

Tax Alert – Canada

Supreme Court of Canada hears the *GlaxoSmithKline* case

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On 13 January 2012, a seven-member panel of the Supreme Court of Canada heard the appeal of the Federal Court of Appeal's (FCA's) decision in favour of Glaxo Canada in the *GlaxoSmithKline* transfer pricing case. The Court heard the Crown's appeal with respect to the taxpayer's 1990 to 1993 taxation years, as well as the taxpayer's cross-appeal on the lower court's decision to send the case back to the Tax Court of Canada for reconsideration in accordance with its findings.

At the hearing, each party, having previously provided a written submission, orally presented its argument – limited to one hour according to the Court's procedures. The hearing allowed the Supreme Court justices to obtain clarification of the parties' positions through questions put to counsel for each party. A decision of the Court is expected to be rendered within 8 to 12 months of the hearing date.

In this Tax Alert, we report on the arguments made at the hearing and the issues that seemed to most interest the Supreme Court justices. A detailed background of the case and of each party's written argument is set out in Tax Alert 2011 Issue No. 34, [GlaxoSmithKline set down for hearing at the Supreme Court of Canada](#).

Background

The Tax Court of Canada decision of 30 May 2008 (2008 TCC 324) concerned the former transfer pricing provisions contained in

subsection 69(2) of the *Income Tax Act* (the Act). In his decision, Justice Gerald Rip accepted the Crown's position that, during the period from 1990 to 1993, Glaxo Canada overpaid Adechsa, its non-arm's-length Swiss supplier, for the purchase of ranitidine, the active pharmaceutical ingredient used in the manufacture of the patented anti-ulcer drug Zantac.

Justice Rip concluded that the price Glaxo Canada paid was not "reasonable in the circumstances," as required by former subsection 69(2) of the Act, based on the comparable uncontrolled price (CUP) method, wherein the price Glaxo Canada paid was compared to the price paid for ranitidine in those years by generic pharmaceutical companies operating in Canada.

On 26 July 2010, the FCA rendered its decision with respect to Glaxo Canada's appeal (2010 FCA 201). While the FCA allowed the taxpayer's appeal, it referred the matter back to the Tax Court for redetermination of the substantive issues based on the proper test.

According to the FCA, Justice Rip erred in his interpretation of the proper test under subsection 69(2) in not considering all relevant circumstances that an arm's-length purchaser would have had to consider. The proper test under subsection 69(2) was not to determine the price *any* arm's-length purchaser of ranitidine was willing to pay, but rather whether an arm's-length Canadian distributor of the patented drug Zantac would have been willing to pay the price Glaxo Canada paid to Adechsa to acquire ranitidine.

Crown's Supreme Court argument

On the principal issue, the Crown contended that the FCA erred in its consideration of whether the price paid by Glaxo Canada was "reasonable in the circumstances."

The Crown argued that applying a "reasonable in the circumstances" test, as the FCA did, does not fulfil the conditions of section 69(2), as a price

that may be reasonable is not necessarily an arm's-length price. According to the Crown, only those circumstances that would be relevant to parties bargaining at arm's length for a particular good should be considered in the analysis. In its view, other circumstances, such as Glaxo Canada's status as a distributor of Zantac, were irrelevant to the consideration of the price paid for ranitidine.

The Supreme Court justices posed a number of questions to the Crown, including how the phrase "reasonable in the circumstances" from subsection 69(2) should be interpreted.

The Crown suggested, citing the *OECD Transfer Pricing Guidelines*, that the phrase was intended to consider only the "economically relevant circumstances" pertaining to the specific transaction in question. Several justices seemed to have difficulty with this position, with Justice Marshall Rothstein questioning why "reasonable in the circumstances" could not include the fact that Glaxo Canada was in the business of distributing Zantac, and suggesting that the Crown was changing the circumstances of Glaxo Canada.

The Crown repeatedly suggested that subsection 69(2) did not allow consideration of "the whole deal." Justice Rosalie Abella replied, "That's what 'in the circumstances' might suggest," and indicated she thought it would be very difficult to strip out from the circumstances the question of who is the buyer and for what purpose.

Questions from Justices Marie Deschamps, Rothstein and Abella ensued with regard to what the Crown's position would be regarding a hypothetical independent licensee entering into an arrangement similar to Glaxo Canada, and whether the independent licensee could be reassessed in the same manner. The Crown responded that the independent licensee could be reassessed as not "dealing at arm's length" if it was tied into a set price and had no ability to bargain.

Glaxo Canada's Supreme Court argument

Glaxo Canada concurs with the FCA's findings on the issue of whether the circumstances of its purchase of ranitidine should include consideration of its licensing arrangement for the sale of Zantac.

Counsel for Glaxo Canada posited that subsection 69(2) situates the parties at arm's length and asks at the bottom line, "Would they do the deal?" Justice Abella asked, "How do we know they would do the deal?"

Prompted by Chief Justice Beverley McLachlin, an extended discussion followed of whether the price paid for ranitidine was a bundled price for tangible and intangible property and whether withholding tax potentially applied.

Counsel for Glaxo Canada replied with an analogy around luxury brands such as Rolex and Porsche – while there are undoubtedly components of intellectual property embedded in the price of the tangible good, it is not Canadian law or practice to segregate and separately tax the discrete elements.

A discussion ensued regarding the meaning of certain portions of the *OECD Transfer Pricing Guidelines* and how they inform the issues at hand, although no definitive conclusions were reached (elements of the *Guidelines* were also referenced and questioned in the Crown's argument).

Further, according to Counsel, this was not the assessment made against Glaxo Canada – there is no dispute between the parties that the issue in question is solely the price of the tangible good rather than its characterization.

The cross-appeal

On the cross-appeal issue, Glaxo Canada asserted that it had demolished the Minister's reassessment by demonstrating that the theory underpinning the liability fixed by the Minister

(that the reasonable price paid for ranitidine in those years was the price paid by generic pharmaceutical companies operating in Canada) was wrong, and therefore the reassessment must be set aside rather than sent back to the Tax Court.

In the Crown's view, Glaxo Canada did not "demolish" the reassessment, and it remains a valid assessment open for reconsideration by the Tax Court of Canada.

Chief Justice McLachlin suggested it was the taxpayer's onus to prove that it didn't overpay for ranitidine, noting that the lower courts haven't addressed this directly, and stated she didn't follow the taxpayer's argument.

Counsel for Glaxo Canada answered that once it had demolished the Crown basis of reassessment, the onus shifted to the Crown to show that Glaxo Canada paid too much.

On the Crown's reply, Justice Rothstein asked whether, if the cross-appeal were allowed and the matter were sent back to Tax Court, what else could be argued (i.e., would the Crown's position be exactly the same, based on the generics' prices)? The Crown answered that the argument would remain essentially the same, the generic comparable prices being the only available information in the evidence to support arm's-length prices for ranitidine.

Summary

The questions posed by the Supreme Court demonstrate the complexity of the issues involved in this case. Pointed questions put to counsel for both Glaxo Canada and for the Crown make it difficult to anticipate the direction of the Court's decision.

Even though the case concerns the former transfer pricing rules, as this is the first transfer pricing case heard by the Supreme Court, the decision should provide valuable guidance on transfer pricing concepts and practice, including

the meaning of dealing at arm's length, the selection of transfer pricing methodologies, functional comparability, and the role of the *OECD Transfer Pricing Guidelines* as an aid to interpretation of domestic legislation.

For Glaxo Canada, the key issue may well be the cross-appeal, as a decision that sends the case back to the Tax Court would fail to provide the certainty it is seeking more than two decades after the events in question.

Learn more

For additional background on this ongoing case, see our Tax Alerts 2010 Issue No. 35, [Crown seeks leave to appeal GlaxoSmithKline decision to Supreme Court of Canada](#), 2011 Issue No. 14, [Supreme Court of Canada grants leave to appeal of GlaxoSmithKline decision](#) and 2011 Issue No. 34, [GlaxoSmithKline set down for hearing at the Supreme Court of Canada](#).

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