Federal Court of Appeal  Cour d'appel fédérale

Date: 20160129

Docket: A-387-14

Citation: 2016 FCA 34

CORAM: **NADON J.A.**
SCOTT J.A.
RENNIE J.A.

BETWEEN:

MARZEN ARTISTIC ALUMINUM LTD.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Vancouver, British Columbia, on November 19, 2015.

Judgment delivered at Ottawa, Ontario, on January 29, 2016.

REASONS FOR JUDGMENT BY: SCOTT J.A.

CONCURRED IN BY: NADON J.A.
RENNIE J.A.

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REASONS FOR JUDGMENT

SCOTT J.A.

[1] The Minister of National Revenue (the Minister) reassessed Marzen Artistic Aluminum Ltd. (the appellant), in respect of fees paid to its wholly-owned Barbados based subsidiary Starline International Inc. (SII) during taxation years 2000 and 2001. The Minister took the position that the appellant, who was not dealing at arm's length, had paid an amount greater than the amount a person dealing at arm's length would have paid to SII for sales, marketing and

support services in the United States under a Marketing and Sales Services Agreement (MSSA). The Minister applied paragraphs 247(2)(*a*) and (*c*) of the *Income Tax Act*, R.S.C. 1985 (5th supp.), c.1 (the Act) and made transfer pricing adjustments in respect of the deduction the appellant took for fees paid to SII.

[2] In reasons cited as 2014 TCC 194, Sheridan J. (the Judge) of the Tax Court of Canada disallowed the appeals of the reassessments made by the Minister in respect of the appellant's 2000 and 2001 taxation years, except for a minor adjustment of US$32,500 in each of those years, to the amount that SII paid to Starline Windows Inc. (SWI).

[3] This is an appeal from that decision.

I. Background

[4] The appellant Marzen Artistic Aluminum Ltd. was in the business of manufacturing and selling window products in Canada. Starline Windows Inc. (SWI) a sister company, was located in the United States and had been involved in an unsuccessful attempt to penetrate the US residential window market in the state of Washington in 1998.

[5] Longview Associated Limited (Longview) is a Barbados based corporation wholly owned by Mr. David Csumrik, a resident of Barbados. Mr. Csumrik is in the business of establishing international business corporations in Barbados and providing management and support services to these corporations through Longview. In 1999, after meeting with Mr.

Martini, the majority shareholder of the appellant, Mr. Csumrik incorporated SII in Barbados, with the appellant as its sole shareholder. Mr. Csumrik became the managing director of SII.

[6] The appellant, SWI, and SII were involved in a business structure aimed at successfully penetrating the US market for window products manufactured by the appellant. SII provided marketing services and support for the appellant's window products in the United States. SWI seconded its employees to SII on a cost plus 10% basis and it purchased the window products directly from the appellant at the same price they were sold in the United States.

[7] In computing its income for 2000 and 2001, the appellant deducted fees paid to its wholly-owned Barbados subsidiary SII in the amounts of CAD$4,168,551 and CAD$7,837,082 respectively.

[8] The MSSA under which SII provided marketing and sales support services to the appellant in the United States, called for the payment of a fee equal to the greater of US$100,000 or 25% of sales originated by SII. The MSSA also stipulated that the appellant had to provide working capital to SII when needed. The MSSA was amended in August 2000, to provide for the payment of a bonus to SII equal to 10% on all confirmed sales in California provided SII made net sales greater than US$10 million between August 1, 2000 and December 31, 2001. The appellant paid a US$2.1 million dollars bonus to SII under the amended MSSA. Mr. Csumrik, the managing director, did not share in the bonus paid to SII.

[9] SII and SWI were also parties to a Personnel Secondment Agreement (PSA) and an Administrative and Support Services Agreement (ASSA). Under the latter, SWI seconded its employees to SII who marketed the appellant's window products in the United States and elsewhere. Secretarial and administrative support services were equally provided to SII. The PSA called for the payment by SII to SWI of the actual cost of the seconded personnel plus a 10% markup. SII paid SWI CAD$2.1 million and CAD$2.8 million in 2000 and 2001 under these agreements.

[10] SII paid Longview US$30,000 in 2000 and 2001 for the management and administrative services and US$2,500 for services provided by Mr. Csumrik as its managing director.

[11] SII declared dividends in 2000 and 2001 of CAD$2,011,500 and CAD$5,299,620 payable to the appellant who included these amounts in its income for Canadian taxation purposes. These dividends were then deducted from the appellant's taxable income pursuant to section 113 of the Act on the basis that they were paid out of SII's exempt surplus.

[12] The Minister imposed a transfer pricing adjustment pursuant to paragraphs 247(2)(*a*) and *c*) of the Act. The Minister limited the appellants fees paid to SII in 2000 and 2001 to respectively CAD$2.1 million and CAD$2.8 million. The Minister also imposed a transfer pricing penalty of CAD$502,519 under subsection 247(3) of the Act for the taxation year 2001 only.

[13] The appellant appealed the reassessment and the levy of the penalty to the Tax Court of Canada.

II. Statutory framework

[14] The following provisions are relevant in this case:

***Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.)**	***Loi de l'impôt sur le revenu*, L.R.C. 1985, ch. 1 (5e suppl.)**
Transfer pricing adjustment	**Redressement**
247(2) Where a taxpayer or a partnership and a non-resident person with whom the taxpayer or the partnership, or a member of the partnership, does not deal at arm's length (or a partnership of which the non-resident person is a member) are participants in a transaction or a series of transactions and	**247(2)** Lorsqu'un contribuable ou une société de personnes et une personne non-résidente avec laquelle le contribuable ou la société de personnes, ou un associé de cette dernière, a un lien de dépendance, ou une société de personnes dont la personne non-résidente est un associé, prennent part à une opération ou à une série d'opérations et que, selon le cas:
(*a*) 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, or	***a*)** les modalités conclues ou imposées, relativement à l'opération ou à la série, entre des participants à l'opération ou à la série diffèrent de celles qui auraient été conclues entre personnes sans lien de dépendance,
…	[…]
(*c*) where only paragraph 247(2)(*a*) applies, the terms and conditions made or imposed, in respect of the transaction or series, between the participants in the transaction or series had been those that would have been made between persons dealing at arm's length, or	***c*)** dans le cas où seul l'alinéa *a*) s'applique, les modalités conclues ou imposées, relativement à l'opération ou à la série, entre les participants avaient été celles qui auraient été conclues entre personnes sans lien de dépendance;
…	[…]

Penalty

247(3) A taxpayer (other than a taxpayer all of whose taxable income for the year is exempt from tax under Part I) is liable to a penalty for a taxation year equal to 10% of the amount determined under paragraph 247(3)(*a*) in respect of the taxpayer for the year, where

…

Tax Court of Canada Rules (General Procedure) **SOR/90-688a**

147(1) The Court may determine the amount of the costs of all parties involved in any proceeding, the allocation of those costs and the persons required to pay them.

(2) Costs may be awarded to or against the Crown.

(3) In exercising its discretionary power pursuant to subsection (1) the Court may consider,

(*a*) the result of the proceeding,

(*b*) the amounts in issue,

(*c*) the importance of the issues,

(*d*) any offer of settlement made in writing,

(*e*) the volume of work,

(*f*) the complexity of the issues,

(*g*) the conduct of any party that tended to shorten or to lengthen

Pénalité

247(3) Tout contribuable (sauf celui dont la totalité du revenu imposable pour l'année est exonéré de l'impôt prévu à la partie I) est passible, pour une année d'imposition, d'une pénalité égale à 10 % du montant déterminé à son égard pour l'année selon l'alinéa *a*), si l'excédent visé à l'alinéa a) est supérieur au montant visé à l'alinéa *b*);

[…]

Règles de la Cour canadienne de l'impôt (procédure générale) **DORS/90-688a**

147(1) La Cour peut fixer les frais et dépens, les répartir et désigner les personnes qui doivent les supporter.

(2) Des dépens peuvent être adjugés à la Couronne ou contre elle.

(3) En exerçant sa discrétion conformément au paragraphe (1), la Cour peut tenir compte :

a) du résultat de l'instance;

b) des sommes en cause;

c) de l'importance des questions en litige;

d) de toute offre de règlement présentée par écrit;

e) de la charge de travail;

f) de la complexité des questions en litige;

g) de la conduite d'une partie qui aurait abrégé ou prolongé inutilement

unnecessarily the duration of the proceeding,	la durée de l'instance;
(*h*) the denial or the neglect or refusal of any party to admit anything that should have been admitted,	*h*) de la dénégation d'un fait par une partie ou de sa négligence ou de son refus de l'admettre, lorsque ce fait aurait dû être admis;
(*i*) whether any stage in the proceedings was,	*i*) de la question de savoir si une étape de l'instance,
(i) improper, vexatious, or unnecessary, or	(i) était inappropriée, vexatoire ou inutile,
(ii) taken through negligence, mistake or excessive caution,	(ii) a été accomplie de manière négligente, par erreur ou avec trop de circonspection;
(i.1) whether the expense required to have an expert witness give evidence was justified given	i.1) de la question de savoir si les dépenses engagées pour la déposition d'un témoin expert étaient justifiées compte tenu de l'un ou l'autre des facteurs suivants :
(i) the nature of the proceeding, its public significance and any need to clarify the law,	(i) la nature du litige, son importance pour le public et la nécessité de clarifier le droit,
(ii) the number, complexity or technical nature of the issues in dispute, or	(ii) le nombre, la complexité ou la nature des questions en litige,
(iii) the amount in dispute; and	(iii) la somme en litige;
(*j*) any other matter relevant to the question of costs.	*j*) de toute autre question pouvant influer sur la détermination des dépens.
…	[…]

[15] Since 1939, the Act has included provisions under which a Canadian taxpayer may be reassessed to include in his Canadian income the difference between the price paid for a property or service to a non-resident with whom he does not deal at arm's length and the price he would

have paid had he be dealing at arm's length. Section 247(2) of the Act is the successor provision to section 69(2) which was repealed in 1998 (Repealed, 1998, c. 19, s. 107(1)).

[16] A multinational enterprise is free to set a price for a transaction between two corporations it controls under different tax jurisdictions. Transfer pricing is the setting of the price between related corporations. Identifying the fair market value of a transaction between related corporations is the underlying principle in transfer pricing. It entails a comparative exercise with what parties dealing at arm's length would have considered.

[17] The language in section 247 does not contain criteria nor does it specify a methodology to determine the reasonable amount parties dealing at arm's length would have paid in any given transaction where transfer pricing principles apply. Consequently, Canadian courts have relied on the *OECD Guidelines 1995* (the Guidelines) as being of assistance in that respect.

[18] The Supreme Court stated in *Canada v. GlaxoSmithKline Inc.* 2012 SCC 52, [2012] 3 S.C.R. 3 [*Glaxo*], at paragraphs 20 and 21 that the Guidelines are not controlling as if they were a Canadian statute but they are useful in determining the amount a reasonable business person, who was party to the transaction, would have paid if it had been dealing at arm's length. The Court also affirmed that a transfer pricing analysis is inherently fact driven.

[19] Since the Guidelines were considered by the Judge in her analysis, a copy of the pertinent extracts has been appended to this decision for ease of reference (see Appendix A).

III. Decision of the Tax Court

[20] In the Tax Court, the main issue before the Judge was whether the terms and conditions of the MSSA between the appellant and SII differed from the terms and conditions parties dealing at arm's length would have agreed to, and whether the Minister was correct in making the adjustments to the actual fees and bonus paid by the appellant to SII. In sum, the Judge had to determine whether the transfer pricing provisions found in paragraphs 247(2)(*a*) and (*c*) of the Act and the penalty imposed pursuant to subsection 247(3) were applicable in this instance.

[21] The Judge allowed the appeals in part. She found:

> …[T]hat an arm's length's [sic] party would have paid an amount to Starline International Inc. that exceeded the fees paid by Starline International Inc. to Starline Windows Inc., but only in the amount of US$32,500 in each of 2000 and 2001 (Judge's reasons at paragraph 242).

[22] The Judge identified the transaction under review as the MSSA between the appellant and SII. While acknowledging that the Guidelines did not have force of law, the Judge indicated they could assist the Court in determining what business people dealing at arm's length would have paid.

[23] On the first issue before her, which was whether the terms and conditions imposed in respect of the MSSA between the parties differed from what would have been agreed to by parties dealing at arm's length, the Judge concluded that SII was essentially an empty shell with no personnel, no assets and no risk.

[24] The Judge, on the basis of the testimonial evidence that was adduced before her, rejected the appellant's position that Mr. Csumrik, SII's managing director, made a significant contribution on behalf of SII in developing the marketing strategy or in managing and supervising SWI's operations. The Judge concluded that the arrangements between the parties did not reflect dealings at arm's length. Mr. Csumrik's advice to shift to the California high-rise market for window products was given in a personal capacity and it followed that there was no need for the appellant to compensate SII for that advice.

[25] The Judge then turned to the second issue and proceeded to determine what an arm's length party would have paid for these services. Her first determination was to the effect that such an analysis is comparative. Therefore, she needed to identify the proper transaction under review and then consider all of the relevant factors a party dealing at arm's length would have considered, and then to compare it with a proxy transaction that truly reflected the circumstances of the appellant's transaction.

[26] It is in that context that the Judge rejected the expert report submitted by the appellant. The Judge found the report to be fundamentally flawed for the following reasons. Firstly, the report assumed that SII and SWI operated as an amalgam under the direction of Mr. Csumrik when providing services to the appellant, notwithstanding the fact that SII and SWI were separate entities. That assumption was contrary to the Guidelines. Secondly, the appellant admitted that SII and SWI were separate entities. Thirdly, the PSA stated that it was not meant to create a partnership or joint venture between SWI and SII.

[27] The Judge rejected the expert's application of the transitional net margin transfer pricing method, and the Judge also dismissed several of the factual assumptions contained in the appellant's expert report regarding Mr. Csumrik's activities in SII and SWI, based on the oral evidence adduced at trial.

[28] With respect to the determination of the arm's length price, the Judge relied again primarily on the Guidelines which identified the Comparable Uncontrolled Price method (CUP method) as appropriate. She determined that the transaction between the appellant and SII was one where SII contracted to supply services. SII bought these services under separate contracts with SWI, Mr. Csumrik, and Longview. The Judge also found that SII used the fees it received to pay those who provided the services. It followed that there were three components to the marketing fee. The Judge determined that the CUP method was more consistent with the Guidelines since it respected the legal relationships between the entities involved and kept SWI and SII as separate legal entities which they were in fact. She also determined that SII acted as a flow through entity.

[29] The Judge accepted the Minister's assumption that the fee paid by SII to SWI under the PSA was an arm's length amount. Consequently, she focussed her enquiry on the two other components. She found that Mr. Csmurik dealt with SII at arm's length and that the fee of US$32,500 paid to Mr. Csmurik and Longwiew by SII was a comparable uncontrolled price for the transaction between the appellant and SII, under the MSSA. This finding led the Judge to conclude that an arm's length party would have paid an amount to SII that exceeded the fees paid by SII to SWI but only in the amount of US$32,500 in each of 2000 and 2001.

[30] The Judge then went on to examine whether the appellant had made reasonable efforts to determine and use arm's length transfer prices for the purposes of the Act and ruled it had not done so. She allowed costs to the respondent despite the fact that the appellant was partially successful in the appeal before her.

IV. The Appeal

A. *Issues*

[31] This appeal raises the following issues:

i. Whether the Judge erred in determining that terms and conditions imposed in respect of the MSSA between the appellant and SII differed from what would have been agreed to by parties dealing at arm's length?

ii. Whether the Judge erred in finding that an arm's length party would not have paid SII any fees in excess of the amounts allowed by the Minister plus US$32,500 had they been dealing at arm's length?

iii. Whether the Judge erred in declining to award costs to the appellant?

V. The Standard of Review

[32] As this appeal is from a decision of the Tax Court the appellant must establish an error of law or a palpable and overriding error on a question of fact (see *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235.

VI. The appellant's position

[33] In its Memorandum of Fact and Law, the appellant raised eight different points in issue. In my opinion these can be best addressed in the three issues identified by the respondent which have been reproduced above.

[34] At the hearing before the Court, the appellant raised the following arguments.

[35] The appellant, after a review of the case law on transfer pricing adjustments and more particularly the principles outlined by the Supreme Court decision in *Glaxo*, underlined that the Judge erred by failing to determine an arm's length price for the services rendered by the seconded US employees. The appellant approached the issues before the Court from the perspective that the Judge should not have confined her analysis to each separate transaction and entity. According to the appellant, the Judge failed to consider the value of the service package received by the appellant from SII, which should have included the efforts of Mr. Csumrik and the efforts of the seconded US employees (SWI) whose skill had been largely upgraded in order to sell windows successfully in the high-rise California market. The appellant takes issue with the Judge's approach which in fact considered three separate transactions.

[36] Counsel for the appellant pointed to the fact that the Minister had failed to adjust the contract prices between SII and SWI on the basis that the only amount SII paid to SWI under the PSA and the ASSA agreements was an arm's length amount. The counsel then directed the Court to paragraph 136 of the Judge's decision where she states that it is not in issue that SWI provided

sales and marketing staff to SII at an arm's length price. According to the appellant, this is a fundamental error. If the Judge had applied the principles outlined by the Supreme Court in *Glaxo* she would have considered Mr. McDonald's expert report who took the position that the Minister should have valued the seconded US employee's skilled efforts. Counsel for the appellant also underlined the significant increase in the appellant's gross margin over the period as evidence of the value provided by SII to the appellant through the efforts of the seconded US employees.

[37] The appellant also disputed the three bases provided by the Judge for rejecting the expert report presented by Mr. McDonald. In the appellant's view, Mr. McDonald was correct to treat SWI and SII as an amalgam under Mr. Csumrik's direction when providing services to the appellant despite the fact that they were separate entities. The report concluded that the services provided by both SII and SWI, when considered together, justified the position that the fees paid were in keeping with the arm's length principle. The appellant contends that the Judge could not rely on the respondent's rebuttal report prepared by Mr. Rogerson (Rogerson Rebuttal Report) to counter the appellant's expert report nor could she rely on it as direct evidence of Mr. Rogerson's opinion on the ultimate issue.

[38] The appellant also challenged the Judge's reliance on the Guidelines to justify her choice of the CUP method as the most appropriate. In the appellant's view, the Guidelines are more flexible on the choice of methodology and the Judge should have considered the transitional net margin transfer pricing method proposed in the appellant's expert report.

[39] Finally the appellant argues that the Judge erred in her award of costs to the respondent because it was partly successful before the Tax Court and because the Minister failed to tender an expert report that met the basic requirements for admission in evidence.

[40] At the onset of the hearing before this Court, counsel for the respondent remarked that the appellant is now bringing forward a different theory of the case than it did before the Judge. In counsel's view, having failed to adduce convincing evidence that Mr. Csumrik was instrumental in implementing and actually overseeing the marketing strategy, the appellant is now arguing its case on the basis that the Judge erred in under-valuing the amounts paid by SII to SWI. The respondent points out, that at trial, the appellant never disputed the Minister's assumption that SWI provided sales and marketing staff and services to SII at an arm's length price nor did the appellant adduce any evidence with a view of establishing a different value for these services.

[41] According to the respondent, the Judge properly applied the teachings in *Glaxo*. She adhered to the principle outlined in that decision that applying the arm's length principle is a comparative exercise. The Judge was correct therefore to consider the independent interests of each party to each of the transactions and their respective roles and functions.

[42] The respondent takes the position that the Judge applied section 247 of the Act correctly and that her analysis addressed the appropriate transaction the MSSA agreement. In the respondent's view the Judge addressed the correct issue that is whether the terms and conditions between the appellant, SII, Mr. Csmurik/Longview and the amount of marketing fees paid to SII differed from what a party dealing at arm's length would have paid.

[43] The respondent contends that the Judge was correct to rely on the Guidelines and to consider the entities involved as separate as in this case, the PSA agreement specified that the agreement did not intend to create a joint venture or partnership between SII and SWI. The respondent also points to the fact that the appellant acknowledged that SWI and SII were separate entities and operated as such.

[44] The respondent disputes the appellant's position that the Judge focussed on the wrong amount and that she erred in concluding that the quantum of fees paid by SII to SWI was not in issue as it was on an arm's length basis. According to the respondent, the Judge had to accept that assumption as true because it was not disputed by the appellant.

[45] In the respondent's view, the Judge could accept the arm's length transaction between SII and Mr. Csumrik/Longview as a comparable uncontrolled transaction which could reliably serve as an internal comparable under the CUP method. According to the respondent, the Judge could conclude that Mr. Csumrik dealt with SII at arm's length and that the fee of US$32,500 paid to Mr. Csumrik and Longview by SII was a comparable uncontrolled price for the transaction between the appellant and SII because it was based on the evidence that was presented before her.

[46] Finally, on the issue of costs the respondent takes the position that costs allocations are discretionary and should not be disturbed.

VII. Analysis

[47] This Court in *Canada v. General Electric Capital Canada Inc.*, 2010 FCA 344, [2011] C.T.C. 126, at paragraph 55, indicated that the statutory objective underlying paragraphs 247(2)(*a*) and (*c*) of the Act is to prevent the avoidance of tax resulting from price distortions which can arise in the context of non-arm's length relationships by reason of the community of interest shared by related parties.

[48] The Act calls for the elimination of all the distortions that arise in any given transaction between related parties.

[49] The Supreme Court has provided further guidance in *Glaxo* at paragraphs 61 to 63 when it referred to the Guidelines which specify that transfer pricing is not an exact science. The Supreme Court noted that because comparators will rarely be identical in all material respects and consequently, the Tax Court judge must allow some leeway in establishing a satisfactory arm's length price. The Court in that case equally cautioned that the judge needed to consider the role and function of each of the entities that are parties to the transaction. Finally, the Court underlined that when determining prices between parties dealing at arm's length the interest of each party to the transaction should to be considered.

[50] The Guidelines assist the Court in its task of ascertaining the price that would have been paid by parties dealing at arm's length in the same circumstances. They identify and describe a

number of pricing methods that can be applied to identify the arm's length price for a given transaction.

[51] In the present appeal, the issue is fundamentally whether the Judge erred in her application of the principle outlined in paragraphs 247(2)(*a*) and (*c*) of the Act and more precisely, whether the Judge identified the proper transaction and took into account the appropriate related party contract prices.

[52] I find that it was open to the Judge, based on the evidence before her, to identify the transaction under review as the MSSA between SII and the appellant. As any transfer pricing analysis is fact driven, the appellant needed to point to an error the Judge made in the assessment of the facts leading to that determination. The appellant argued that its expert report did not dispute that the transaction under review was the MSSA but indicated that the value of the services provided to SII by SWI through the seconded US employees should also have been taken into consideration.

[53] The Judge's finding was based on the Guidelines (see OECD Guidelines 1995 chapter 1 paragraph 1.6). I find no error on her part in that regard. More so, as I review the evidence that was before her, it is undeniable that the appellant never challenged the Minister's assumption that the quantum of fees paid by SII to SWI were not in issue in the appeal before her. Having reviewed the record and the Notice of Appeal filed before the Tax Court, I cannot find any evidence that was adduced by the appellant in the Tax Court to challenge the Minister's

assumption that the price for the seconded US employees, set on a cost plus 10% basis, was not an arm's length price.

[54] As a taxpayer, the appellant had indeed the initial onus to "demolish" the Minister's assumptions in the assessment (see *Hickman Motors Ltd. v. Canada* [1997] 2 S.C.R. 336, [1997] S.C.J. No. 62 at paragraph 92; and *Canada c. Salaison Lévesque Inc.*, 2014 FCA 296, [2014] A.C.F. No. 1272 at paragraphs 25-26).

[55] The Judge rejected the appellant's expert report which proposed to treat SII and SWI as operating as a single entity under the direction of Mr. Csumrik. She provided three reasons for doing so. As I turn to these reasons, I find no error that would warrant this Court's intervention. The Judge acknowledged that the arm's length principle necessarily entailed separating SII and SWI's roles. In looking at the underlying agreements, more precisely article 4.1 of the PSA (Appeal Book, volume I page 157) and article 4.1 of the ASSA (Appeal Book, volume I page 164), I am forced to conclude that these agreements clearly spelled out the intent of the parties not to create a partnership or a joint venture between them. The Judge also found that the appellant's expert report rested on an incorrect factual basis since, as acknowledged by the appellant, SWI and SII were separate legal entities and operated as such. I see no valid reason to disturb this finding. Thirdly, I am forced to conclude that it was open to the Judge based on the Guidelines to favour the CUP method and dismiss the TNMM method proposed by the appellant's expert report as the Guidelines at the time favoured the CUP methodology (see paragraph 2.7 of the Guidelines).

[56] I must also reject the appellant's argument that the Judge relied on the Rogerson Rebuttal Report produced by the respondent to implicitly adopt the respondent's view that the value of the US employees work was set by the reassessments and was therefore not in issue. The appellant contends that Mr. Rogerson referenced his own primary report, which had not been admitted in evidence, when he opined that Mr Csmurik's contribution represents an internal comparable uncontrolled price for the amount in issue. Having reviewed the Judge's decision, more specifically paragraphs 212, 214 and 215, I have to dismiss that argument. The Judge did not rely on Mr. Rogerson's rebuttal report, as the appellant contends. Rather, the Judge states having relied on the respondent's written arguments pointing to the errors contained in the appellant's expert report. In her reasons, she also provided additional explanations for rejecting the appellant's expert report and relied on the Guidelines in support. The Judge also dismissed the appellant's expert report on the grounds that it contained some factual inaccuracies as to the role and contribution of Mr. Csumrik when he provided services to the appellant on behalf of SII.

[57] I also find that the Judge could, based on the evidence before her, dismiss the appellant's argument that its success in the US was sufficient proof of the value of the services Mr. Csumrik provided to SII .The Judge made several factual findings in that regard that were based on the oral evidence that was presented to her during the course of the trial. The Judge concluded that Mr. Csumrik only provided marginal services to the appellant on behalf of SII that could not justify the fees charged to the appellant under the MSSA. In coming to that conclusion, the Judge did find overlap between the activities of Mr. Csumrik under the MSSA and the management services he was providing to SII through Longview.

[58] With respect to the second issue, the determination of the Arm's length price, the Judge relied again primarily on the Guidelines which identified the CUP method as the most direct and reliable way to apply the arm's length principle (see section 2.7 of the appended Guidelines). I find no error in that respect as the Guidelines applied. The Judge concluded that Mr. Csumrik dealt with SII at arm's length and that the $32,500 fee payable to Mr. Csumrik and his corporation Longview is the amount a reasonable business person would have paid thereby confirming in essence the transfer pricing adjustment made by the Minister subject only to this minor adjustment of $32,500. That conclusion was based on the oral evidence before her. The appellant has failed to point to an overriding and palpable error in the Judge's appreciation of the evidence to overturn this finding.

[59] On the third issue regarding the granting of costs to the respondent, it is a well-established principle that orders granting costs are discretionary and command deference. Rule 147 of the *Tax Court of Canada Rules (General Procedures*) SOR/90-688a, specifies the factors that a judge must consider in awarding costs. An appellate Court should only intervene if the Judge considered irrelevant factors, failed to consider relevant factors, or reached an unreasonable conclusion (see *Guibord v. Canada*, 2011 FCA 346). In the present case, I see no valid reason to intervene.

[60] For these reasons I propose that this appeal be dismissed with costs.

"A.F. Scott"

J.A.

"I agree.
M. Nadon J.A."

"I agree.
Donald J. Rennie J.A."

APPENDIX A

Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

Chapter 1

The Arm's Length Principle

[…]

B. Statement of the arm's length principle

i) Article 9 of the OECD Model Tax Convention

1.6 The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD Member countries and an increasing number of non-Member countries. Article 9 provides:

> [When] conditions are made or imposed between … two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

By seeking to adjust profits by reference to the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances, the arm's length principle follows the approach of treating the members of an MNE group as operating as separate entities rather than as inseparable parts of a single unified business. Because the separate entity approach treats the members of an MNE group as if they were independent entities, attention is focused on the nature of the dealings between those members.

1.7 There are several reasons why OECD Member countries and other countries have adopted the arm's length principle. A major reason is that the arm's length principle provides broad parity of tax treatment for MNEs and independent enterprises. Because the arm's length principle puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity. In so removing these tax considerations from economic decisions, the arm's length principle promotes the growth of international trade and investment.

[…]

1.12 Both tax administrations and taxpayers often have difficulty in obtaining adequate information to apply the arm's length principle. Because the arm's length principle usually requires taxpayers and tax administration to evaluate uncontrolled transactions and the business activities of independent enterprises,

and to compare these with the transactions and activities of associated enterprises, it can demand a substantial amount of data. The information that is accessible may be incomplete and difficult to interpret; other information, if it exists, may be difficult to obtain for reasons of its geographical location or that of the parties from whom it may have to be acquired. In addition, it may not be possible to obtain information independent enterprises because of confidentiality concerns. In other cases information about an independent enterprise which would be relevant may simply not exist. It should also be recalled at this point that transfer pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and taxpayer.

[…]

C. Guidance for applying the arm's length principle

i) Comparability analysis

a) Reason for examining comparability

1.15 Application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the condition in transactions between independent enterprises. In order for such comparisons to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. In determining the degree of comparability, including what adjustments are necessary to establish it, an understanding on how unrelated companies evaluate potential transactions is required. Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter into the transaction if they see no alternative that is clearly more attractive. For example, one enterprise is unlikely to accept a price offered for its product by an independent enterprise if it knows that the other potential customers are willing to pay more under similar conditions. This point is relevant to the question of comparability, since independent enterprises would generally take into account any economically relevant differences between the options realistically available to them (such as differences in the level of risk or other comparability factors discussed below) when valuing those options. Therefore, when making the comparisons entailed by application of the arm's length principle, tax administrations should also take these differences into account when establishing whether there is comparability between the situations being compared and what adjustments may be necessary to achieve comparability.

1.16 All methods that apply to arm's length principle can be tied to the concept that independent enterprises consider the options available to them and in comparing one option to another they consider any differences between the options that would significantly affect their value. For instance, before purchasing a product at a given price, independent enterprises normally would be expected to consider whether they could buy the same product at a lower price from another party. Therefore, as discussed in Chapter II, the comparable uncontrolled price method compares a controlled transaction to similar uncontrolled transactions to provide a direct estimate of the price the parties would have agreed to had they resorted directly to a market alternative to the controlled transaction.

[…]

ii) Recognition of the actual transactions undertaken

1.36 A tax administration's examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them, using the methods applied by the taxpayer insofar as there are consistent with the methods described in Chapters II and III. In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transaction for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity which could be compounded by a double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.

[…]

iii) Evaluation of separate and combined transactions

1.42 Ideally, in order to arrive at the most precise approximation of fair market value, the arm's length principle should be applied on a transaction-by-transaction basis. However, there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis. Example may include *1*. some long-term contracts for the supply of commodities or services, *2*. rights to use intangible property, and *3*. Pricing a range of closely-linked products (e.g. in a product line) when it is impractical to determine pricing for each individual product or transaction. Another example would be the licensing of manufacturing know-how and the supply of vital components to an associated manufacturer; it may be more reasonable to assess the arm's length terms for the two items together rather than individually. Such transactions should be evaluated together using the most appropriate arm's length method or methods. A further example would be the routing of a transaction through another associated enterprise; it may be more appropriate to consider the transaction of which the routing is a part in its entirety, rather than consider the individual transactions on a separate basis.

1.43 While some separately contracted transactions between associated enterprises may need to be evaluated together in order to determine whether the conditions are arm's length, other transactions contracted between such enterprises as a package may need to be evaluated separately. An MNE may package as a single transaction and establish a single price for a number of benefits such as licenses for patents, know-how, and trademarks, the provision of technical and administrative services, and the lease of production facilities. This type of arrangement is often referred to as a package deal. Such comprehensive packages would be unlikely to include sales of goods, however, although the price charged for the sales of goods may cover some accompanying services. In some cases, it may not be feasible to evaluate the package as a whole so that the elements of the package must be segregated. In such cases, after determining separate transfer pricing for the separate elements, the tax administration should nonetheless consider whether in total the transfer pricing for the entire package is arm's length.

Chapter 2

Traditional Transaction Method

[…]

B. Relationship to Article 9

2.2. As stated in Chapter I, paragraph 1 of Article 9 of the OECD Model Tax Convention provides that where "conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2.3 The Commentary on paragraph 1 of Article 9 indicates that paragraph 1 authorizes a tax administration "for the purpose of calculating tax liabilities [to] re-write the accounts of the [associated] enterprises if as a result of the special relations between the enterprises the accounts do not show the true taxable profits arising in that State." The "true taxable profits" are those that would have been achieved in the absence of the conditions that are not arm's length. The Commentary emphasizes that the Article does not apply where transactions have occurred on "normal open market commercial terms (on an arm's length basis)"; accounts may be rewritten "only if special conditions have been made or imposed between the two enterprises." Thus, the issue under Article 9 is whether the conditions in the commercial or financial relations of associated enterprises are arm's length or whether instead one or more "special conditions" exist (i.e. conditions that are not arm's length).

[…]

The most direct way to establish whether the conditions made or imposed between associated enterprises are arm's length is to compare the prices charged in controlled transactions undertaken between those enterprises with prices charged in comparable transactions undertaken between independent enterprises. This approach is the most direct because any difference in the price of a controlled transaction from the price in a comparable uncontrolled transaction can normally be traced directly to the commercial and financial relations made or imposed between the enterprises, and the arm's length conditions can be established by directly substituting the price in the comparable uncontrolled transaction for the price of the controlled transaction. However, there will not always be comparable transactions available to allow reliance on this direct approach alone, and so it may be necessary to compare other less direct indicia, such as gross margins, from controlled and uncontrolled transactions to establish whether the conditions between associated enterprises are arm's length. These approaches, direct and indirect, are reflected in the traditional methods described below.

C. Types of traditional transaction methods

i) Comparable uncontrolled price method

2.6 The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two prices, this may

indicate that the conditions of the commercial and financial relations of the associated enterprises are not arm's length, and that the price in uncontrolled transaction may need to be substituted for the price in the controlled transaction.

2.7 Following the principles in Chapter I, an uncontrolled transaction is comparable to a controlled transaction (i.e. it is a comparable uncontrolled transaction) for purposes of the CUP method if one of two conditions is met: *1*. None of the differences (if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market; or *2*. Reasonably accurate adjustments can be made to eliminate the material effects of such differences. Where it is possible to locate comparable uncontrolled transactions, the CUP Method is the most direct and reliable way to apply the arm's length principle. Consequently, in such cases, the CUP Method is preferable over all other methods.

2.8 It may be difficult to find a transaction between independent enterprises that is similar enough to a controlled transaction such that no differences have a material effect on price. For example, a minor difference in the property transferred in the controlled and uncontrolled transactions could materially affect the price even though the nature of the business activities undertaken may be sufficiently similar to generate the same overall profit margin. When it is the case, some adjustments will be appropriate. As discussed below in paragraph 2.9, the extent and reliability of such adjustments will affect the relative reliability of the analysis under the CUP method.

2.9 In considering whether controlled and uncontrolled transactions are comparable, regard should be had to the effect on price of broader business functions other than just product comparability (i.e. factors relevant to determining comparability under Chapter I). Where differences exist between the controlled and uncontrolled transactions or between the enterprises undertaking those transactions, it may be difficult to determine reasonably accurate adjustments to eliminate the effect on price. The difficulties that arise in attempting to make reasonably accurate adjustments should not routinely preclude the possible application of the CUP method. Practical considerations dictate a more flexible approach to enable the CUP Method to be used and to be supplemented as necessary by other appropriate methods, all of which should be evaluated according to their relative accuracy. Every effort should be made to adjust the data so that it may be used appropriately in a CUP method. As for any method, the relative reliability of the CUP Method is affected by the degree of accuracy with which adjustments can be made to achieve comparability.

2.10 The following examples illustrate the application of the CUP method, including situations where adjustments may need to be made to uncontrolled transactions to make them comparable uncontrolled transactions.

2.11 The CUP method is a particularly reliable method where an independent enterprise sells the same product as is sold between two associated enterprises. For example, an independent enterprise sells unbranded Colombian coffee beans of a similar type, quality, and quantity as those sold between two associated enterprises, assuming that the controlled and uncontrolled transactions occur at about the same time, at the same stage in the production/distribution chain, and under similar conditions. If the only available uncontrolled transaction involved unbranded Brazilian coffee beans, it would be appropriate to inquire whether the difference in the coffee beans has a material effect on the price. For example, it could be asked whether the source of coffee beans commands a premium or requires a discount generally in the

open market. Such information may be obtainable from commodity markets or may be deduced from dealer prices. If this difference does have a material effect on price, some adjustments would be appropriate. If a reasonably accurate cannot be made, the reliability of the CUP Method would be reduced, and it might be necessary to combine the CUP method with other less direct methods, or to use such methods instead.

2.12 One illustrative case where adjustments may be required is where the circumstances surrounding controlled and uncontrolled sales are identical, except for the fact that the controlled sales price is a delivered price and the uncontrolled sales are made f.o.b. factory. The differences in terms of transportation and insurance generally have a definite and reasonably ascertainable effect on price. Therefore, to determine the uncontrolled sales price, adjustment should be made to the price for the difference in delivery terms.

2.13 As another example, assume a taxpayer sells 1 00 tons of a product for $80 per ton to an associated enterprise in its MNE group, and at the same time sells 500 tons of the same product for $100 per ton to an independent enterprise. This case requires an evaluation of whether the different volumes should result in an adjustment of the transfer price. The relevant market should be researched by analysing transactions in similar products to determine typical volume discounts.

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