



Insights: Transfer Pricing

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In the circumstances: The Supreme Court of Canada hears the GlaxoSmithKline transfer pricing case

By Brad Rolph



After more than 15 years, the battle between the Canada Revenue Agency and Glaxo Canada over the transfer price for ranitidine—the active pharmaceutical ingredient used to make the anti-ulcer drug Zantac—finally reached the Supreme Court of Canada last month.

At issue were the Crown's appeal and the taxpayer's cross appeal of the Federal Court of Appeal decision in favor of Glaxo Canada to set aside the decision of the Tax Court of Canada in favor of the Canada Revenue Agency and remitted the case back to the Tax Court for reconsideration.

Seven members of the Supreme Court heard oral arguments from each party in support of a 40-page brief that had been presented to the Supreme Court during 2011. In accordance with the Supreme Court's procedures, the oral arguments were limited to one hour.

According to the Crown, the Federal Court of Appeal erred when it relied on the "reasonable business person" test to strike down Justice Rip's seemingly narrow interpretation of the "reasonable in the circumstances." In doing so, the Federal Court of Appeal interpreted s. 69(2) of the *Income Tax Act* in a way that is incompatible with the arm's length principles as set out in the OECD transfer pricing guidelines. Instead, the Crown argued that Justice Rip had correctly applied the "reasonable in the circumstances" test and only considered those circumstances that would be "economically relevant" to parties bargaining at arm's length; specifically, the market price for ranitidine in isolation of the licensing agreement between Glaxo Canada and Glaxo UK.

Several of the Justices seemed to have difficulty with this argument. Justices Marshall Rothstein and Rosalie Abella insinuated that it would be difficult to ignore the fact that Glaxo Canada purchased ranitidine for the purpose of manufacturing and selling a branded drug and that it was contractually restricted from purchasing ranitidine on the open market to make Zantac. Given that third party distributors with licenses to manufacture and sell Zantac in other countries were contractually restricted from purchasing ranitidine on the open market, it would appear that the Crown was fighting an uphill battle.¹

¹ Routinely, counsel for the Canada Revenue Agency and the taxpayer refer to business enterprises that are licensed to manufacture and sell pharmaceutical drugs as distributors. In other contexts, such enterprises are often described as manufacturing licensees.

It was appropriate for the Justices to challenge the Crown's interpretation of and general lack of regard for the phrase "in the circumstances." The entire outcome of the case rests on this very phrase. There is a difference between asking whether an amount is "reasonable" and whether an amount is "reasonable in the circumstances." I can go to a grocery store and purchase a bottle of water for \$1.25. I can also pay \$4.50 for that same brand of water in the same container inside a sports stadium. Both prices are the result of an arm's length transaction. Is paying \$4.50 a reasonable amount for a bottle of water? Many of us would respond no, it is not a reasonable amount. However, we are often faced with paying \$4.50 for that bottle of water, or an equally unreasonable amount for a great number of other items, at the stadium. Why? Because the circumstances in which the purchases are being made are different. The price that I pay in the grocery store reflects the competitive market that the grocery store is in for my business. The price that I am faced with at the sports stadium reflects the fact that I'm a captive audience. If I want to purchase that bottle of water while I'm at the sporting event, I can only do so from the stadium owner. That is part of the deal I made when I purchased the ticket to enter the stadium. My only alternative is to not purchase the bottle of water.

Similar circumstances faced Glaxo Canada. It was contractually restricted to purchase ranitidine from a Glaxo-approved supplier of ranitidine, in this case its Swiss or its Singapore affiliate. As a result of entering into this contract, Glaxo Canada was able to sell its product under the Zantac trade name rather than as a generic drug. The Glaxo affiliates, knowing that they had a captive audience, could charge Glaxo Canada a monopoly price that was higher than the competitive price that the Crown's generic comparable companies paid on the open market. Such a theory of the case focuses on the transaction (i.e., the price of ranitidine), treats each party as a separate entity, and considers the economically relevant circumstances facing Glaxo Canada. Such an approach would clearly result in a price for ranitidine that was higher than the transfer price used by the Canada Revenue Agency to calculate its reassessment. For these reasons, I believe that the Crown's appeal to the Supreme Court should be denied.

Unfortunately, I fear that the taxpayer's cross appeal will also be denied for procedural reasons. Glaxo Canada had appealed the Federal Court of Appeal's decision because it had erred by remitting the case back to the Tax Court for reconsideration. Counsel of Glaxo Canada argued that it had demolished the Minister's reassessment by demonstrating that the reassessment was based on a completely incorrect premise. As such, the Federal Court of Appeal should set aside the reassessment rather than sending it back to the Tax Court.

The cross appeal is a procedural matter in which I have no expertise. As argued by the Crown in its brief, section 52(c)(ii) of the Federal Courts Act gives the Federal Court of Appeal the power to refer the matter back to the Tax Court "for determination in accordance with such directions as it considers to be appropriate."

The Supreme Court is expected to render its decision in six to 12 months.

For further information regarding this case, follow the link [here](#) to coverage by *TP Week*.

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