

Cross Border Cases

November 30, 2018

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Cameco Corporation v. The Queen



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Transfer Pricing in Canada

Re-Price Transactions (Typical)

- the ***terms or conditions*** made or imposed, in respect of the transaction or series, between any of the participants in the transaction or series differ from those that would have been made between persons dealing at arm's length

Recharacterize Transactions (Not typical)

- the ***transaction series*** would not have been entered into between persons dealing at arm's length and can reasonably be considered not to have been entered into primarily for bona fide purposes other than to obtain a tax benefit



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Cameco Corporation v. The Queen

Key Facts

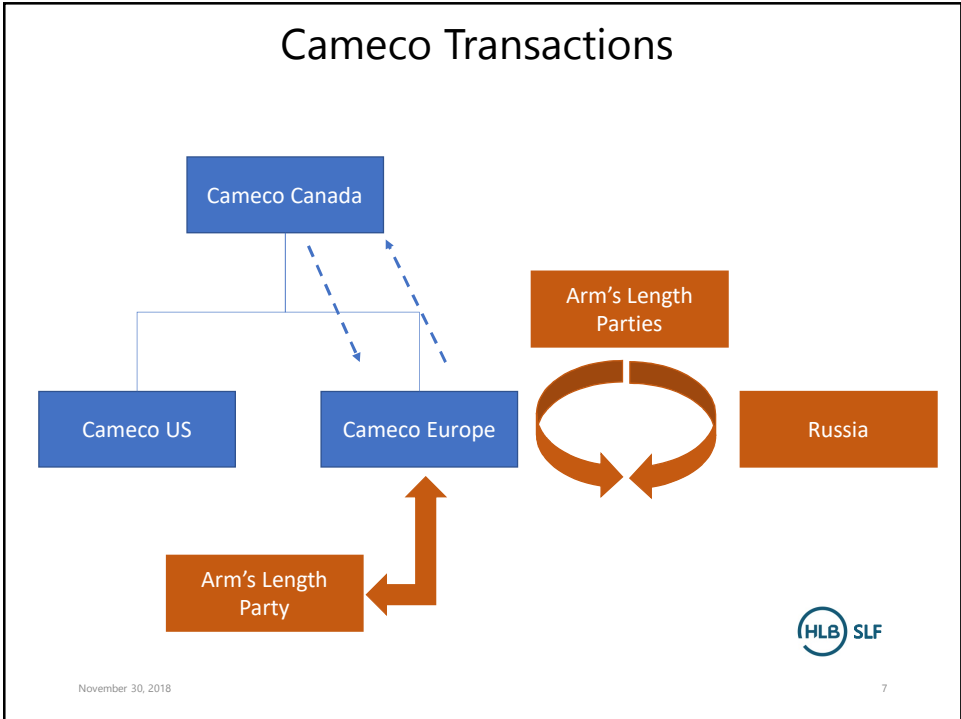
- Cameco reorganized itself (primarily for tax reasons) to contract with Russia;
- Cameco entered a contract with Russia along with 3 arm's length parties involved to purchase certain amounts of weapons grade uranium;
- Cameco Europe had 2 employees, duties included conclusion of contracts (20-25 per year);
- Uranium is not listed on an exchange. Couple of companies publish prices;
- Cameco Europe entered into another agreement with an arm's length party to buy certain amounts of uranium;
- Cameco also entered buy/sell agreements with Cameco Europe for uranium (one purpose of which was tax motivated);
- Cameco ultimately challenged on \$7 billion of profit which would result in \$2.2 billion in tax in Canada



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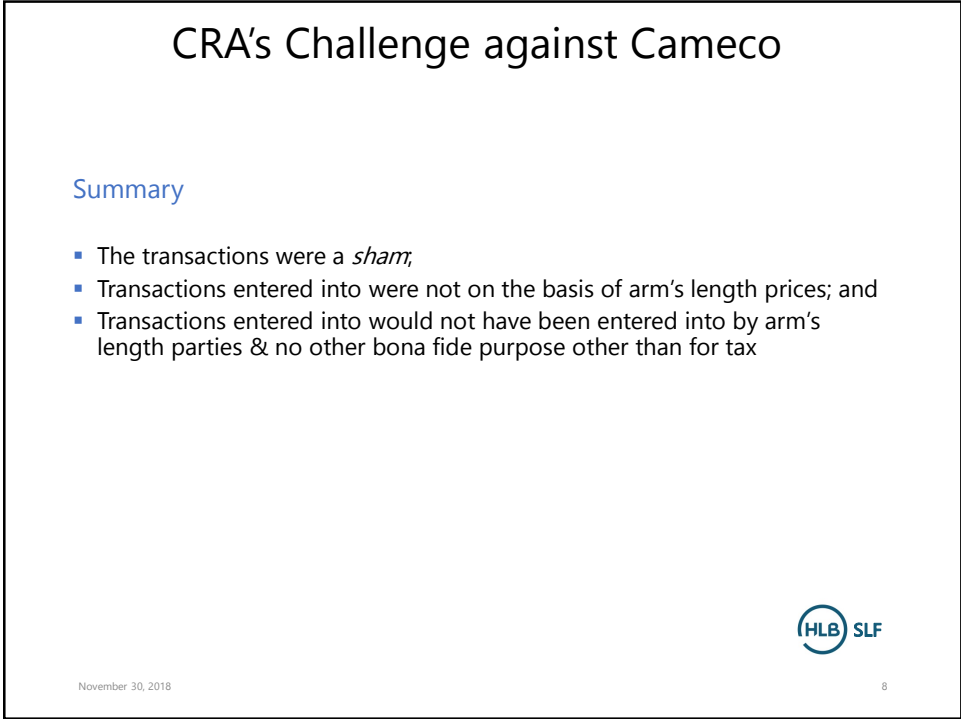
Cameco Transactions



CRA's Challenge against Cameco

Summary

- The transactions were a *sham*;
- Transactions entered into were not on the basis of arm's length prices; and
- Transactions entered into would not have been entered into by arm's length parties & no other bona fide purpose other than for tax



CRA Reviews of TP Challenges

Transfer Pricing Review Committee ("TPRC")

- Where there is a CRA challenge for transfer pricing; a referral must be made to the TPRC where;
 - Penalty Referrals – TP adjustment exceeds 10% of gross revenues or \$5,000,000;
 - Transaction Recharacterization Referrals

Referrals Made

- From January 2012 – April 2017;
- Transaction Recharacterization Referrals – 39 (7 per year average);
- Penalty Referrals – 325 (60 per year average);



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Recharacterizing Transactions

ITA 247(2)(b), Two prong Test

- Would arm's length persons have engaged in such a transaction; and
- Was the transaction entered into primarily for bona fide purposes other than to obtain a tax benefit



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Recharacterizing Transactions

How the court addressed the two prong test

- First, the concept of commercially rational. (i.e. Arm's length parties would only enter a contract if it were commercially rational);
- The involvement of competitors in the agreements with the Russian government meant each party had to give up a business opportunity to achieve other objectives;
- Thus, commercially rational, and did not meet the criteria to recharacterize the transaction;
- Second, although Cameco admitted its tax motivation, the court found that Cameco entered into these transactions for the bona fide purpose of earning a profit



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Takeaway from the case

- Taxpayers can continue to rely on Form over Substance doctrine in Canada;
- The decision is a strong focus on contractual arrangements. For Canada there is a strong preference for fact-based analysis over subjective analysis (which may not align with the approach in other jurisdictions);
- The case reiterates, taxpayers can conduct their affairs in a way to minimize taxes;
- Recharacterization of a transaction will not apply where the taxpayer is transacting in a commercially rational manner, even if a tax benefit exists;
- If the transaction is commercially rational, the only TP consideration remaining is that of price;
- A parent organization in a MNC is permitted to provide a business opportunity to a subsidiary;
- Ensure robust intercompany agreements, defining roles, responsibilities and risks align with actual conduct of parties. Play important role in defending against TP reassessments;
- CRA has appealed the decision, stay tuned



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Canada v. Oxford Properties Group Inc.



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General Anti-Avoidance Rule ("GAAR")

What is it?

- A tax avoidance transaction or series of transactions that abuses specified provisions in the Act;

What's needed for GAAR?

- Goes back to Copthorne and Canada Trustco cases. There must be;
 1. A tax benefit;
 2. An avoidance transaction giving rise to such benefit; and
 3. The avoidance transaction is abusive.



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CRA's Challenge against Oxford

Summary

- Transactions were entered into by Oxford to minimize the amount of taxes on the disposition of three real estate properties to a tax exempt entity;
- Specifically, tax on latent recapture of previous amounts claimed as tax depreciation ("CCA") and a reduced amount of tax on capital gains;
- Complex steps were involved which spanned over 5 years;

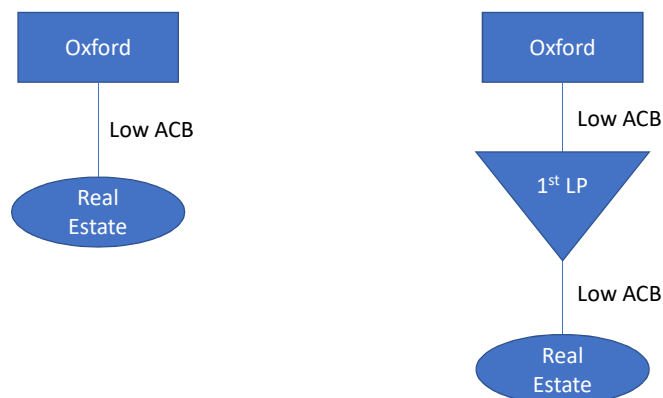


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Pre-Closing Reorganization Transactions

Step 1



Election made under 97(2) to transfer to 1st LP at its ACB and UCC (i.e. tax deferred)

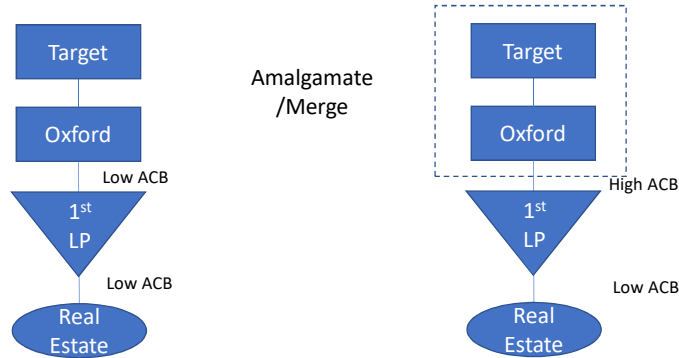


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Pre-Closing Reorganization Transactions

Step 2



This amalgamation permitted Oxford to make a “bump” election under 88(1)(d) on ACB on non-depreciable capital property. This transaction happened in 2011. A legislative change in a later year would not have permitted this.

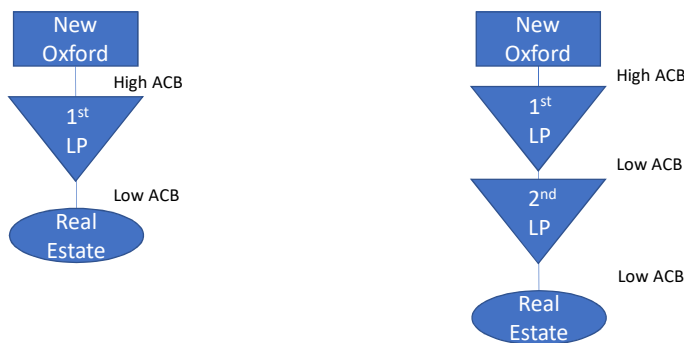


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Pre-Closing Reorganization Transactions

Step 3



Election made under 97(2) to transfer to 2nd LP at its ACB and UCC (i.e. tax deferred)

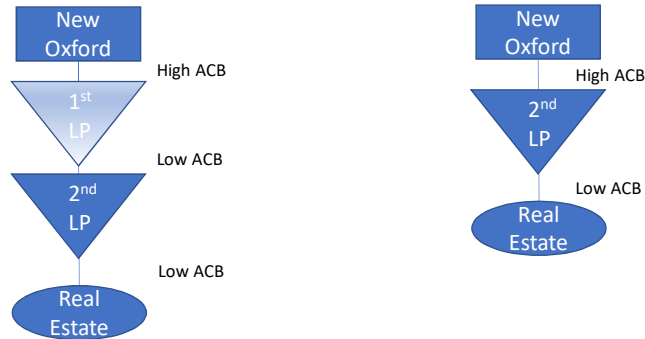


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Pre-Closing Reorganization Transactions

Step 4



1st LP is wound up into New Oxford and an election is made under 98(3) to bump tax cost of capital property owned by 1st LP.

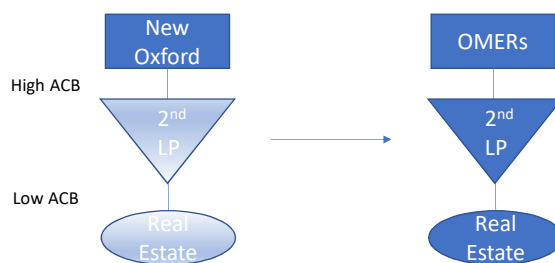


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Pre-Closing Reorganization Transactions

Step 5



Sell 2nd LP to OMERs, reduced capital gain on sale due to 2 “bumps”, no recapture as partnership interest sold, not the underlying asset.



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Section 100(1) avoided

What is it?

- This specific anti-avoidance comes into play where an LP interest is sold to tax-exempt entities (including *non-residents* not carrying on business in Canada);
- Crux of the provision is to recharacterize proceeds from such a sale into two buckets
 - 1st towards capital property of the partnership (other than depreciable property); and
 - 2nd towards depreciable property
- One of the reasons for this mechanism is to ensure latent recapture is taxed in hands of seller at 100%, but not the appreciated value at 100% (instead 50%).



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Takeaway from the case

- Which rule triggered the GAAR decision, the rollovers, the first bump, the second bump or the inapplicability of 100(1), the judgement did not reveal;
- In the mergers and acquisitions context, this now provides uncertainty as to what can and what cannot be done as part of pre-closing reorganization transactions;
- Although simplified facts and steps shown, these transactions took over 5 years to consummate.
- 100(1) is applicable where a taxpayer sells to a non-resident. Must consider pre-sale transactions of non-residents owning real estate in Canada and implications thereof;
- Lots of foreign passive ownership of real property in Canada by foreign pension funds that may be tax exempt under treaties;
- Oxford has appealed the decision, stay tuned



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Suraj joined SLF in 2018 after spending 13 years with a national accounting firm.

EDUCATION

- CPA Canada Advanced International Tax - 2013
- CICA In-Depth Tax Course – 2010
- Chartered Accountant - 2006
- Brock University, Bachelor of Accounting - 2005

CURRENT MEMBERSHIPS

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- Chartered Professional Accountants of Ontario (CPA Ontario)
- Canadian Tax Foundation



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