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# ‘Cameco’ decision addresses the sham doctrine in Canada

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## In brief

The Tax Court of Canada (the TCC or the Court) on September 26 published its decision in *Cameco Corporation* (2018 TCC 195), resolving a long-running dispute between Cameco Corporation (Cameco, the Appellant) and the Minister of National Revenue (the Respondent) involving reassessments to Cameco’s 2003, 2005, and 2006 taxation years.

The adjustments made in the reassessments related to the prices used in the purchase and sale of uranium contracts involving Cameco, Cameco Europe (CESA, a Swiss branch of Cameco’s Luxembourg subsidiary) and, later, its Swiss subsidiary (CEL), as well as its US-based subsidiary (Cameco US) and third parties. The Minister’s reassessments were based on arguments that Cameco’s structure — specifically the reorganization that took place in 1999 — was a sham. The Minister further argued that CESA/CEL performed few if any valuable functions during the years under consideration and, accordingly, that reassessments were warranted pursuant to either paragraphs 247(2)(b) and (d) or paragraphs 247(2)(a) and (c) of the Income Tax Act (the Act).

In short, the Court held that the Appellant and its related entities did not factually misrepresent their legal arrangements or the transactions created by those arrangements, and that consequently there was no sham. The Court also determined that the transactions were carried out for a *bona fide* business purpose, and the terms and conditions of the transactions were those that would have existed between arm’s-length parties under the same or similar circumstances. Consequently, neither paragraph 247(2)(a) nor 247(2)(b) applied. The Court allowed the appeal and vacated the reassessments.

This Tax Insight focuses on the Court’s findings in respect of the sham argument. See our previous [Tax Insight](#) for details on the Court’s findings in respect of the application of paragraphs 247(2)(a) and (c) of the Act. A further Tax Insight will cover the Court’s findings with respect to the application of paragraphs 247(2)(b) and (d).

**Note:** The Canada Revenue Agency (CRA) has appealed the TCC’s judgment and specifically its determination that the Appellant’s transfer prices were arm’s length within the meaning of paragraphs 247(2)(a) to (d) of the Act.

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## In detail

### Crown’s arguments

The Crown alleged that the Appellant’s uranium-trading business was operated by

Cameco in Canada despite documents that showed such business had been transferred to a non-arm’s-length entity in Switzerland. The Crown also asserted that Cameco ‘created

an illusion’ that its uranium trading activities were moved out of Canada when in reality it continued to control and carry on such trading business.

### ***Cameco's position***

Cameco argued that the conduct of the parties was consistent with their legal arrangements and there was no deception and no sham.

### ***Court's decision***

The Court noted the well-established definition of 'sham' as acts done or documents executed by the parties that are intended to give third parties the appearance of creating legal rights and obligations that differ from the actual legal rights and obligations the parties intended to create. A sham exists where the transactions were conducted with an element of deceit so as to create an illusion.

Importantly, the Court noted that a party's factual presentation of legal rights differs from the legal characterization of that relationship (i.e., calling a contract a lease when its legal effect is a sale). A party's view of the legal characterization is not evidence of a sham if the terms and conditions accurately reflect the parties' legal rights and obligations.

The Court held that Cameco's business activities and legal relationships were not a sham, stating that the Crown's position reflected a fundamental misunderstanding of this concept. The Court concluded there was no evidence that the terms and conditions of the parties' contracts did not reflect the parties' true intentions or were created to give the appearance of legal fictions that did not reflect the reality of the parties' relationships. While the Court also identified evidence that Cameco had been sloppy and cavalier in respect of its corporate documents, this carelessness did not rise to the level of intentional deceit and the existence of a sham.

***Observation:*** While the Court found that the sloppy and cavalier execution of various notices required by the terms of the agreements, including

backdating of notices by personnel administering the contracts, did not give rise to the level of intentional deceit required for the finding of sham, it did provide cautionary words to the effect that "... it is nevertheless important to say that taxpayers must be extremely careful not to give the impression that an agreement exists before it does in fact exist."

### ***The takeaway***

In the context of transfer pricing, intercompany transactions should be documented in the same manner as is used for transactions with third parties. For example, robust intercompany agreements should record the parties' rights and obligations as well as their intent and expectations.

Failure to do so, in both circumstances, could result in the CRA challenging the legal effectiveness of the transactions or the deductibility of certain expenses, leading to a higher probability of tax disputes.

## Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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