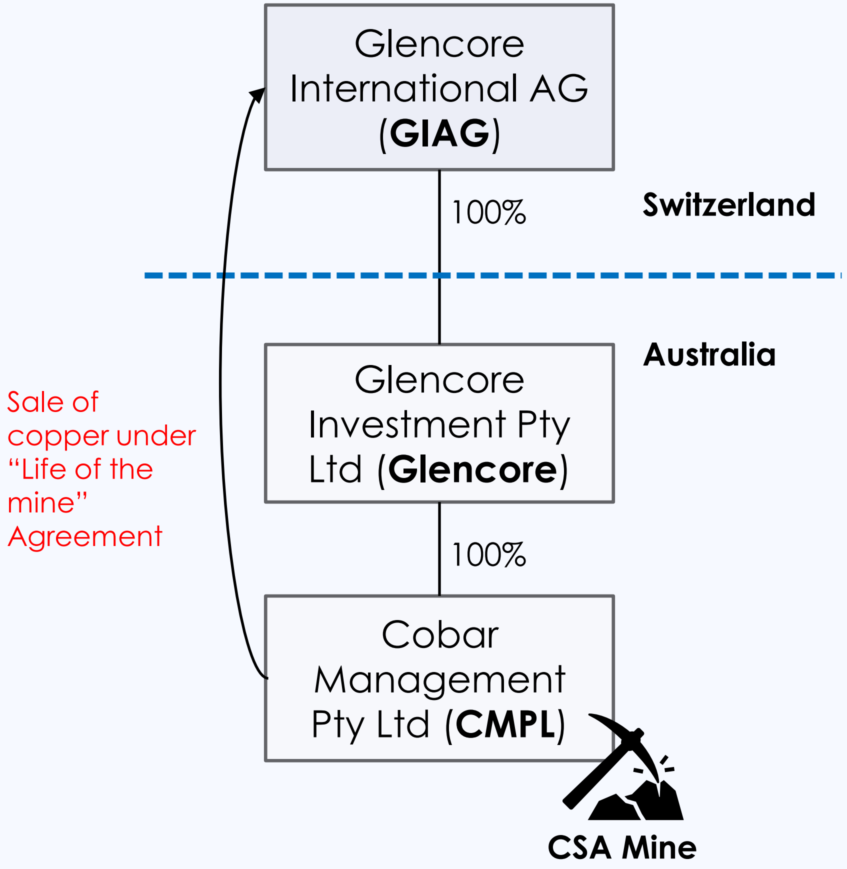
BACKGROUND FACTS

- Purchase of copper concentrate from Glencore Internation AG (“GIAG”) from Cobar Management Pty Ltd (“CMPL”) – wholly owned by Glencore Investment Pty Ltd (“Glencore”).
- Pre Feb 2007: the offtake agreements were 'market-related' agreements.



BACKGROUND FACTS (CONT'D)

- Feb 2007 onwards:
  - "Price sharing agreement".
  - Treatment and copper refining charges ("TCRCs") was fixed at 23% of the copper reference price.
  - More options given to GIAG to determine the relevant period used to determine the average applicable copper price.
  - For the 2009 year only set higher freight rates.



POSITIONS OF THE PARTIES

Commissioner

- Independent mine producers would not have agreed to price sharing at all or to quotational periods with back pricing optionality.
- Instead, they would agree to a life of mine agreement on market-related terms and limited quotational period optionality with no back pricing.

Taxpayer

- The terms in the 2007 Agreement existed in contracts between independent market participants.
- No basis to assume a wholly different agreement for the sale of copper concentrate to that which the parties in fact agreed.

DECISION OF THE COURT

Full Federal Court: *For the Taxpayer (but not fully)*

- Agreed with primary judge that 2007 Agreement reflected an arm's length rate, except in relation to the freight allowance.
- The hypothetical requires drawing upon commercially rational practices adopted by independent parties operating in a particular market.
- But disagreed with one of the primary judge's findings:
  - While different contract terms can't be substituted if they don't define the consideration received for supply of goods…
  - **…but,** if the price was to be determined by a formula or methodology, the Commissioner is permitted under 815-A to substitute a different formula or methodology to ascertain the arm's length consideration.

GLENCORE VS CAMECO

1. Substance vs form.
2. Recharacterisation.

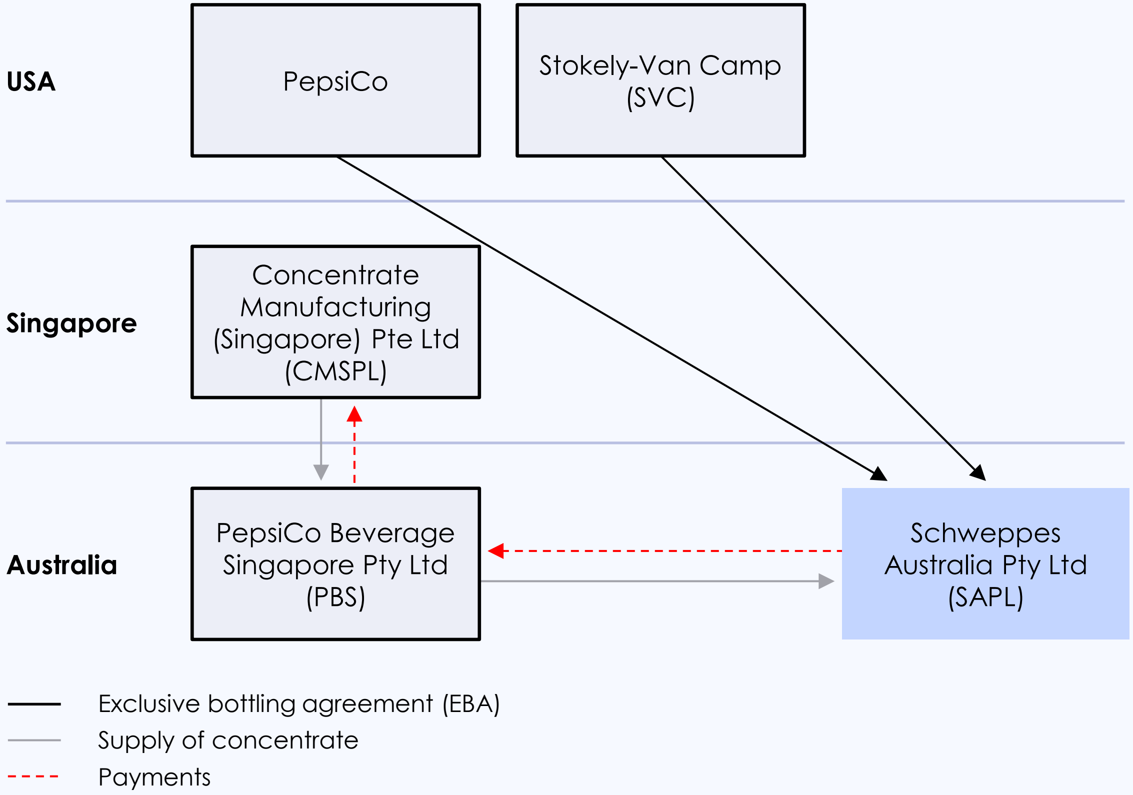
BUNDLED TRANSACTIONS/SERIES OF TRANSACTIONS

PEPSICO, INC V COT [2024] FCAFC 86

BACKGROUND

Exclusive Bottling Agreement (EBA):

- SVC and PepsiCo entered respective EBAs with SAPL (third-party bottler) for sale of concentrate for the production of beverages in Australia.
- Right to use trademarks and other IP, but no explicit payment for it.
- Concentrate supplied by PBS to SAPL (permitted under the EBA).



KEY ISSUES FOR THE COURT

Among others, the Court had to decide whether:

1. As a matter of contractual construction – was the price paid under the EBA include the use of IP?
2. What was the commercial and economic substance of the scheme? i.e. was the amount of money paid under the scheme for concentrate and use of IP i.e. embedded royalty?

The Diverted Profit Tax (DPT) regime includes a sufficient economic substance (SES) test whereby

"*…the inquiry is similar* [to a transfer pricing case] *to the extent that it involves a determination that a price charged for one thing in substance includes an economic transfer of value for something else.*"

FULL FEDERAL COURT DECISION: *FOR THE TAXPAYER (FOR NOW?)*

Majority judgment

- Also focused on the construction of the EBA.
- **BUT** rejected the Commissioner's argument that PepsiCo and SVC were "giving away" the right to use valuable IP for nothing unless some element of the concentrate price has an embedded value for it.
- The licence granted should not be viewed in isolation of the overall obligation.

Minority judgment

- Regard to the whole of the terms of the EBA reveals that the agreement should be characterised as one to bottle, sell and distribute beverages, not just for the supply of concentrate.
- Parties knew the IP was strong and valuable.
- Overall, to say the EBA is just for concentrate "is a commercially unreasonable view of the terms of the EBAs considered as a whole".

CANADA V GLAXOSMITHKLINE 2012 SCC 52

BACKGROUND

- GlaxoSmithKline Inc. ("GSK Canada") acted as a secondary manufacturer and marketer – it acquired pharmaceutical ingredients, put those ingredients into a delivery mechanism (e.g., tablet, liquid or gel) and packaged and marketed pharmaceutical drugs.
- Between 1990 and 1993, GSK Canada purchased ranitidine (active pharmaceutical ingredient) from Adescha, a Swiss related party, under a supply agreement.
- Additionally, a licence agreement conferred rights and benefits to GSK Canada (6% royalty of net sales).
- The combined effect of the license and supply agreements was to allow GSK Canada to purchase ranitidine, manufacture and market gastric reflux product under the Zantac trademark.

POSITIONS OF THE PARTIES

- The Minister's position:
  - The Licence Agreement is irrelevant – Canadian jurisprudence & the OECD Guidelines both require a transaction-by-transaction approach.
  - The price paid by GSK Canada for ranitidine was too high based on generic comparable prices (CUP method).
- The taxpayer's position:
  - The comparison with generic companies is inappropriate – the Licence Agreement must be taken into account, as it conferred certain rights and benefits related to the purpose for which its ranitidine was purchased.
  - Based on European comparables, the resale price, the transactional net margin, and CUP methods support the transfer prices adopted.

DECISIONS OF THE TAX COURT OF CANADA, FEDERAL COURT OF APPEAL AND SUPREME COURT OF CANADA

- The Federal Court of Appeal and Supreme Court disagreed with the Tax Court: The Licence Agreement is relevant.
- While a transaction-by-transaction approach may be ideal, it is not appropriate in all cases.
- However, the matter was sent back to Tax Court: The taxpayer had not yet demolished the Minister's assumption that the amounts paid to Adescha were unreasonable.

BUNDLED TRANSACTIONS/SERIES OF TRANSACTIONS

1. Pricing intangibles.
2. Expert evidence.
3. What if this was a transfer pricing case?