THE CAMECO AND GLENCORE TRANSFER PRICING CASES – COMMENTS ON THE COMMON COMPLICATIONS IN COMMODITIES COMMERCE CONTROVERSY

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INTRODUCTION

Two significant transfer pricing cases about pricing mined materials between controlled companies have now been finally concluded in Australia[1] and Canada.[2] Both decisions upheld the original transfer pricing policy of the respective taxpayer after lengthy disputes that challenged tax administration practices in the two countries and the 1995 edition of the O.E.C.D. Transfer Pricing Guidelines, since replaced by 2009, 2010 and 2017 editions.

This article begins by examining two transfer pricing questions that appear on the surface to be similar, but were approached in different ways by the tax authorities and evaluated in broadly similar ways by the courts. This article then addresses how each of these controversies might have differed under the 2017 O.E.C.D. published guidance.

COMMODITIES

Cameco[3] was a transfer pricing controversy about the price of uranium between a Canadian producer or buyer and a controlled Swiss trader or seller in 2003-2006. *Glencore*[4] was a copper concentrate pricing controversy between the Australian subsidiary of the Anglo-Swiss miner and the Australian Tax Office ("A.T.O.") over sales to a controlled Swiss trader during the 2007-2009 tax years. Both companies are among the largest suppliers of their product to world markets. Copper concentrate spot and forward prices are quoted on the London Metal Exchange. While uranium prices are not widely quoted on public markets, conditions are extensively reported in commonly referenced trade publications that (i) track pricing at various stages of production for various types of supplies, (ii) report on extraction and processing or refining cost, and (iii) publish periodic forecasts of regional and worldwide demand and supply.

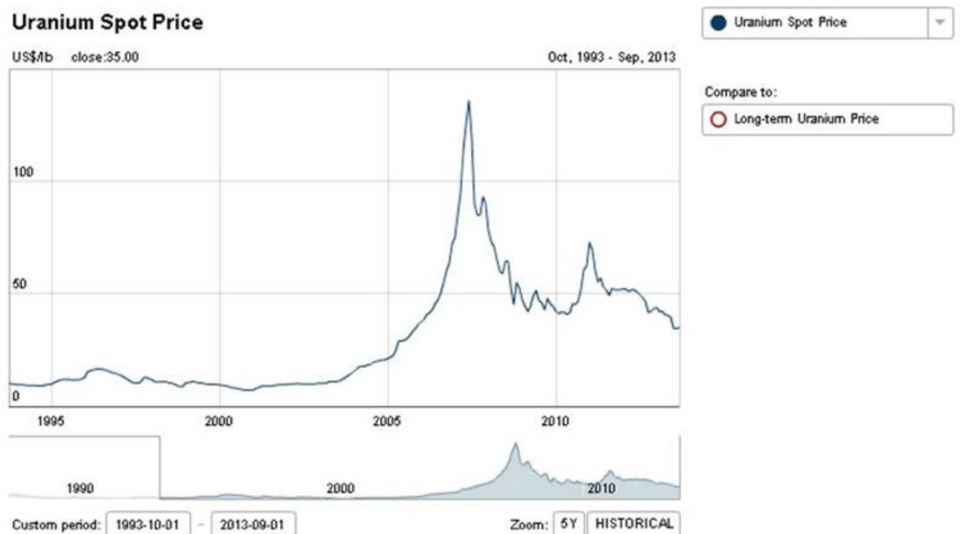
In each case, the respective Canadian and Australian tax authorities conducted examinations of the controlled transactions entered into by commodity producers[5] at

1. *The Commissioner of Taxation of the Commonwealth of Australia v Glencore Investment Pty Ltd* [2021] HCA Trans 98.
2. *Her Majesty the Queen v. Cameco Corporation* Docket 39368/
3. *Cameco Corporation v. Her Majesty The Queen* (2018 TCC 195).
4. *Glencore Investment v Commissioner of Taxation of the Commonwealth of Australia* [2019] FCA 1432.
5. Cameco Corp. did not produce all the uranium in question. A significant share of the product was purchased by the Swiss trading company from Russian sources following decommissioning of nuclear weapons and sold to Cameco Corp.

a time when market conditions and pricing were volatile. Both cases showed that industry participants incorporated market volatility into their forward-looking decisions made during this period of uncertainty.

The *Cameco* controversy involved uranium transactions that were priced before a period of significant spot price increases that began in 2002, as shown in the first graph below. In *Glencore*, Glencore International AG revised the purchase pricing policy for minerals supplied by its Australian subsidiary mine from a spot market arrangement to a price-sharing arrangement in 2007, during a period of record-high world prices as shown in the second graph below.

For the years under examination in both cases, the relevant tax authority sought to adjust the transaction terms with the benefit of hindsight, in ways that would reflect higher future market prices and increase the taxable profit of the resident company. Both tax authorities took issue with the actual profitability of the nonresident counterparty.



Source: Cameco**, using data from Ux Consulting and Tradetech.**

Source: International Monetary Fund, Global price of Copper [PCOPPUSDA], retrieved from FRED, Federal Reserve Bank of St. Louis**; August 17, 2021.**

COMMON COMMERCIAL TERMS

Both taxpayers had written agreements in place with uncontrolled parties that governed the pricing of transactions with controlled parties. In *Glencore*, supply agreements existed between uncontrolled mines and trading companies. These were entered into evidence and served as critical support for the argument that the controlled transactions were comparable to independent transactions. Importantly, both taxpayers followed the terms set forth their agreements made with controlled parties. In *Cameco*, the Canada Revenue Agency ("C.R.A.") took issue with the alleged difference between the form of the controlled transactions and their economic substance. Ultimately, C.R.A. was unsuccessful in arguing the controlled transactions were a sham.

The two principal pricing terms that were in dispute in *Glencore* were the discount allowed by the miner for the refining of the ore being sold, and the reference price quotation period used to price the controlled transaction. C.R.A. did not dispute the price of uranium directly, but instead took issue with the apportionment of profit resulting from the controlled transaction.

In both cases, the arm's length nature of the transaction terms were challenged. The tax authorities questioned (i) the business and commercial practices used by the taxpayers to set price levels and receivable terms, (ii) the basis for forming management expectations concerning cost and the strategic responses of competitors, and (iii) the origin of certain critical assumptions made by management in determining the transfer prices and the preconditions for the transfer price. In response, the taxpayers presented testimony of past and present employees that was relied on by the courts in reaching their decisions.

The decision in *Cameco*, relevant excerpts of which were cited in *Glencore*, made use of key pieces of expert reports and testimony by two finance and business economics professors. All employees that were deposed or cross-examined at trial were found to be credible, and clearly indicated the extent of their expertise and knowledge. The credibility of several company witnesses in *Cameco* survived challenge despite testimony that occasionally shed a somewhat unflattering light on the accuracy of their prior work or the consistency of certain business practices critical to the management of transfer pricing policy. All were shown to be practical people managing real businesses under uncertain conditions.

Certain expert testimony in *Glencore*, however, was disregarded or given less weight due to the lack of experience or first-hand information of the expert with a particular topic. Hearsay or learned information was less helpful to the court on topics such as the operation of certain types of offtake contracts, and experience with certain contractual terms. A keen understanding of offtake contracts by the court was critical to the case.

COMMERCIAL RATIONALITY

The commercial terms of supply agreements mattered less however to the tax authorities. For different reasons, and owing largely to the construction of the respective country transfer pricing legislation, the Australian and Canadian tax authorities argued that two independent parties would not have adopted many of the transaction terms used in the controlled transactions. Neither country's legislation specifically

incorporates the O.E.C.D. Guidelines, however the concept of "commercial rationality" crept into both cases as a necessary condition of an arm's length transaction.

The A.T.O. rejected all the independent offtake agreements put forward by the taxpayer to demonstrate comparable terms, contending they were unusable for the purpose of applying the taxpayer's transfer pricing method because they were not exact comparables. The A.T.O. argued that the taxpayer would have retained its pre-2007 controlled transaction terms based on spot market pricing and a different quotation reference period were it a participant in a transaction with an uncontrolled party. At trial, it introduced testimony of experts. Based on their experience, they proposed a different set of hypothetical commercial terms that they believed would have been more acceptable to independent parties.

Like the A.T.O., C.R.A. initially rejected the comparable uncontrolled price method used by Cameco. Instead, C.R.A. contended the trading company was a sham, and proposed adjusting the taxpayer's income based on an indeterminate transfer pricing method that set the transfer price to the Swiss trading company at an amount equal to that company's selling price to its customers. This had the effect of leaving the controlled Swiss trader with zero profit.

C.R.A. later changed its approach to recharacterize the transaction between the controlled parties from a form deemed to be a sham to an alternative form that assumed the controlled Swiss trader would be entirely excluded from the actual controlled transaction were it carried out between uncontrolled parties. This change in strategy forced C.R.A. to demonstrate the intent of Canadian Parliament in legislating transfer pricing rules was to restructure actual transactions to hypothetical transactions that eliminated the controlled intermediary for purposes of determining an arm's length price.

While the courts disagreed with the respective tax authorities over the recharacterization of the controlled transactions, they did so in different ways. The Canadian courts upheld a transaction recharacterization logic that first asks whether any two independent parties would have refrained from entering the controlled transaction under any transaction terms. It thereby challenged the logic of C.R.A.'s revised adjustment because it found that a price existed at which two independent parties would have entered the transaction. In comparison, the Australian courts employed a logical test that asked whether the actual controlled transaction was commercially rational.

All three Australian courts rejected the A.T.O. approach as counter to the intended objective of Australian transfer pricing legislation and referred to the *Chevron*[6] decision to distinguish between (i) a hypothetical transaction between two arm's length parties and (ii) an arm's length transaction between controlled parties with characteristics of the actual transaction undertaken by the taxpayer and an uncontrolled counterparty.

The two cases leave several clues concerning how commercial rationality can be demonstrated, but give no clear guidance. Choosing one transaction form over another is generally considered in most contemporary economic modelling. The analysis compares the present values of the streams of future benefits (appropriately defined and measured) arising from different identified alternatives. It is not unusual

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6 *Chevron Australia Pty Ltd v Commissioner of Taxation* (2017 FCAFC 62).

that a component of future benefit is expected profit. Both tax authorities argued in both qualitative and quantitative terms that the profit of the taxpayer during the tax years in dispute would have been higher under the selected hypothetical controlled transaction than under the actual controlled transaction. Both tax authorities pointed to the relatively low profit or the existence of a loss realized by the taxpayer and contrasted this with the relatively high profit of the foreign controlled taxpayer during the tax years in dispute. In contrast to the expected outcome from conventional present-value derived decision making, the courts rejected the use of hindsight by both tax authorities to substitute an *ex post* outcome for the consequence of *ex ante* controlled transaction terms.

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In transfer pricing matters, we are often left to compare the profit of a controlled company to a sample of comparable companies, after having ruled out other pricing approaches that reference, among other things, forward-looking pricing of one kind or another. While it is clear that the intent of country transfer pricing rules is to allocate taxable income between tax jurisdictions in a fair and reasonable way and to prevent double taxation, these two cases show that allocation of profit or income is mainly a policy outcome and not necessarily the instrument to compute an arm's length transaction value.

COMPARABILITY

In *Glencore*, the courts' decisions showed that, despite some imprecision in the taxpayer's comparability analysis, a thorough comparability analysis using independent agreements that evaluates the most economically relevant commercial terms can prevail in a transfer pricing controversy. Especially useful is support from company management to relate the terms of the controlled agreement to the relevant functions of the counterparties and the associated risks each incurs.

In *Cameco*, the court was left to evaluate the reliability of the taxpayer's comparable uncontrolled price method application after having rejected C.R.A.'s recharacterization position. A thorough analysis of relevant transaction terms and a comprehensive use of transaction data supported by a secondary application of the resale price method prevailed at trial.

COMME IL FAUT?

With transfer pricing guidance changing frequently, the value of cases such as *Cameco* and *Glencore* must be carefully considered as precedent for current transfer pricing analysis and policy administration. How might the analysis in each case stack up against the 2017 standard set out in the O.E.C.D. Guidelines?

Both cases relied on the 1995 edition of the O.E.C.D. Guidelines, and to a lesser extent, the 2010 edition as authorities on transaction recharacterization. The substance-over-form condition for recharacterization set out in the 2010 O.E.C.D. Guidelines has been replaced by the more expansive requirement that a controlled transaction must be accurately delineated before applying the arm's length standard. Leaving aside the meaning of "accurate delineation," it seems that the courts addressed the relevant transfer pricing questions by transaction or transaction type and scrutinized the relevant transaction attributes before proceeding with their analyses.

The 2017 O.E.C.D. Guidelines introduce a new test criterion of "respective perspectives and the options realistically available to each of them at the time of entering into the transaction"[7] to supplement the specification of the main test for transaction recharacterization or disregard in paragraph 1.65 of the 2010 O.E.C.D. Guidelines. U.S. readers are familiar with the principle of "options realistically available" translated as "alternatives realistically available to the buyer and seller" as one of the factors to be considered under the broader subheading of economic conditions while conducting a comparability analysis. The *Glencore* analysis included consideration of counterfactual circumstances facing the controlled counterparties at the outset of the series of transactions governed by the revised intercompany terms.

Interestingly, though perhaps too specific to the mining industry, the long-term viability of the mine featured prominently in the courts' analyses of the question of whether one group of contractual terms would be preferred over another group. Mine viability figured into the more general determination of whether the controlled transaction met the "commercially rational" test. In this respect, the most recent guidance from the O.E.C.D. seems to have been taken into account by the Australian courts. The 2017 edition of the O.E.C.D. Guidelines offers no definition of "commercially rational" firm behavior other than to allude rather unhelpfully that single-year pretax profit might be a relevant hallmark of behavior that strays outside the painted lines of commercial rationality.

The C.R.A. extreme position of a zero-profit counterfactual transaction does not lend itself well to the modern method of recharacterization. If C.R.A. were to have had better mining industry fact witnesses to evaluate the alternative transaction form potentially available in the circumstances of the controlled transaction, some analysis of the "options realistically available" may have served to support a different recharacterization decision. Interestingly, in the case of *Cameco*, there was general agreement that the controlled transactions were entered into for the principal purpose of saving tax, often thought of by practitioners as a high hurdle in controversy. Canadian controversy covering years that are controlled by current O.E.C.D. guidance may result in a different taxpayer outcome under a similar fact pattern.

". . . some analysis of the 'options realistically available' may have served to support a different recharacterization decision."

If anything, these two cases demonstrate the volume of data, the effort, the time, and the expense that is required to settle a transfer pricing dispute for a large multinational company. Significant effort was expended to clearly define critical terms and to apply practical definitions to the facts of each case. Further effort will be needed from O.E.C.D. member country courts to continue the work of clarifying the meaning of a number of key terms in the 2017 edition of the O.E.C.D. Guidelines that will be central to the large and growing number of transfer pricing controversies.

More generally, both cases illustrate the transfer pricing effects of surprises, the importance of expectations, and documenting those expectations when evaluating the appropriateness of outcomes. In both cases, the surprise was a sudden change in market conditions. Some guidance can be taken from these decisions when contending with the transfer pricing effects of the sudden change in market conditions brought about by the COVID-19 pandemic.

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[7] Paragraph 1.122, OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris.

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