International Tax

Report No.: 109

Date: December, 2019

GLENCORE: AUSTRALIAN COURT RELIES ON CAMECO

--Nathan Boidman, Davies Ward Phillips & Vineberg LLP

A foreign decision on transfer pricing involving highly specialized industry practices may ordinarily be of only passing interest to Canadian tax practitioners. Where, however, the decision (in this case rendered by the Federal Court of Australia in *Glencore Investment Pty Ltd.*[1]) relied, in part, on a recent high-profile Canadian case (the decision of the Tax Court of Canada (TCC) in Cameco[2]), a closer look is warranted. And that interest is only heightened where the issue linking the two cases is whether tax authorities can recast taxpayer transactions or pricing procedures.[3]

The background is the TCC's rejection, a year ago, of 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 were resold into the market. One prong asserted that the intercompany transactions were shams, the second invoked the provisions of paragraph 247(2)(*b*) and (*d*) of the *Income Tax Act* (Canada)[4] — dealing with transactions that lack commercial reality — are irrational and lack business purpose, and the third relied on the straight arm's length pricing requirements of paragraph 247(2)(*a*) and (*c*).

The facts in *Glencore* were straightforward and left nothing to be challenged by the Australian tax authorities. The issue was strictly whether the formulas and procedures used to price the transactions met arm's length standards.

Glencore of Switzerland (not owned/controlled by Australians) owned an Australian subsidiary that produced copper concentrate all of which was sold to the Glencore parent company, under renewing supply contracts, for resale into the market. The complexity and cause of dispute was the manner in which the intercompany price for the copper concentrate was established. This, in Canadian terms, is a straight paragraph 247(2)(*a*) issue. There was no dispute for the years up to 2007. For those years, the price was established by first determining a price on a recognized copper exchange for treated copper and then deducting an agreed estimate of the treatment costs (referred to as treatment and copper refining charges) that the Glencore parent company would incur in order to then sell treated copper. Pivotal to the issue was a change the parties made, effective in 2007, to the estimate of the treatment costs, a change that the Australian tax authorities believed resulted in prices that did not meet the arm's length standard. It was the attempt by the Australian tax authorities to reset the prices by using the pre-2007 formula for the years in question (2007-2009) that led the Court in *Glencore* to rely on language in *Cameco* in striking down the government's reassessments. Whether such reliance was necessary is considered further below.

For the sake of completeness, it must be noted that the government's reassessments were also based on seeking to change the reference periods for prices on the copper exchange — from dates that, at the option of the buyer preceded the delivery or receipt of the copper to dates that followed delivery or receipt. That approach was also rejected by the Court.

The pre-2007 treatment costs that the government did not challenge were established by negotiation having regard to certain market benchmarks and reference points but did not comprise the actual costs incurred by the Glencore parent company. For example, for the immediately three preceding years (2004 to 2006) the costs were described in paragraph 4 of the Judgment as consisting of "50% benchmark/50% spot". The parties agreed that this approach gave rise to arm's length prices.

For 2007 to 2009, the treatment costs were determined by applying a factor of 23% to the base copper exchange price used for the particular sale. The government challenged the appropriateness of such a method as well as the 23% factor, arguing that 6% made more sense, and sought to re-compute the treatment charges by resort to the formula used for the prior three-year period.

It was in rejecting the latter (as well as the attack on the reference periods for choosing the prices on the copper exchanges) that the Federal Court of Australia cited *Cameco* at paragraphs 305, 327-332, and 360. Given the Canadian government's direct and indirect focus in *Cameco* on sham and commercial irrationality, which was ultimately rejected by the TCC, and given that there was the usual contest in both cases over facts and circumstances-driven pricing (with *Cameco* involving negotiated contracts pricing and *Glencore* involving recognized commodity markets pricing factors),it is not clear why *Cameco* would be relevant to the *Glencore* dispute of how to price a transaction, the *bona fide* nature of which was not challenged as being a sham or commercially irrational. Leaving aside penalties, whether the price is correct (as an arm's length price) is not a matter of how you get there or fail to get there. Rather, it is a matter of getting there relying first on comparability or, where there is no third party price to adopt as an appropriate comparable, then it is a matter of what is commercially reasonable, which is a matter of assessing the facts and circumstances.

In Canadian transfer pricing terms, this analysis is a paragraph 247(2)(*a*) inquiry where each case is based on its own facts and circumstances and not a paragraph 247(2)(*b*) inquiry. Consequently, it is not clear why the Australian Court needed to rely on *Cameco* in arriving at what appears to be a fully supported decision.

[1] *Glencore Investment Pty Ltd. v. Commissioner of Taxation of the Commonwealth of Australia*, [2019] FCA 1432 ("*Glencore*").
[2] *Cameco Corporation v. The Queen*, 2018 TCC 195 ("*Cameco*").
[3] This differs from "re-characterizing" transactions, an issue that did not arise in either case.
[4] All statutory references herein are to the *Income Tax Act* (Canada) unless otherwise noted.