



Dear Colleagues:

This is the first of what will hopefully be many newsletters from the IATJ.

The IATJ was, as you are no doubt aware, formed by Statute effective January 1, 2010. Its objectives include:

The purpose of the International Association of Tax Judges is to promote exchanges of views and experience on matters submitted to Tax Judges, the organization and functioning of such Tax Judges and the Rules of Law applicable to a variety of jurisdictions.

Your interest, support and involvement will ensure the success of this organization for the benefit of all who have an interest in tax. If you have not already become a member, please consider doing so in the near future. The IATJ will be holding its 1st Assembly in Rome on August 27 and 28, 2010 which will be followed by another update on its activities by newsletter.

Kindest personal regards,

Gerald J. Rip, President

The founding members of the IATJ represent tax courts from around the world. The interim executive for the IATJ is:

Chief Justice Gerald Rip (Canada), President;
Judge Olof Olsson (Finland), Vice-President;
Associate Chief Justice Eugene Rossiter (Canada), Secretary-General;
Judge Philippe Martin (France), 2nd Vice-President;

executive members at large: Judge Juan Carlos Vicchi (Argentina), Judge John Avery Jones (U.K.), Judge Kjeld Lund-Andersen (Denmark), Judge Willem Wijnen (Netherlands) and Judge Peter Panuthos (U.S.A.).

2010 IATJ Assembly – Rome

**August 27th and 28th, 2010
Westin Excelsior Hotel
Via Vittorio Veneto, 125**

AGENDA

Friday, August 27, 2010

16:00 hrs to 19:00 hrs Registration

19:00 hrs to 21:00 hrs Reception

Saturday, August 28, 2010

8:00 hrs to 9:00 hrs Continued registration and refreshment

Business Session:

9:00 hrs to 9:15 hrs Opening remarks by IATJ President

9:15 hrs to 11:00 hrs Discussions with respect to IATJ organization; objectives and purpose; procedural matters, suggestions from Delegates and business resolutions including Nominating Committee Report.

11:00 hrs to 11:15 hrs Refreshment Break

Tour de Table : Domestic Procedural Outlines

**First Educational
Session:**

11:15 – 12:15 hrs Speakers from countries representative of differing
13:45 – 14:45 hrs approaches to tax disputes:

Vimal Ghandi, India
Philippe Martin, France
Olof Olsson, Finland
Ricarda Piliciauskas, Lithuania
Joao Francisco Bianco, Brazil
Eugene Rossiter, Canada

Civil Law versus Common Law
Full trial versus judicial review versus legal principles only
Interactive / Q&A at end of each speaker to allow countries to self-identify/comment
Speakers to address how their country's régime deals with:
administrative objections with the tax authorities

court appeals
procedures
restrictions
time and other constraints on judges
how unrepresented taxpayers are
provided for
large versus small amounts
role of lawyers / accountants / agents
expert witnesses
relying on foreign court decisions
income tax versus VAT/commodity taxes

**Second Educational
Session:**

15:00 – 16:30 hrs

Significant Recent Developments in International Tax Law

*Willem Wijnen, Court of Appeal, Netherlands, and Pramod Kumar, India Tax Appellate Tribunal:
The Interpretation of Tax Treaties*

*Pramod Kumar, India Tax Appellate Tribunal:
Relevance of Foreign Court Decisions in Applying Tax
Treaties*

*Emmanuel Glaser, Conseil d'État (France):
Commissionaire Companies as Permanent Establishments
PEs – the Zimmer decision*

*Friederike Grube, Bundesfinanzhof (Germany): Significant
Value Added Tax VAT Decisions*

*Clement Endresen, Supreme Court of Norway: The
Influence of the European Charter on Human Rights
ECHR on Procedures in Tax Law Disputes*

*Richard Edmonds, Federal Court of Australia:
Recent Transfer Pricing Cases.*

*Patrick Boyle, Tax Court of Canada: Significant OECD
Developments -- Business Profits, Artistes & Athletes,
Revised Transfer Pricing Guidelines, Mutual Agreement
Procedures, Partnerships and FTEs*

Dinner Session:

18:30 -- 20:30 hrs

**Guest Speaker: Honourable Mr. Justice Marshall Rothstein,
Supreme Court of Canada**

Programme Chair: Patrick Boyle, Tax Court of Canada,
patrick.boyle@tcc-cci.ca

Transfer Pricing Jurisprudence in Canada

by Serena Sial¹

The issue of transfer pricing places an important mandate on tax court adjudicators. Transfer pricing, the regulating of prices of cross-border transactions between related corporations, is a global tax issue for which international agreement is important. While the OECD has formulated guidelines² to encourage consensus on transfer pricing rules, it is the courts that play the role of adapting these guidelines into jurisprudence. This article will provide an overview of how Canada has approached this role in transfer pricing dispute resolution.

The OECD Guidelines suggest that transfer prices should be held to the arm's length principle: acceptable transfer prices should accord with those of arm's length parties in comparable transactions. In Canada, this arm's length rule is embodied in section 247 (derived from its predecessor, section 69(2)) of the *Canadian Income Tax Act*³. Section 247 entitles the Canadian Minister of National Revenue ("Minister") to reassess or re-characterize international transactions between non-arm's length parties where one of two conditions is met: (i) there is reason to believe that the terms and conditions of the transaction differ from those that would have been entered into by arm's length parties, or (ii) the transaction would not have been entered into by arm's length parties and can reasonably be thought not to have been entered into for purposes other than to obtain a tax benefit⁴.

In recent years, two cases have been brought before the Tax Court of Canada pursuant to transfer pricing legislation⁵: *GlaxoSmithKline*⁶ ("Glaxo") and *General Electric Corporation*⁷ ("GE"). These disputes required the Court to determine the arm's length value of the transactions in issue. Essentially, this analysis requires a comparison between the transaction in issue and a transaction that is similar but subject to open market forces. OECD Guidelines describe methods that may be adopted for this analysis that fall into two categories: (i) transaction based methods⁸, and (ii)

¹ A Law Clerk at the Tax Court of Canada with the assistance of Nathalie Perron and Jose Rodrigues.

² "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations", Organisation for Economic Co-operation and Development (OECD) Guidelines. The guidelines found in the OECD Report, "Transfer Pricing and Multinational Enterprises" (1979), were approved by OECD Council, 1995 [OECD]

³ *Income Tax Act* (1985, c. 1 (5th Supp.))

⁴ Hejazi, Jamal, "Transfer Pricing: The Basics From a Canadian Perspective", LexisNexis Canada Inc. 2009, page 10

⁵ Section 247 was adopted in 1998. The *Glaxo* and *GE* cases involved assessments made before 1998, and therefore were brought under paragraph 69(2).

⁶ *GlaxoSmithKline Inc. v. R.*, 2008 CarswellNat 1666, 2008 TCC 324, 2008 D.T.C. 3957 (Eng.) (Tax Court of Canada [General Procedure] [Case under appeal])

⁷ *General Electric Capital Canada Inc. v. R.*, 2009 TCC 563, 2010 D.T.C. 2521 (Eng.), [2010] 2 C.T.C. 2187 (Tax Court of Canada [General Procedure]) [Case under appeal]

⁸ These include comparable uncontrolled price method (CUP), resale price method and the cost plus method.

profit-based methods⁹. The *Glaxo* case concerned multinational enterprises in the business of manufacturing and distributing pharmaceuticals. In this case, several transaction based comparables were presented to the Court, requiring a determination of the most appropriate comparable for a transfer pricing analysis. The *GE* case related to multinational enterprises engaged in financial services ventures. In this case, no comparable transactions existed and the Court resolved the issue by applying a profit-based method to a suitable hypothetical transaction. These cases will be briefly reviewed below.

In *Glaxo*, the Appellant, GlaxoSmithKline Inc., paid amounts to Adechsa, a non-resident, non-arm's length party, for the purchase of ranitidine, the active pharmaceutical ingredient in Zantac. The amounts paid were deducted from the Appellant's income. The Minister found it unreasonable that the Appellant paid between \$1500-\$1600 per kilogram of ranitidine, while companies that were selling generic versions of Zantac in Canada were paying \$300 per kilogram. The Minister adjusted the Appellant's income accordingly.

The Minister's position was that the generic companies' transactions were comparable uncontrolled transactions to that between the Appellant and Adechsa, and therefore reflected the appropriate arm's length value for the purchase of ranitidine. The Appellant argued that it was entitled to pay more than the generic companies for ranitidine for two reasons: (i) it was required to purchase ranitidine from Adechsa pursuant to a licensing agreement with Glaxo Group, and (ii) the ranitidine sold by Adechsa was subjected to more severe quality testing than the one sold to generic companies. The Appellant argued that the transaction between European licensees and the Glaxo Group were better comparables to the transaction in issue.

In its analysis, the Court officially adopted two critical aspects of the OECD transfer pricing rules: that transfer prices must accord to arm's length values and that transfer pricing methods exist on a hierarchy of accuracy. The comparable uncontrolled price (CUP) method was accepted by the Court to be the preferred method, and other methods were held to be applicable "only in the absence of useful evidence of an uncontrolled transaction" [para 65].

In analyzing the comparable transactions, the Court applied the criteria provided in the 1979 and 1995 OECD Commentaries, putting emphasis on the fact that the generic companies operated in the same geographic market as the Appellant, unlike the European licensees, and that the generic companies had similar risks and responsibilities to the Appellant.

The Court determined that the licensing agreement between the Appellant and Glaxo Group was irrelevant to the issue of whether the purchase price of ranitidine was reasonable and that the generic companies' final product was sufficiently similar to Zantac to be comparable, despite the differences in manufacturing standards. The Court held that the purchase of ranitidine by the generic companies formed the most appropriate comparable for the CUP analysis¹⁰. This decision is significant for endorsing the OECD Guidelines and recognizing the principle that the CUP is the preferred transfer pricing method.

⁹ These include the profit-split method and the transactional net margin method.

¹⁰ The parties also produced transfer prices that were developed under alternative methods namely, the resale price method, the transactional net margin method and the cost plus method. The Court found flaws in each that made them inapplicable.

The *Glaxo* decision was recently overruled by the Federal Court of Appeal. The Federal Court of Appeal found that the licensing agreement between Glaxo and Glaxo Group was relevant to determine the appropriate arm's length value of Zantac. The Federal Court of Appeal emphasized that the transfer pricing analysis must be based on all the circumstances that constitute the business reality of an arm's length purchaser, standing in the shoes of the Appellant.

In *GE*, GE Capital US ("GECUS"), acted as a guarantor for the Appellant, General Electric Capital Canada, an indirect wholly owned subsidiary. The guarantee was for debts owing by the Appellant to third-party creditors. The Appellant paid fees to GECUS for this guarantee and deducted these amounts from its income. The Minister alleged that the arm's length value of the guarantee was zero. According to the Minister, the Appellant benefited from the *implicit support*¹¹ of GECUS. The Minister contended that this implicit support effectively bumped up the Appellant's credit rating to the same status as GECUS, AAA, so that ultimately there was no benefit received by the Appellant under the guarantee arrangement. Thus the Minister believed that the Appellant had overpaid for the guarantee.

The parties agreed that no comparable transactions were available. Consequently, the Court adopted a yield approach to approximate the value of such a guarantee in the free market. The yield was calculated by comparing the Appellant's stand alone credit rating with its credit rating under the explicit guarantee. The interest cost savings resulting from the difference between these rates was held to be the maximum amount that the Appellant was justified to pay for the guarantee.

The Court determined that the implicit support provided by the parent was relevant to credit rating valuation, but it did not bump up the Appellant's credit rating to the same rate as GECUS. Instead, the Court found that the Appellant's stand-alone rating ranged from BBB- to BBB+ which, compared with the AAA credit-rating under the guaranteed debt, gave rise to a benefit equal to 1.83%. This amount was held to be the arm's length value of the transaction, after factoring in all relevant adjustments. As the Appellant's fees were below this value, the appeal was allowed. *GE* has been appealed to the Federal Court of Appeal but has not yet been argued.

The specific approach of the courts in Canada in resolving transfer pricing disputes is becoming clearer under a building body of jurisprudence. The OECD guidelines provide a constructive framework within transfer pricing analyses may be conducted. However transfer pricing jurisprudence from Canada demonstrates that the courts bear the ultimate responsibility to determine which factors are relevant and how they should be applied.

¹¹ Implicit support is the assumption that the parent company would not let down its subsidiary in case of financial hardship because of the impact that this financial hardship could have on the group credit rating.

Registration Form

International Association of Tax Judges (IATJ)
1st Annual Assembly
August 27th and 28th, 2010
Rome, Italy

NAME: _____

TITLE: _____

AFFILIATE COURT or TRIBUNAL: _____

COUNTRY: _____

ADDRESS: _____

STREET

CITY COUNTRY POSTAL CODE

TELEPHONE: _____

FAX: _____

E-MAIL ADDRESS: _____

AREA OF FISCAL INTERESTS OR EXPERTISE: _____

PAYMENT:

Please make payment of \$250.00 U.S. to the Order of the International Association of Tax Judges by cheque, money order or by wiring to:

credit to IATJ
c/o TCC 200 Kent Street, Ottawa, ON, Canada K1A 0M1.

Instn: 004 (TD Canada Trust)
Branch: 32906
Acct: 0167-7305531 45
Refer to Swift Code: TDOMCATTOR
ABA #026009593

If payment by cheque or money order, please forward the payment, together with the registration form to:

IATJ, c/o Mary MacMillan
Tax Court of Canada
200 Kent Street, Ottawa, Ontario
Canada K1A 0M1
fax (613) 996-5863

**International Association of Tax Judges (IATJ)
Presentation Form of Tax Judge**

Country:

Judge / Adjudicator:

Name of Applicant:

Title:

Address:

Phone number:

Fax:

E-mail:

Composition of Court/Tribunal (Number of members):

Chief Justice/President of Court/Tribunal:

Court functions

Jurisdiction:

Organization of the courts system: Brief outline

Powers of the judge (annulment, reversal, compensation ...)

Miscellaneous remarks: