Cameco Corporation v. The Queen [1] – Case Comment

This case involved a landmark transfer pricing dispute in which the Canada Revenue Agency (the "**CRA**") reassessed the taxpayer for additional income of CAD$483,431,713 for the years 2003-2006, with exposure of up to CAD$2 billion if the same principles were to be applied in respect of subsequent years to 2017.

During the taxation years 2003-2006, Cameco Corporation ("**Cameco**") and its subsidiaries constituted one of the world's largest producers and suppliers of uranium. Uranium is bought and sold in an unregulated market, under bilateral contracts but it is not traded on a commodity exchange.

In the 1990's, the Russian government agreed to convert its weapons-grade uranium to UF_6 which could be used in American light water nuclear reactors. Cameco saw an opportunity to structure its affairs to address the international business opportunity of buying and selling the Russian uranium as well as its own uranium.

In 1999, Cameco reorganized into three businesses: Cameco in Saskatchewan, Canada was to remain the miner and producer; Cameco Europe S.A., a Luxembourg subsidiary of Cameco (**"CESA**") and Cameco Europe AG, a Swiss subsidiary of Cameco ("**CEL**") were together ("**CESA/CEL**") to be the traders, the price speculators on buying and selling uranium, a commodity with a history of volatile price movements; and Cameco Inc., the U.S. subsidiary, was to be the broker that would market and solicit the customers (mostly U.S. utilities).

CESA/CEL was authorized by the Swiss nuclear regulator to buy and sell uranium, and it was able to buy Russian uranium and sell it to European utilities on a profitable basis.

CESA/CEL was contractually part of a tripartite consortium (established to spread the price risk of uranium among arm's length parties) to buy the Russian uranium: CESA/CEL on behalf of Cameco; Cogema, a French company controlled by the French government; and Nukem, an American commodity trading company with expertise in uranium trading.

Cameco guaranteed due payment for the purchases by CESA/CEL to the arm of the Russian government. In addition, administrative services for CESA/CEL were provided by Cameco from Canada.

Cameco sold its uranium to CESA/CEL at a price that was fixed with some adjustment mechanisms in the contract, and Cameco bought some Russian uranium from CESA/CEL, also based more or less on fixed prices. CESA/CEL bore the price risk on the purchases and sales of uranium.

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[1] 2018 DTC 1138(Tax Court of Canada).

During the years in question, CESA/CEL earned substantial profits and Cameco realized significant losses. Undoubtedly, this discrepancy led the CRA to challenge Cameco's arrangements.

The CRA argued that the 1999 reorganization was motivated strictly to save tax; that mind and management of CESA/CEL essentially remained with Cameco in Canada; that CESA/CEL had only two employees who were incapable of transacting the millions of dollars' worth of uranium sales; that the inter-company contractual arrangements were a sham; and that even if those arrangements had legal substance, Cameco had violated the Canadian transfer pricing rules which would allow the CRA to recharacterize the transactions to those that arm's-length parties would have entered into, unlike the ones entered into by the Cameco Group, resulting in the attribution of all the profits of CESA/CEL to Cameco.

The Court ruled in favour of Cameco on all points.

After 65 days of hearings and a detailed examination of the facts reflected in a nearly-300 page decision, the Court concluded that the 1999 reorganization and the uranium purchase and sale contracts to which CESA/CEL was a party are what they appear on their face to be. The CRA misconstrued the meaning of sham – there must be an element of deceit, and none was present here: just tax-motivated arrangements. There was no deception or sham here. CESA/CEL's trading profits did not result from functions performed by Cameco, but from CESA/CEL's *bona fide* trading activity pursuant to which it entered into legally effective and commercially normal contracts to purchase uranium from Cameco and third parties and to resell that uranium at market prices.

The arrangements created by the contracts among Cameco, CESA/CEL and Cameco U.S. were not a façade but were the legal foundation of the implementation of Cameco's tax plan. Cameco's motivation for these arrangements may have been tax-related, but the Court held that a tax motivation does not transform these arrangements into a sham.

Evidence showed that sales by CESA/CEL were agreed upon in a collaborative effort among executives of CESA/CEL, Cameco and Cameco U.S., as was proven to be common practice within many multinational enterprises.

CESA/CEL purchased and aggregated uranium from both related and unrelated parties, sold uranium to Cameco and indirectly to external customers, and reviewed and ensured compliance with Swiss regulations. CESA/CEL's key assets included its contracts, regulatory relationships, and uranium inventory (from multiple sources not just from Cameco).

CESA/CEL's price risk arose from the difference between its commitments to purchase and its commitments to sell, and the resulting exposure to any fluctuation in the price of uranium.

Evidence was accepted that CESA and CEL each had at least one senior employee with extensive experience in the uranium industry, and each had the assistance of a third-party service provider. These were adequate resources to address the number of contracts entered into by CESA/CEL.

The Court also rejected the CRA's position that the fact Cameco realized losses while CESA/CEL earned profits leads to the inference that the sales' prices were not at arm's length. The difference in outcomes was as a result of the increase in the price of uranium in the market, regardless of any subjective forecasts or motivation expressed by Cameco when providing CESA/CEL with the business opportunity regarding the purchase and sale of the Russian uranium. Moreover, Cameco was operating rationally like any other multinational doing business globally, taking advantage of Canada's system for taxing international income, based on having an active business of substance being carried on through subsidiaries in countries with which Canada has double taxation agreements, resulting in legitimate deferral of Canadian taxes.

The Court also rejected the CRA's attempt to apply the transfer pricing rules in subsection 247(2) of the *Income Tax Act* (Canada) to the series of transactions starting with the 1999 reorganization and including transactions between Cameco and CESA/CEL, as well as between CESA/CEL and Cameco U.S.

The Court held that paragraph 247(2)(a) asks if the terms and conditions made or imposed in respect of the transaction or in respect of the series depart from arm's length terms and conditions. Paragraph 247(2)(b) asks about the purpose of the transaction or series and whether arm's length persons would have entered into the transaction or the series. Paragraphs 247(2)(c) and (d) each require a substitution of the terms and conditions that arm's length persons would have agreed upon in the circumstances, determined either by reference to the actual transaction or series or by reference to an alternative transaction or series.

In particular, subparagraph 247(2(b)(i) asks whether the transactions or series under review would have been entered into by persons dealing with each other at arm's length. Referring to the OECD Guidelines, the Court held that if a transaction is commercially rational then it is reasonable to assume arm's length persons would have entered into the transaction or series. The fact that the transaction or series is uncommon or even unique does not alter this assumption. If a transaction or series is not commercially rational, then it is reasonable to assume that arm's length persons would not have entered into the transaction or series.

The Court accepted Cameco's expert evidence that the purchases and sales of Russian uranium by CESA/CEL were heavily negotiated among four parties, that the significant profits earned by CESA/CEL were more a product of the increase in the market price for uranium than of any subjective forecast of prices with an expected return for Cameco.

The Court held that the arrangements for CESA/CEL to be the signatory to the Russian contracts along with the arm's length parties, Cogema and Nukem, were commercially rational and, accordingly, paragraph 247(2)(b) did not apply.

Moreover, the Court stated that the answer is not simply to disregard all the transactions that did take place, and tax Cameco as if nothing in fact occurred because arm's length persons would not have entered into the series of transactions. Such an approach uses the series to define the result, and in so doing completely disregards the purpose and focus of the transfer pricing rules, by circumventing the comparability analysis that is at the heart of the rules.

The Court also rejected the CRA's attempt to apply the traditional transfer pricing methods to the sales transactions of CESA/CEL. For example, the CRA's expert likened CESA/CEL's function to that of a routine distributor, but tellingly noted that such distributors typically buy and sell products with stable prices over time, which was clearly not the case with uranium. Moreover, the Court rejected the evidence of the CRA's expert on the basis that it was in substance supporting the CRA's notional position on the facts, and not the actual facts of the case.

The Court rejected the CRA's expert application of the Cost Plus method of transfer pricing on sales of uranium from Cameco to CESA/CEL, because such a method assumes stable prices, so that the non-arm's length transaction could be compared with the notional arm's length transaction, not based on a comparison of cost but the reasons why sales prices may differ; but here the volatile nature of uranium's sales price made the Cost Plus method inappropriate.

The Court also rejected the use of the Resale Price Method to the sale of uranium from CESA/CEL to Cameco U.S., because such a method assumes a back-to-back sales arrangement with resulting routine distributorship profits that would have been allocable to CESA/CEL; but that ignores the very real risk of price volatility assumed by CESA/CEL, thus entitling it to commensurate profits when the price of uranium rose through uncontrolled market forces.

The Court further rejected the CRA's assertion that various research studies, information sharing, and provision of administrative services by Cameco to CESA/CEL constituted consideration for the profit earned by CESA/CEL, as it did not take into account the price risk assumed by CESA/CEL.

The Court also rejected the CRA's argument that Cameco made all the substantive decisions for CESA/CEL, as the Court held that the two senior officers of CESA/CEL were well qualified to make their own decisions for CESA/CEL.

Finally, the Court accepted the use of the Comparable Uncontrolled Price method put forward by Cameco's expert as the most reliable and appropriate transfer pricing method to apply in these circumstances.

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