Dockets: 2014-895(IT)G
2014-896(IT)G

BETWEEN:

SIFTO CANADA CORP. and
SIFTO CANADA CORP.
(AS SUCCESSOR TO SIFTO CANADA INC.),

Appellants,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on July 11, 12, 13 and 14, 2016, at Toronto, Ontario
Written Submissions received on August 8, 2016 and September 9, 2016

Before: The Honourable Justice John R. Owen

Appearances:

Counsel for the Appellants:	Al Meghji, Ian MacGregor, Al-Nawaz Nanji and Ilana Ludwin
Counsel for the Respondent:	Naomi Goldstein, Alexandra Humphrey, Rishma Bhimji and Alisa Apostle

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JUDGMENT

In accordance with the attached Reasons for Judgment, the appeals in respect of the issue described in paragraph 3 of the attached Reasons for Judgment are allowed and the reassessments made under the *Income Tax Act* for the taxation years ending December 31, 2004, November 23, 2005, December 31, 2005 and December 31, 2006 ("taxation years"), notices of which are dated August 1, 2012, are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the income of the Appellants from the sale of rock salt to the North American Salt Company during the taxation years is to be determined so as to be consistent with the Agreements (as defined in paragraph 166 of the attached Reasons for Judgment). The parties have 30 days from the date of the Judgment in these appeals to make submissions of no more than ten pages as to costs.

Signed at Ottawa, Canada, this 10th day of March 2017.

"J.R. Owen"

Owen J.

Citation: 2017 TCC 37
Date: 20170310
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REASONS FOR JUDGMENT

Owen J.

I. Introduction

[1] These reasons address one issue raised in the appeals by Sifto Canada Corp.[1] (the "Appellant") from reassessments dated August 1, 2012 (collectively, the "Reassessments") of its taxation years ending December 31, 2004, November 23, 2005, December 31, 2005 and December 31, 2006 (collectively, the "Taxation Years"). The appeals in respect of this single issue were heard on common evidence. The nature of the issue is such that if I find in favour of the Appellants on the issue, the appeals from the Reassessments must be allowed.

II. The Issue

[2] The appeals raise three issues in respect of the Taxation Years: (1) whether the Minister of National Revenue (the "Minister") was entitled to issue the Reassessments; if she was, (2) whether the transfer price reflected in the

[1] The taxpayer for the years ending December 31, 2004 and November 23, 2005 was Sifto Canada Inc., a predecessor of the Appellant.

Reassessments was correct and (3) whether the Minister was entitled to assess penalties under subsection 247(3) of the *Income Tax Act* (the “ITA”).

[3] At the written request of the parties, the Court ordered that these issues be bifurcated pursuant to subsection 171(2) of the ITA and that the first issue be addressed in a separate hearing. The first issue is framed by the parties as follows:

> [W]hether the Minister was precluded from issuing the August 1, 2012 reassessments by virtue of any agreement (the existence of which is in dispute), the *Canada-United States Tax Convention* or the *Income Tax Act*?[2]

[4] The circumstances giving rise to this issue can be briefly summarized as follows. The Appellant determined that for 2002 to 2006, it had understated its income from the sale of rock salt to a related corporation resident in the United States. To correct the situation, the Appellant made a voluntary disclosure to the Canada Revenue Agency (the “CRA”) that adjusted its income upward for those years. The upward adjustment of income requested in the voluntary disclosure was accepted by the CRA and the Appellant was reassessed accordingly for its 2002 through 2006 taxation years. The Appellant and a related US corporation then applied to their respective competent authorities to request a commensurate reduction in the income recognized in the United States. The competent authorities reached two agreements which were memorialized in two separate letters and the Canadian Competent Authority asked the Appellant to accept the terms of these letters, which it did. The CRA subsequently audited the Appellant and reassessed the Taxation Years to further increase the income of the Appellant from the sale of rock salt to the related United States corporation.

III. The Facts

A. The Statement of Agreed Facts (Partial)

[5] At the commencement of the hearing, the parties tendered a Statement of Agreed Facts (Partial) (the “SAF”) and a Joint Book of Documents consisting of two spiral-bound volumes (collectively, the “JBD”). The facts recited in the SAF are set out in Appendix A to these reasons.

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[2] This description of the issue is set out in a letter from the parties to the Court dated August 26, 2015. The letter was delivered in response to an order of the Court requiring the parties to define the issue so that the Court could accept or reject the bifurcation request.

[6] The JBD included only the documents cited in the SAF. The SAF states:

> The parties to this proceeding admit, for the purposes of this proceeding only, the truth of the following facts and to [*sic*] the authenticity of the documents referred to in the Statement of Agreed Facts (Partial) as that term is defined in the *Tax Court of Canada Rules (General Procedure).*
>
> The parties do not admit the truth of the contents of the documents referred to in the Statement of Agreed Facts (Partial) and may challenge the accuracy of any statements contained in those documents.

B. **The Witnesses**

[7] At the commencement of the hearing, the Appellant tendered an expert report addressing two questions. I rejected the expert report on the grounds that the content of the report was neither relevant nor necessary.[3] The Appellant did not call any witnesses.

[8] The Respondent called four witnesses. The first witness was Mr. Timothy R. Mertz, who is the vice-president of tax at Compass Minerals International Inc. ("Compass"), the indirect parent of the Appellant and a publicly traded U.S. corporation.[4]

[9] The other three witnesses were Mr. Daniel Quinn, who is a manager in a Mutual Agreement Procedure – Advance Pricing Arrangements Section of the Competent Authority Services Division (the "CASD") of the CRA; Mr. Shaun Harkin, who is a senior international auditor in a Mutual Agreement Procedure – Advance Pricing Arrangements Section of the CASD; and, Mr. Darryl Boychuk, who is the manager of the Mutual Agreement Procedure – Technical Cases Section of the CASD. I will sometimes refer to these three witnesses as the "CRA witnesses".

[10] Mr. Quinn and Mr. Harkin had direct knowledge of the Appellant's file with the CASD and testified accordingly. Mr. Boychuk had no such knowledge and only testified as to the practices and procedures of his group within the CASD.

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[3] The requirement that expert evidence be relevant and necessary was recently confirmed by the Supreme Court of Canada in *White Burgess Langille Inman v. Abbott and Haliburton Co.*, 2015 SCC 23, [2015] 2 S.C.R. 182.
[4] SAF paragraph 2.

[11] Shortly after Mr. Quinn started to testify, the Appellant's counsel objected to the testimony of the CRA witnesses on the basis that any evidence of the subjective intent of the CASD/CRA or its employees in respect of its dealings with the United States Internal Revenue Service (the "IRS") and with the Appellant was not relevant to the determination of whether agreements existed and, if so, to the interpretation of those agreements. Counsel suggested that for this reason the CRA witnesses should not be allowed to testify.

[12] I allowed the CRA witnesses to testify on the basis that I could not determine materiality and relevance before hearing the evidence of the CRA witnesses and that I would address in the context of my analysis of the applicable law any issue with respect to the materiality and relevance of any permitted testimony describing subjective intent. I also advised the Appellant's counsel that he was free to object to specific testimony as he saw fit.

[13] The Appellant's counsel objected to Mr. Boychuk testifying on the grounds that he had no personal knowledge of the Appellant's file with the CASD and that the practices and procedures of the Mutual Agreement Procedure – Technical Cases Section of the CASD were not material or relevant to the issue as that group had no involvement in the Appellant's file.

[14] I allowed Mr. Boychuk to testify because the issue defined by the parties involves, among other things, whether the Minister and the Appellant entered into agreements, and Mr. Boychuk's testimony could conceivably provide further context to the circumstances described by the first two CRA witnesses. The Appellant's counsel renewed his objection on several occasions during Mr. Boychuk's testimony. I address the import of Mr. Boychuk's testimony in Section: IV. Analysis.

C. **Summary of the Facts**

(1) Background

[15] The Appellant is a Canadian corporation resident in Canada and is an indirect subsidiary of Compass. The Appellant owns and operates a salt mine in Goderich, Ontario.

[16] During the Taxation Years, the Appellant sold approximately 50% of its annual rock salt production to North American Salt Company ("NASC"), a

United States corporation resident in the United States for the purposes of the *Canada-United States Tax Convention* (the "Convention"). At the time of the rock salt sales, NASC was an indirect subsidiary of Compass with the result that, for the purposes of Article IX of the Convention, the Appellant and Compass were related under paragraph (2) of Article IX of the Convention.

[17] The sales of rock salt by the Appellant to NASC were reported by the Appellant in its T2 income tax returns filed for the Taxation Years. Compass reported the purchases of the salt by NASC in its consolidated U.S. income tax returns filed for the period covered by the Taxation Years.

(2) The Voluntary Disclosure

[18] In 2006, Mr. Gary Gose was hired by Compass as Director, International Tax, a position subordinate to that of Mr. Mertz.[5] Mr. Gose and others raised concerns regarding the transfer price of the rock salt sold by the Appellant to NASC. It appears this price was based on a transfer pricing report and that the methodologies used in that report were called into question.[6] At some point after 2006, KPMG prepared a new transfer pricing report (the "2002-2006 TPR") that addressed the Appellant's sales of rock salt to NASC for 2002 through 2006. Mr. Mertz referred to the 2002-2006 TPR as the 2002 to 2006 report.[7]

[19] Because of the 2002-2006 TPR, the Appellant and NASC reached the conclusion that the transfer price used to determine the Appellant's income from its sales of rock salt to NASC during its taxation years ending in 2002 through 2006 was less than an arm's length price.

[20] By letter dated April 11 2007, the Appellant made a no-names application to the CRA's voluntary disclosure program (the "VDP"). The CRA acknowledged this application in a letter dated April 19, 2007. The Appellant subsequently made a named application to the VDP by letter dated August 13, 2007 with an enclosure (the "VDP Application").[8]

[21] In the VDP Application, the Appellant disclosed an accounting error of $2,470,272 for its 2006 taxation year and the following additional amounts of

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[5] Lines 3 to 10 of page 84 of the transcript of the proceedings held on July 11 to 14, 2016 in Toronto (the "Transcript").

[6] Lines 25 to 28 of page 84 and lines 1 to 4 of page 85 of the Transcript.

[7] Lines 5 to 13 of page 85 of the Transcript

[8] A copy of the letter and enclosure is found at Tab C of the JBD.

income in respect of its sales of rock salt to NASC for its taxation years ending in 2002 through 2006 (the “VDP Period”):

Taxation year ended	Additional income disclosed
December 31, 2002	$1,899,577
December 31, 2003	$4,206,408
December 31, 2004	$4,306,553
November 23, 2005 and December 31, 2005 combined	$841,745
December 31, 2006	$2,082,036

[22] The enclosure with the VDP Application letter is a 51-page document with the following on the cover page: “Transfer Pricing Sifto Canada Inc. Voluntary Disclosure Program Submission Fiscal Years 2002 to 2006” (the “VDP Document”). Section 2.3 of the VDP Document states:

> There is essentially only one transaction to be included under the VDP: during the VDP period, Sifto acted as a simple extractor of raw material (i.e. salt) from its Goderich salt mine and sold that salt to NASC. The issue is whether Sifto sold that salt to NASC at an arm’s length price, and if not, how much the price of the salt must be adjusted in order to reflect arm’s length pricing.

[23] Sections 3 to 9 of the VDP Document and its three appendices (approximately 39 pages in total) address the arm’s length price, section 10 addresses penalties, section 11 addresses the accounting error for 2006, section 12 describes the requirements for a voluntary disclosure, and section 14 is titled “Conclusion”. Section 13 describes the relief requested as follows:

> Sifto requests the following:
>
> 1 The CRA accept the proposed adjustments to its income in each of the years under the VDP period.
>
> 2 The CRA waive or eliminate all applicable penalties in respect of the transactions discussed above.

[24] As part of the VDP process, the Appellant filed amended T2 income tax returns for its taxation years ending in the VDP Period (the "VDP Taxation Years") to reflect the adjustments to income set out in the VDP Application.

[25] By letter dated March 13, 2008, the Minister advised the Appellant that the VDP Application had been accepted and that reassessments would be issued for the VDP Taxation Years to reflect the additional income disclosed in the VDP Application.

[26] On April 21 and 22, 2008, the Minister issued notices of reassessment to the Appellant for the VDP Taxation Years (the "2008 Reassessments"). The 2008 Reassessments reflected the additional income disclosed by the Appellant in the VDP Application and reported by the Appellant in the amended T2 income tax returns filed for the VDP Taxation Years. The CRA did not audit the Appellant prior to issuing the 2008 Reassessments.

(3) The Application to the Canadian Competent Authority

[27] Because of the 2008 Reassessments, the income resulting from the adjustment to the transfer price of the rock salt sold by the Appellant to NASC during the VDP Period was taxed twice: once in Canada and once in the United States. This incidence of economic double taxation could only be eliminated by a commensurate increase in the cost to NASC for U.S. tax purposes of the salt sold by the Appellant to NASC during the VDP Period. Because NASC was part of a consolidated group for U.S. income tax purposes, the resulting downward adjustment to income would be reflected in the consolidated income tax return of Compass. As a result, Compass was the relevant U.S. taxpayer.

[28] The Appellant applied to the Canadian Competent Authority (the "CCA") and Compass applied to the United States Competent Authority (the "USCA") for relief from double taxation under Articles IX and XXVI of the Convention. The IRS is the USCA[9] and the Minister is the CCA. At the time of the applications, Ms. Patricia Spice was the Minister's authorized representative.[10]

[9] Paragraph 17 of the SAF.
[10] Paragraph 15 of the SAF and lines 9 to 16 of page 197 of the Transcript.

[29] The Appellant's application to the CCA (the "CCA Application")[11] was made by letter dated April 30, 2008. A copy of the VDP Document was enclosed with the CCA Application. The CCA Application stated, in part:

> We are writing to request Competent Authority assistance on behalf of our client, Sifto Canada Inc. ("Sifto"), regarding Notices of Reassessment mailed April 21, 2008 for Sifto's taxation year ended December 31, 2006, and April 22, 2008 for Sifto's taxation years ended December 31, 2002, 2003, and 2004, and November 23, 2005. In accordance with paragraph 19 of Information Circular IC71-17R5 ("the IC"), we have provided the relevant information of Sifto in italics below:
>
> . . .
>
> q) the taxpayer's views on any possible bases on which to resolve the issues.
>
> *As a result of the Notices of Reassessment mentioned above, Sifto is requesting the Canadian Competent Authority to request the US Competent Authority to allow a corresponding deduction in the taxable income of NASC in order to prevent double taxation.*[12]

[Italics in original.]

[30] At the time of the application, Mr. Quinn was a manager in the CASD. He assigned the file to Mr. David Dougherty, who was an analyst in the CASD. After Mr. Dougherty left the CASD around February 16, 2009,[13] the file was assigned to Mr. Harkin, who was also an analyst in the CASD.

[31] Mr. Quinn described his role with respect to the Appellant's CCA file and the role of the CCA in general as follows:

> My role was to oversee the decision-making, to sign letters, to sit in on conversations with the taxpayer and with the IRS, and just to be involved on a regular basis as to the progress of the file.[14]
>
> . . .
>
> Competent Authority endeavours to resolve issues of tax contrary to our Tax Treaties, so, for example, double taxation. We engage with other tax authorities

[11] Tab F of the JBD.
[12] Tab F of the JBD, pages 1 and 4.
[13] Lines 11 to 13 of page 170 of the Transcript.
[14] Lines 11 to 15 of page 154 of the Transcript.

> under the Mutual Agreement Procedure Article and endeavour to resolve double tax with other tax authorities on behalf of taxpayers.[15]

[32] Mr. Quinn explained that the CCA would become involved with a taxpayer's file once the taxpayer initiated a mutual agreement procedure ("MAP") request under one of Canada's bilateral income tax conventions. Mr. Quinn confirmed that the CCA Application was made under Article XXVI of the Convention. He described in general terms the steps taken by the CASD in response to a MAP request from a taxpayer:

> When we receive a MAP request, we log it in our inventory system, and it gets assigned to a group, and then it gets assigned to an analyst. And that analyst then determines if there's tax contrary to the Convention and initiates work to acknowledge the request to the taxpayer and engage the other tax authority and work towards resolving the issue.[16]

[33] Mr. Quinn described the process with the competent authority of the other country in the following exchange with Respondent's counsel:

> Q. Mr. Quinn, continuing on, can you tell us how Competent Authority cases are discussed between countries?
>
> A. Yes. They're discussed by telephone, by letter, and in-person meetings. Regular meetings are held with tax authorities that we have a lot of work with. So, with the U.S., we would meet the IRS on a regular basis, two to three times a year. And, besides that, we would converse with them via telephone on a regular basis.
>
> Q. And who is involved in these discussions?
>
> A. For Sifto or in general?
>
> Q. Generally, and then for Sifto.
>
> A. Well, generally, the analyst that has the case would be involved via telephone. If there's a meeting, then both the analyst and myself, as manager, would normally be present at the meeting. Sometimes I would be involved in conference calls. And, on the U.S. side, it would be the same. It would be the analyst and manager involved in meetings, and telephone conversations would normally just be between the analysts.

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[15] Lines 18 to 23 of page 154 of the Transcript.
[16] Lines 1 to 7 of page 156 of the Transcript.

> Q. And are taxpayers involved in these discussions?
>
> A. Taxpayers are not directly involved. They are involved to the extent that they are to provide information, as they would in their initial request. And if the tax authorities have any additional requests for information, then, again, they're obligated to provide that to both tax authorities. And they are kept informed as to the progress of the discussions.
>
> Q. What happens if the Competent Authorities come to an agreement?
>
> A. If we come to an agreement, then we would generally memorialize that agreement in a letter or an exchange of letters. We would advise the taxpayer of the agreement, the terms of the agreement. Normally we would do that verbally, and we would also normally follow that up with a letter outlining what the agreement is. And then we would notify our local offices. If there's an objection in play, then we would notify our appeals office, and we would also notify our Tax Services Office, our Audit division normally.

[34] Compass's application to the USCA (the "USCA Application")[17] was made by letter dated May 13, 2008. Various documents were enclosed with the USCA Application, including copies of the 2008 Reassessments and a copy of the VDP Document.

[35] By letter dated August 12, 2008 received by the CASD on August 29, 2008,[18] Mr. Barry Shott asked Ms. Spice to provide "us with the details of your position concerning the adjustments so that we can evaluate the issue for purposes of considering relief from economic double taxation". At the time, Mr. Shott was the United States Competent Authority, Deputy Commissioner (International), Large and Mid-size Business. The letter was on the letterhead of the Department of the Treasury, IRS.

[36] In cross-examination, Mr. Quinn conceded that the CCA knew that the IRS would conduct an evaluation. However, he avoided the suggestion that the evaluation was of Canada's position on the transfer price of the rock salt sold by the Appellant to NASC during the VDP Period. He instead suggested that the USCA needed to confirm that the Appellant had been reassessed by the CRA as indicated in Compass's application to the USCA.[19]

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[17] Tab G of the JBD.
[18] Tab H of the JBD.
[19] Lines 1 to 11 of page 187 of the Transcript.

[37] In two letters from Ms. Spice to Mr. Shott dated November 20, 2008 and February 16, 2009[20] respectively, Ms. Spice describes in general terms the circumstances giving rise to the Appellant's request for competent authority relief under the MAP provision of the Convention:

> The request arose as a result of Sifto's acceptance into Canada's voluntary disclosure program. The adjustment relates to Sifto's intercompany transactions with a related party, the North American Salt Company, located in Overland Park, Kansas, for the taxation years ending 2002 through to 2006.

[38] Ms. Spice then states:

> [November 20, 2008 letter]
>
> We will provide you with details of our position concerning these adjustments in the near future, for purposes of providing correlative relief from economic double taxation.
>
> [February 16, 2009 letter]
>
> . . . Please find attached our position paper regarding the CRA reassessments resulting from the voluntary disclosure.
>
> Once you have had the opportunity to review this position paper, please contact Dan Quinn, who may be reached at . . . .

[39] Mr. Dougherty wrote the letter dated November 20, 2008 and Mr. Quinn reviewed that letter.[21] Mr. Quinn wrote the letter dated February 16, 2009 and Mr. Dougherty wrote the enclosed position paper,[22] which described the position taken by the Appellant in the VDP Document.

[40] Mr. Quinn testified that the CRA did not audit the Appellant regarding the transfer price and that the position paper was "basically a summary of the taxpayer's voluntary disclosure" and was "based on the taxpayer's voluntary disclosure".[23] Mr. Harkin testified that the position paper was not "typical" and

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[20] Tabs I and J of the JBD.
[21] Lines 19 to 24 of page 207 of the Transcript.
[22] Lines 2 to 14 of page 170 of the Transcript.
[23] Lines 4 to 5 and 17 to 22 of page 170 of the Transcript.

that it "puts forth the taxpayer's position for consideration to the IRS".[24] Mr. Harkin explained:

> A typical Competent Authority position would have normally come through the audit background and have extensive analysis done by its CRA audit. And the position paper would be more, "This is our view," meaning in our view, in Competent Authority's view. "This is what the adjustment should be."[25]

[41] Mr. Harkin met with the USCA on October 22, 2009 and was prepared to present and explain the position paper at that meeting.[26] However, the USCA initiated a discussion on the nature of voluntary disclosures and taxpayer-initiated adjustments, and as a result the CCA "never really discussed the details of the position paper" with the USCA.[27] The CCA did not express an opinion on taxpayer-initiated adjustments at the meeting.[28] The meeting concluded with an indication that the USCA would get back to the CCA regarding how taxpayer-initiated adjustments should be handled.[29]

[42] The USCA did get back to the CCA on May 11, 2010 when Ms. Indu Subbiah, an analyst with the USCA[30], called Mr. Harkin to advise that the USCA would provide relief from double taxation, subject to further evaluation of the comparable set.[31] Mr. Harkin was asked about the extent of the negotiations with the USCA:

> Q. What was the extent of the negotiations that you had with the IRS regarding Sifto's MAP request?
>
> A. There were no negotiations. I did use the word "negotiated" in that entry, in the CATS entry, but it is -- in Competent Authority, typically any time we meet with another Competent Authority, we consider it a negotiation. We just use that term, "negotiation," but a better word -- often we meet with them and don't negotiate, and we might just be talking about status of the files. Or in

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[24] Lines 7 to 8 of page 278 of the Transcript.
[25] Lines 9 to 14 of page 278 of the Transcript.
[26] Lines 4 to 10 of page 279 of the Transcript. Meetings between the CCA and USCA were held from October 19 to 23, 2009 and the Appellant's situation was one item of many on the agenda: Exhibit A-4 at 27th and 28th pages, lines 17 to 19 of page 223, lines 26 to 28 of page 227 and lines 1 to 10 of page 228 of the Transcript.
[27] Lines 10 to 14 of page 279 of the Transcript.
[28] Lines 15 to 20 of page 279 of the Transcript.
[29] Lines 21 to 23 of page 279 of the Transcript and Exhibit R-3, entry for 2009-10-22.
[30] Lines 17 to 23 of page 225 of the Transcript.
[31] Lines 1 to 6 of page 281 of the Transcript; Exhibit R-3, entry for 2010-05-11; and Exhibit R-7.

> some situations, like this situation, we're just presenting a position. So, in this file, there was no real negotiation at all.[32]

[43] The USCA subsequently agreed with Canada's adjustments to the Appellant's income for all but the 2002 taxation year. On November 10, 2010, Ms. Spice wrote to Mr. Shott's successor, Mr. Michael Danilack, describing the terms of the settlement.[33] The letter states, in part:

> This letter is to confirm the settlement recently negotiated by our representatives on the above-mentioned case.
>
> The double taxation arose from the Canada Revenue Agency ("CRA") initiated adjustments relating to the sale of tangible goods by Sifto to its U.S. parent company, North American Salt Company ("NASC") for the taxation years 2002 through 2006.
>
> The adjustments made by the CRA were as follows:
>
> 1) Adjustment to Sifto's operating income to obtain a return on total cost equal to the low point of the weighted average observations obtained from the comparable company data:
>
> . . .
>
> Under the terms of the competent authority settlement:
>
> 1. The Internal Revenue Service ("IRS") will grant correlative relief by allowing NASC to decrease its income for the taxation years 2003 through 2006 as follows:
>
> . . .
>
> 2. The IRS has allowed NASC to repay US$11,090,756 to Sifto free of any U.S. withholding taxes . . . .
>
> 3. It is understood that this settlement is not intended to create a precedent for any subsequent years involving these taxpayers or for any other case.
>
> We now consider this case closed and will advise Sifto of the terms of this settlement. . . .

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[32] Lines 9 to 20 of page 282 of the Transcript.
[33] Tab L of the JBD.

[44] By letter dated January 25, 2011 received by the CASD on February 11, 2011, Mr. Danilack responded to Ms. Spice as follows: [34]

> We are writing in furtherance of the mutual agreement procedure concerning Compass Minerals International, Inc. and its Canadian subsidiary, Sifto Canada Inc. As U.S. Competent Authority, I hereby confirm, on behalf of the U.S. Internal Revenue Service, the terms of the agreement memorialized by your letter of November 23 [*sic*], 2010.[35] This exchange of letters constitutes a mutual agreement under Article 26 of the U.S.-Canada Income Tax Treaty.
>
> We are notifying Compass Minerals International, Inc. of our determination and are providing our Natural Resources and Construction Industry Director instructions for implementing our agreement. We now consider this case closed.

[45] On the same day, Mr. Danilack wrote a letter to Compass stating in the second paragraph:

> A mutual agreement has been reached regarding the transfer price of the transaction between Compass and Sifto Canada Inc. (“Sifto”). As a result of our discussions, the US Competent Authority has agreed to provide full correlative relief in the amounts shown in the table below.[36]

[46] Mr. Quinn testified that the CCA viewed the exchange of the November 10, 2010 and January 25, 2011 letters as a mutual agreement under Article XXVI of the Convention.[37]

[47] Ms. Spice advised the Appellant’s counsel of the CCA agreement with the USCA by letter dated November 10, 2010.[38] The letter describes the terms of the competent authority settlement as described in the November 10, 2010 letter to Mr. Danilack and then states:

> We would appreciate your advising this office within 30 days of the date of this letter whether Sifto is prepared to accept the terms of the competent authority settlement as outlined above. Once we receive your acceptance, we will instruct our Toronto West Tax Services Office to adjust your tax returns in accordance with this settlement.

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[34] Tab Q of the JBD.

[35] Mr. Danilack misstated the date of Ms. Spice’s letter, which was November 10, 2010 as confirmed by the letter of her successor at Tab S of the JBD. See also, lines 17 to 22 of page 180 of the Transcript.

[36] Tab R of the JBD.

[37] Lines 3 to 6 of page 186 of the Transcript.

[38] Tab M of the JBD.

[48] Mr. Quinn testified that Mr. Harkin wrote the letter, that this paragraph was "standard wording in our closing letters" and that it was "actually wrong".[39] He also stated that he reviewed this letter before it was sent to the Appellant's counsel.[40]

[49] The Appellant responded to this letter by a letter dated December 1, 2010,[41] with which was enclosed a "signed acceptance of the terms contained in the letter from your office dated November 10, 2010 for Sifto Canada Corp. (formerly, Sifto Canada Inc.)". The enclosure is a copy of Ms. Spice's November 10, 2010 letter to the Appellant's counsel with "agreed & accepted by" written in capitals below Ms. Spice's title at the end of letter. Below that statement is the signature of Mr. Rodney L. Underdown and the title "vice president & chief financial officer".

[50] On December 2, 2010 at 1:56 p.m., Mr. Craig Reeder of KPMG sent an e-mail to Mr. Quinn which reads:

> We understand that Shaun is out of the office this week and thought we would also provide you with a copy of the acceptance of the Competent Authority settlement by Sifto Canada Corp. Please confirm that you have received this document and are satisfied with its contents as acceptance of the Competent Authority settlement by Sifto Canada Corp.[42]

[51] On the same day at 1:59 p.m., Mr. Quinn responded to this email as follows:

> Received in good order Craig, and it is exactly what we need. Thank you.[43]

[52] In cross-examination, Mr. Quinn acknowledged that he did not advise the Appellant that there was no agreement between the Appellant and the CCA.[44]

[53] The CASD advised Mr. Kamlesh Kumar, the Assistant Director, Audit at the Toronto West Tax Services Office, and Mr. Arun Khanna, Chief of Appeals at the Toronto West Tax Services Office, of the agreement with the IRS by

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[39] Lines 12 to 19 of page 178 of the Transcript.
[40] Lines 2 to 4 of page 178 of the Transcript.
[41] Tab N of the JBD.
[42] Exhibit A-8.
[43] Exhibit A-8.
[44] Lines 21 to 28 of page 251 and lines 1 to 5 of page 252 of the Transcript.

memoranda dated December 17, 2010 from Mr. Harkin.[45] The memoranda were each signed by Mr. Quinn.

[54] Enclosed with the memorandum to Mr. Kumar was a copy of an “internal decision summary” and of Ms. Spice’s November 10, 2010 letter to the Appellant’s counsel with Mr. Underdown’s acceptance at the end. The last paragraph of the internal decision summary states under the heading “RATIONALE”:

> After numerous negotiations, the IRS agreed to the adjustments presented in the voluntary disclosure. The IRS agreed the adjustments conform to the arm’s length principle. The adjustments adjust Sifto’s operating income to obtain a return on total cost equal to the low point of the weighted average observations obtained from the comparable company data.

[55] The first MAP agreement reached by the CCA and the USCA did not address the 2002 fiscal period of the Appellant because the USCA took the position that NASC’s MAP request was made too late to apply to that year.[46] However, the USCA reconsidered this position and a second MAP agreement that included 2002 was reached in April 2011.[47]

[56] A letter from Ms. Spice’s successor, Mr. André Lamarche,[48] to Mr. Danilack, dated April 7, 2011,[49] states in the introductory paragraph:

> This letter is to confirm the settlement recently negotiated by our representatives on the above-mentioned case and is subsequent to our letter of November 10, 2010 as a result of the Internal Revenue Service (“IRS”) now granting correlative relief with respect to the 2002 year.

[57] The letter goes on to describe the details of the settlement and concludes:

> We now consider this case closed and will advise Sifto of the terms of this settlement.

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[45] Tab O and Tab P of the JBD.
[46] Lines 22 to 27 of page 178 of the Transcript.
[47] Lines 7 to 10 of page 179 of the Transcript.
[48] Mr. Lamarche was appointed acting Director of the CASD after Ms. Spice left the position of Director: lines 21 to 24 of page 268 of the Transcript.
[49] Tab S of the JBD.

[58] Mr. Quinn testified that Mr. Harkin wrote the April 7, 2011 letter to the IRS, that he himself reviewed the letter, and that Mr. Lamarche signed the letter.[50] He described the letter as a "standard closing letter".[51]

[59] Mr. Lamarche advised the Appellant's counsel of the second MAP agreement by letter dated April 7, 2011,[52] and the Appellant accepted the terms of the agreement in the same manner as the first settlement, by a letter to the attention of Mr. Lamarche dated April 19, 2011.[53]

[60] The CASD advised Mr. Khanna and Mr. Paul Kohut, International Tax Auditor with the Toronto West Tax Services Office, of the second MAP agreement by memoranda dated April 7, 2011 from Mr. Harkin but signed by Mr. Quinn. The memorandum to Mr. Khanna included a copy of the CASD's "internal decision summary" and a copy of the letter sent by Mr. Lamarche to the Appellant's counsel. The internal decision summary included the same last paragraph under the heading "RATIONALE" as that reproduced above.

[61] Mr. Quinn described these memoranda and attachments as follows:

> These are final letters, memos from Competent Authority to our Toronto West TSO and to Toronto West Appeals Division, and they summarize the result of our discussions with the IRS. And there are some letters attached. The final letters that we discussed already are attached.[54]

[62] Mr. Quinn described the paragraph following the heading RATIONALE as "[s]tandard wording in our decision summaries".[55] Mr. Quinn also stated repeatedly that at that time a MAP negotiation following a voluntary disclosure was unique.[56] With respect to the reference in the paragraph to an arm's length price, the following exchange with the Respondent's counsel took place:

> Q. And the next spot I would like to take you to is the decision summary that we were just speaking about.

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[50] Lines 14 to 15 of page 179 of the Transcript.
[51] Lines 4 to 5 of page 179 of the Transcript.
[52] Tab T of the JBD.
[53] Tab W of the JBD. This time the wording added by the Appellant was typed rather than handwritten.
[54] Lines 19 to 24 of page 182 of the Transcript.
[55] Lines 16 to 17 of page 183 of the Transcript.
[56] See, for example, lines 18 to 24 of page 195, lines 12 to 21 of page 196 and lines 24 to 26 of page 212 of the Transcript.

Did the Canadian Competent Authority have a view on the arm's-length transfer price?

A. No, we didn't. We had no idea whether or not the transfer price was arm's length, because we're not mandated to audit, and there was no audit in this case that existed. The Mutual Agreement was that the IRS would provide relief for the adjustments that were initiated by the taxpayer and CRA processed under our voluntary disclosure program. But in terms of the transfer price, we didn't have any view on it. We simply presented the adjustments to the IRS for relief from double taxation.[57]

(4) The Transfer Pricing Audit of the Appellant

[63] A chain of e-mails dated between May 20 and 25, 2010[58] indicates that as of May 20, 2010, Mr. Quinn and Mr. Harkin were aware of a possible transfer pricing audit of the Appellant's taxation years ending in 2004 through 2008 (the "Audit Taxation Years").

[64] In an e-mail from Mr. Quinn to Ms. Tiina Wainman sent May 25, 2010 at 2:50 p.m.,[59] Mr. Quinn states:

> I just want to clarify that the taxpayer's request to competent authority was inclusive of the 2002 through 2006 taxation years. The taxpayer has been reassessed by CRA for all of these years, and are [*sic*] in a double tax situation. We presented the adjustments to the IRS for their consideration to provide relief. If you are proceeding with an audit which includes 2004 through 2006 we will advise the IRS accordingly. We don't know what the IRS reaction will be (ie. we don't know if the IRS will terminate discussions for some years or all years and we don't know if they will accept the same case a second time under the MAP article, should CRA raise more adjustments). We wanted you to be aware of the increased risk to the taxpayer of being subject to double tax for a longer period of time (the time it takes to finalize your audit) and potentially permanently (depending on the IRS reaction).

[65] Mr. Harkin testified that he had a telephone conversation with Ms. Indu Subbiah on May 28, 2010 during which he advised her of the taxation years of the Appellant that would be under audit.[60] Mr. Harkin had a further telephone conversation with Ms. Subbiah on June 7, 2010. He described the content of the conversation as follows:

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[57] Lines 26 to 28 of page 186 and lines 1 to 11 of page 187 of the Transcript.
[58] Exhibits R-4, R-5 and R-6 and Exhibits A-5 and A-6.
[59] Exhibit R-6.
[60] Lines 15 to 19 of page 283 of the Transcript.

> This is a follow-up phone call with Indu approximately 10 days after the prior one, after we had informed them of the years that would be under audit.
>
> And Indu indicated that we should proceed, basically, with resolving the double tax. She was concerned that the arbitration date was getting close, and she was also concerned with the fact that the audit could be prolonged, and the taxpayer would be facing double tax for a prolonged period of time.
>
> She also indicated that, if another MAP were to come in as a result of the CRA audit, that the IRS would not be receptive to another transfer pricing method. They would more or less -- their transfer pricing method would be what was presented in the taxpayer's voluntary disclosure.[61]
>
> . . .
>
> Well, in the subsequent phone call with Indu, she indicated that, if a second MAP request were to come in, the transfer pricing method that they would put forth would be the method that's described in the voluntary disclosure. I guess they didn't comment directly on whether they would accept a second case, but they said that, if it were to come in, that would be their position, their transfer pricing method.[62]

[66] In cross-examination, Mr. Quinn acknowledged that further adjustments to the transfer price because of an audit could have placed the Appellant at risk for permanent double taxation if the USCA did not agree to a second MAP agreement.[63] Mr. Quinn was asked about the CCA's specific actions regarding the pending audit:

> Q. . . . What do you do at that point? Did you consider a number of options to put your current review in abeyance?
>
> A. What we did is we consulted the IRS first and advised them of the situation. Putting the request in abeyance wasn't a viable option because this file was becoming eligible for arbitration as of December 2010, and they could have invoked arbitration at that time. And there was no guarantee that the audit would be finished at that time. So that's the problem with involving Audit when we have a current case in Competent Authority.[64]
>
> . . .

[61] Lines 10 to 24 of page 284 of the Transcript.
[62] Lines 16 to 23 of page 286 of the Transcript.
[63] Page 240 and lines 1 to 10 of page 241 of the Transcript.
[64] Lines 15 to 25 of page 241 of the Transcript.

> Q. I appreciate the file was resolved. But did you ever advise the IRS that you wanted to hold off further discussions?
>
> A. We didn't advise them that we wanted to. What we advised them was our auditors were auditing those years, and we wanted to know what they felt was the best way to proceed, given that fact, given the fact that there would potentially be further reassessments. And their view was they wanted to close the case as it was.[65]
>
> . . .
>
> Q. Did anyone from Canada ever pick up the phone and say to the IRS, "We have to hold off this file. That's what Canada wants to do. We have to hold it off"?
>
> A. No.[66]
>
> . . .
>
> Q. All right. 2011. So let's go back to 2010. Did you ever get confirmation from the IRS that they would accept another MAP at this stage?
>
> A. No.[67]

[67] In an e-mail from Ms. Wainman to Mr. Quinn sent on December 17, 2010 at 10:39 a.m., Ms. Wainman states:

> We had a bit of a frantic call from the auditor on the file I had discussed with you several months ago. [It's] the file which involved the voluntary disclosure - my recollection is that, although CA was about to embark on a discussion with the IRS to resolve the double tax issue, you were going to hold off as you became aware of the ongoing audit, which included some of the VD years. I believe CA was going to advise the IRS of that decision.[68]

[68] Mr. Quinn responded at 10:43 a.m. as follows:

> Yes, we advised the IRS of the ongoing audit, and the potential for further adjustments. However, I recall that the IRS had already agreed to provide full

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[65] Lines 12 to 20 of page 242 of the Transcript.
[66] Lines 17 to 20 of page 243 of the Transcript.
[67] Lines 11 to 14 of page 244 of the Transcript.
[68] Exhibit A-9.

> relief, and they didn't retract that when we informed them of the audit, and potential additional adjustments.[69]

[69] Mr. Quinn responded again at 10:48 a.m. as follows:

> And I just (a second ago) signed the closing memo to the field, directed to Kamlesh Kumar (ADA)… It summarizes situation.[70]

[70] A subsequent chain of e-mails between Ms. Spice and Mr. Harkin dated May 31, 2011[71] indicates that Ms. Spice was concerned about the audit of the Audit Taxation Years following the MAP agreement. In the first e-mail in the chain, from Mr. Harkin to Ms. Spice, sent on May 31, 2011 at 11:00 a.m., Mr. Harkin states:

> It was at the May 28/10 discussions where I advised the IRS of the possible intention of CRA auditing the 2004-08 years. The possibility of a CRA audit had just recently been brought to our attention prior the May 28 phone call. This was late in the negotiation process where an agreement was imminent. The IRS felt that since the t/p is currently facing double tax we should endeavor to resolve the case. The IRS did not comment directly on whether they would accept a second case. They indicated, that if we were to present a second MAP case, their position would likely be what they were about to agree to. These views were presently [*sic*] orally.

[71] In the second e-mail in the chain, Ms. Spice asks "At what point did we know an audit was initiated?" Mr. Harkin responds:

> I became aware of the audit years on May 20/10. It was my understanding that the audit had not started yet. To clarify, I advised the IRS, on May 28/10, that the 2004-08 would be audited and that possible adjustments could arise regarding the transfer price of the issue being discussed.
>
> I don't recall any discussions with the t/p prior to settlement about being under audit. The t/p was advised of our agreement with the IRS shortly after the agreement was reached on June 7/10 by phone and then subsequently with the closing letter.

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[69] Exhibit A-9.
[70] Exhibit A-10.
[71] Exhibit A-7.

[72] The Competent Authority Tracking System (the "CATS")[72] shows a telephone conversation between Mr. Harkin and Ms. Indu Subbiah on May 28, 2010. The log entry states:

> Discussed file again with Indu. She indicated that they would provide relief. I advised our Audit area intends to audit the years 2004-08. Indu indicated she will consider this and get back to us.

[73] In the fourth e-mail in the chain, Ms. Spice asks Mr. Harkin: "Can I get a copy of the taxpayer agreement to the settlement please."[73] Mr. Harkin responds: "I'll provide you copies of the taxpayer agreement to the settlement."[74]

[74] A chain of e-mails ending with an e-mail from Ms. Spice sent on November 22, 2011 at 2:47 p.m. reveals continued concern regarding the proposed reassessment of the Appellant's 2004 through 2008 taxation years based on a transfer pricing audit. Ms. Spice states, in part:

> Hi Geri and Tiina and Jennifer – Shaun suggested we indicate that only some of the years of the VDP are under audit so that change was made.
>
> I have made more edits which I think are self-explanatory. . . .
>
> Track changed and clean versions attached.[75]

[75] Attached to the chain of e-mails are a blacklined copy and a clean copy of a document titled "MEMORANDUM FOR TERRANCE McAULEY SIFTO CANADA CORP. (Information Only)".[76] At the time, Mr. McAuley was the Assistant Commissioner of Compliance, Programs Branch.

[76] At the end of the document is the name of Lucie Bergevin, who at the time was the Director General, International and Large Business Directorate. The body of the clean version of the document states on the first page:

> The purpose of this memorandum is to provide you with information on a contentious audit and the issuance of proposal letters on November 16, 2011.

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[72] Exhibit R-3.
[73] E-mail from Ms. Spice to Mr. Harkin sent May 31, 2011 at 12:18 p.m.: Exhibit A-7.
[74] E-mail from Mr. Harkin to Ms. Spice sent May 31, 2011 at 12:26 p.m.: Exhibit A-7.
[75] Exhibit A-11.
[76] Exhibit A-11.

> This audit relates to the above-noted taxpayer for Canada Revenue Agency (CRA) adjustments that were previously the subject of a mutual agreement procedure (MAP) settlement with the Internal Revenue Service (IRS). These CRA transfer pricing adjustments were founded on the taxpayer's voluntary disclosure under the CRA's Voluntary Disclosure Program (VDP). For your information, there is concern, mainly raised by Competent Authority Services Division (CASD) [Redacted] of possible consequences that may arise from the proposed (second) reassessment on the same issue for the same years covered by the voluntary disclosure and the MAP settlement.
>
> [Redacted]
>
> [Redacted] there is also a relationship risk. MAP negotiations are concluded on the basis that they are final and binding on the two treaty partners, and if the taxpayers concur, on the taxpayers. It has never occurred, to my knowledge, that a treaty partner has concluded a MAP settlement and then sought to re-open the same case again. It would be a waste of resources for both countries and would undermine the credibility of the country raising the second set of adjustments that form the basis of the second case. [Redacted] The presentation of the second MAP case by the CRA could negatively affect relations with our treaty partner. [Redacted][77]

[77] Mr. Quinn acknowledged that he had received the e-mail from Ms. Spice with the clean and the blacklined versions of this document attached, and he said that to his knowledge he had not indicated disagreement with this version.[78]

[78] In an earlier e-mail in the chain, from Mr. Quinn to Ms. Spice, sent on November 22, 2011 at 12:00 p.m., Mr. Quinn states:

> I've read it. It looks fine to me.

[79] Mr. Quinn could not recall which version of the document this comment was in reference to, but he noted that his e-mail to Ms. Spice preceded Ms. Spice's e-mail.[79]

(5) The Policy Discussion Regarding Voluntary Disclosures

[80] In cross-examination, Mr. Quinn was asked about a policy discussion meeting that took place on January 21, 2009 and two sets of related e-mails: one

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[77] Exhibit A-11.

[78] Lines 23 to 25 of page 272 and lines 1 to 3 of page 273 of the Transcript.

[79] Lines 18 to 22 of page 272 of the Transcript.

set dated May 30, 2011 from Ms. Spice and the other set consisting of emails dated June 15, 2009 and June 23, 2009 from Mr. Quinn.[80]

[81] The emails and the written summary of the meeting indicate that the CASD discussed how to address a MAP request following a voluntary disclosure. In the written summary of the policy discussion, under the heading "Decision", the following is stated:

> These requests would fall under the provisions of the MAP article. [Redacted] Accordingly, CASD will accept requests, and consult the IRS to determine if they concur with accepting requests and also determine appropriate and reciprocal procedures for dealing with such cases. CASD will also engage the TSO where appropriate. [Redacted] In cases of voluntary disclosure in Canada (example 2), CASD will engage the TSO to obtain the background audit work on the downward adjustment request, and where substantive audit work to verify the adjustment was not done, CASD will ask the TSO [to] do such work.

[82] In one of the two May 30, 2011 e-mails from Ms. Spice, sent at 2:18 p.m., she states:

> Hi all – I was just checking my files on our position that originated in 2009 and attach the email and position paper that I understand would still be relevant today. I believe there was an error in the position paper concerning scenario 2 and suggest the wording should have been (change is underlined):
>
> > In cases of voluntary disclosure in Canada (example 2), CASD will engage the TSO to obtain the background audit work on the <u>up</u>ward adjustment request, and where substantive audit work to verify the adjustment was not done, CASD will ask the TSO [to] do such work.

[83] Mr. Quinn testified that, notwithstanding the heading of the paragraph which Ms. Spice is correcting, the CASD did not adopt the policy identified in the paragraph and did not contact the TSO to have it perform an audit of the transfer price adjustments made by the CRA in the 2008 Reassessments.[81] Mr. Quinn stated that instead of the CASD adopting the policy from the January 21, 2009 policy discussion meeting, the CRA has, within the past couple of years, amended its voluntary disclosure policy to provide that transfer pricing

[80] The e-mails and the written summary of the policy discussion meeting make up Exhibit A-3.
[81] Lines 3 to 25 of page 219 of the Transcript.

voluntary disclosures will not be accepted without their first being reviewed by audit.[82]

IV. Position of the Appellant

[84] The Appellant submits that the Appellant and the Minister entered into a binding agreement that established the transfer price of the rock salt sold by the Appellant to NASC during the Taxation Years. A reasonable person looking at the conduct of the parties (including the language used in the relevant written communications) would conclude that the parties intended to enter into such an agreement. The Minister's state of mind and subjective intention are not relevant as intention must be determined by reference to conduct, including the language chosen by the parties.

[85] The Appellant submits that the objective circumstances establish the existence of the agreement and that the agreement is enforceable against the Minister as a settlement agreement as well as being enforceable under the Convention and section 115.1 of the ITA.

V. Position of the Respondent

[86] The Minister submits that the Appellant has failed to establish that the Minister is legally barred from issuing the Reassessments. The letters exchanged by the CCA and USCA, which concluded their consideration of the Appellant's and Compass's competent authority requests, do not reference a transfer price for the salt sold by the Appellant to NASC during the Taxation Years and do not represent an agreement between the CCA and the USCA on the arm's length transfer price of that salt. The Respondent submits that the subject matter of the settlement reached by the CCA and USCA was whether, and on what terms, the competent authorities were willing to provide the relief from double taxation requested by the Appellant and Compass. The role of the CCA was advising the USCA on whether, in the particular circumstances, it believed relief from double taxation was available under the Convention. The letters exchanged by the CCA and USCA represented a mutual agreement under the Convention to provide

[82] Lines 26 to 28 of page 219 and lines 1 to 14 of page 220 of the Transcript.

relief from double taxation. The USCA implemented the agreement by allowing Compass to reduce its income for U.S. tax purposes.[83]

[87] The Respondent submits that the Minister did not enter into a settlement agreement with the Appellant. The CCA accepted the Appellant's request for relief from double taxation, presented the Appellant's request to the USCA, obtained the agreement of the USCA to provide relief from double taxation and communicated the result to the Appellant. Nothing in the facts suggests an intention on the part of the Minister or the Appellant to create a binding contractual relationship. Specifically, there was no consideration, no certain terms and no communication of an intention to fix the transfer price of the salt. Furthermore, even if there was an agreement, it was not an agreement to fix the transfer price of the salt. This is confirmed by the factual matrix or surrounding circumstances.

[88] The Respondent submits that the Minister has a duty to administer and enforce the ITA, which requires the Minister to apply the ITA as she understands it to the facts as she finds them. In carrying out this duty to assess each taxpayer in accordance with the ITA, the Minister is not bound by the tax returns filed by the taxpayer or by earlier assessments of the taxpayer. The Minister's duty is to apply the ITA as it stands subject only to the time limits imposed by the ITA. The Minister issued the Reassessments following an audit of the Appellant in which the Minister determined that the facts showed an arm's length transfer price different from the price used in the 2008 Reassessments. In the circumstances, the Minister was duty-bound to issue the Reassessments.

VI. Statutory and Treaty Provisions

[89] The provisions of the ITA and the Convention relevant to the issue under consideration are set out in full in Appendix B to these reasons. For ease of reference, I have also reproduced some of the relevant language here:

> Section 115.1 of the ITA
>
> 115.1(1) Competent authority [tax treaty] agreements — Notwithstanding any other provision of this Act, where the Minister and another person have, under a provision contained in a tax convention or agreement with another country that

[83] I understand that the adjustment was made to the income of Compass because it files a consolidated return with the IRS that includes the income of NASC.

has the force of law in Canada, entered into an agreement with respect to the taxation of the other person, all determinations made in accordance with the terms and conditions of the agreement shall be deemed to be in accordance with this Act.

Article IX of the Convention, titled “Related Persons”

1. Where a person in a Contracting State and a person in the other Contracting State are related and where the arrangements between them differ from those which would be made between unrelated persons, each State may adjust the amount of the income, loss or tax payable to reflect the income, deductions, credits or allowances which would, but for those arrangements, have been taken into account in computing such income, loss or tax.

2. For the purposes of this Article, a person shall be deemed to be related to another person if either person participates directly or indirectly in the management or control of the other, or if any third person or persons participate directly or indirectly in the management or control of both.

3. Where an adjustment is made or to be made by a Contracting State in accordance with paragraph 1, the other Contracting State shall (notwithstanding any time or procedural limitations in the domestic law of that other State) make a corresponding adjustment to the income, loss or tax of the related person in that other State if:

> (*a*) It agrees with the first-mentioned adjustment; and
>
> (*b*) Within six years from the end of the taxable year to which the first-mentioned adjustment relates, the competent authority of the other State has been notified of the first-mentioned adjustment. The competent authorities, however, may agree to consider cases where the corresponding adjustment would not otherwise be barred by any time or procedural limitations in the other State, even if the notification is not made within the six-year period.

4. In the event that the notification referred to in paragraph 3 is not given within the time period referred to therein, and the competent authorities have not agreed to otherwise consider the case in accordance with paragraph 3(*b*), the competent authority of the Contracting State which has made or is to make the first-mentioned adjustment may provide relief from double taxation where appropriate.

5. The provisions of paragraphs 3 and 4 shall not apply in the case of fraud, willful default or neglect or gross negligence.

Article XXVI of the Convention, titled "Mutual Agreement Procedure"

> 1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case in writing to the competent authority of the Contracting State of which he is a resident or, if he is a resident of neither Contracting State, of which he is a national.
>
> 2. The competent authority of the Contracting State to which the case has been presented shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Except where the provisions of Article IX (Related Persons) apply, any agreement reached shall be implemented notwithstanding any time or other procedural limitations in the domestic law of the Contracting States, provided that the competent authority of the other Contracting State has received notification that such a case exists within six years from the end of the taxable year to which the case relates.
>
> . . .
>
> 5. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

VII. <u>Analysis</u>

A. **Introduction**

[90] The Appellant and the Respondent put forward two entirely different interpretations of the facts. The Appellant says that the competent authority proceedings resulted in a binding agreement between the Appellant and the Minister that fixed the arm's length transfer price of rock salt sold by the Appellant to NASC during the Taxation years (the "Salt"). The Respondent says that there is no such agreement and that, even if there is an agreement between the Appellant and the Minister, it does not fix the arm's length transfer price of the Salt. In the circumstances, the Minister was not only authorized, but was required, by the ITA to issue the Reassessments once in possession of the facts revealed by her audit of the Appellant.

B. The Factual Matrix

[91] To resolve the question posed by the parties, I must first consider the relevant terms of the Convention, as it is under the Convention that the competent authority proceedings took place and the two consecutive MAP agreements were concluded. This information is part of the factual matrix relevant to understanding the terms of the MAP agreements reached by the CCA and the USCA. In *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633 ("*Sattva*"), the Supreme Court of Canada described the significance of the factual matrix as follows:

> The shift away from the historical approach in Canada appears to be based on two developments. The first is the adoption of an approach to contractual interpretation which directs courts to have regard for the surrounding circumstances of the contract — often referred to as the factual matrix — when interpreting a written contract [citations omitted].
>
> Regarding the first development, the interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine "the intent of the parties and the scope of their understanding" [citations omitted]. To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract. Consideration of the surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning:
>
>> No contracts are made in a vacuum: there is always a setting in which they have to be placed. . . . In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
>
> (*Reardon Smith Line*, at p. 574, *per* Lord Wilberforce)[84]

[92] With respect to the interpretation of the Convention, in *Crown Forest Industries Ltd. v. Canada*, [1995] 2 S.C.R. 802 ("*Crown Forest*"), the Supreme Court of Canada said that the paramount goal in interpreting a treaty is:

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[84] *Sattva* at paragraphs 46 and 47. The factual matrix is less important for standard form contracts: *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37. A MAP agreement is not a standard form contract.

> . . . to find the meaning of the words in question. This process involves looking to the language used and the intentions of the parties.[85]

[93] With that in mind, let us turn to paragraph (1) of Article IX of the Convention, which provides that, where persons are related and the arrangements between them differ from those which would be made between unrelated persons, each state may adjust the amount of the income, loss or tax to reflect the income, deductions, credits or allowances that, but for those arrangements, would have been taken into account in computing such income, loss or tax. There is no question that the Appellant and NASC were related during the Taxation Years.

[94] Paragraph (3) of Article IX of the Convention provides that where an adjustment is made by a contracting state, the other state shall make a corresponding adjustment to the income of the related person if it agrees with the adjustment and certain notification requirements are met.

[95] Paragraphs (1) and (2) of Article XXVI of the Convention together provide that, where a person considers that the actions of one or both of the contracting states result in taxation of the person that is not in accordance with the Convention, that person may present his case to the competent authority of the state of which he is a resident and, if the objection appears to be justified and cannot be resolved unilaterally by the competent authority, that contracting state shall endeavour to resolve the case by mutual agreement with the competent authority of the other state.

[96] The mutual agreement procedure described in paragraphs (1) and (2) of Article XXVI of the Convention applies only when a person believes he is being taxed in a manner not in accordance with the Convention and the contracting state of which he is a resident is of the view that the position is justified. The commentary (the "OECD Commentary") to the OECD *Model Tax Convention on Income and on Capital* (the "OECD Model Convention") describes this aspect of the nearly identical Article in the OECD Model Convention as follows:

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[85] Paragraph 22. Article 31(1) of the *Vienna Convention on the Law of Treaties* (23 May 1969, Can TS 1980 No. 37) (the "Vienna Convention"), of which Canada is a signatory, states that "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The United States of America is not a signatory to the Vienna Convention. However, in *Crown Forest*, the Supreme Court of Canada referenced sections 31 and 32 of the Vienna Convention as support for the use of extrinsic materials to aid in the interpretation of the Convention.

> . . . the mutual agreement procedure is clearly a special procedure outside the domestic law. It follows that it can be set in motion solely in cases coming within paragraph 1, *i.e.* cases where tax has been charged, or is going to be charged, in disregard of the provisions of the Convention. So where a charge of tax has been made contrary both to the Convention and the domestic law, this case is amenable to the mutual agreement procedure **to the extent only that the Convention is affected**, unless a connecting link exists between the rules of the convention and the rules of the domestic law which have been misapplied.[86]
>
> [Emphasis added.]

[97] The Appellant and Compass[87] each presented its case to the competent authority of the country of which it was a resident. The case presented focussed on the fact that the Minister's unilateral adjustment of the Appellant's income had resulted in economic double taxation and asked that the economic double taxation be eliminated. The case presented necessarily raised the question of whether the Minister's adjustments to the Appellant's income were in accordance with paragraph (1) of Article IX of the Convention. Paragraph (3) of Article IX mandated that the IRS make corresponding adjustments to the income of Compass only if the IRS agreed that the Minister's adjustments were in accordance with paragraph (1) of Article IX of the Convention.

[98] The focus of the MAP provision in transfer pricing cases is identified in the 1992 OECD Commentary:

> 9. Article 25 also provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing problems, not only problems of juridical double taxation but also those of economic double taxation, and especially those resulting from the inclusion of

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[86] OECD *Model Tax Convention on Income and on Capital (Condensed Version)*, July 2010, page 355, paragraph 8. This commentary has remained unchanged since 1977: *Model Double Taxation Convention on Income and on Capital, Report of the OECD Committee on Fiscal Affairs*, 1977, page 176, paragraph 7. In *Crown Forest*, at paragraph 57, the Supreme Court of Canada referred to the commentary to the OECD Model Convention in interpreting Article IV of the Convention, thereby implicitly endorsing the use of the OECD Commentary as an aid to the interpretation of tax treaties. In *Prévost Car Inc. v. The Queen*, 2009 FCA 57, [2010] 2 F.C.R. 65, the Federal Court of Appeal stated at paragraph 10:

> The worldwide recognition of the provisions of the Model Convention and their incorporation into a majority of bilateral conventions have made the Commentaries on the provisions of the OECD Model Convention a widely-accepted guide to the interpretation and application of the provisions of existing bilateral conventions. . . .

See also, paragraph 55 of *Crown Forest* regarding the interpretive value of the OECD Model Convention in the context of the Convention.

[87] Compass and not NASC, presented the case to the IRS since Compass was the taxpayer in the U.S. because of consolidated tax reporting.

> profits of associated enterprises under paragraph 1 of Article 9; the corresponding adjustments to be made in pursuance of paragraph 2 of the same Article [paragraph (3) of Article IX of the Convention] thus fall within the scope of the mutual agreement procedure, **both as concerns assessing whether they are well-founded and for determining the amount**.
>
> 10. This in fact is implicit in the wording of paragraph 2 of Article 9 when the bilateral convention in question contains a clause of this type.[88]

[Emphasis added.]

[99] The 1984 U.S. Treasury Department technical explanation of paragraph (2) of Article XXVI of the Convention also highlights the focus of the MAP provision where Article IX applies:

> Paragraph 2 provides that the competent authority of the Contracting State to which the case is presented shall endeavor to resolve the case by mutual agreement with the competent authority of the other Contracting State, unless he believes that the objection is not justified or he is able to arrive at a satisfactory unilateral solution. **Any agreement reached between the competent authorities of Canada and the United States shall be implemented notwithstanding any time or other procedural limitations in the domestic laws of the Contracting States** . . . . In a case where the provisions of Article IX apply, the provisions of paragraphs 3, 4, and 5 of that Article **are controlling with respect to adjustments and corresponding adjustments of income, loss, or tax** and the effect of the Convention upon time or procedural limitations of domestic law. Thus, if relief is not available under Article IX because of fraud, the provisions of paragraph 2 or Article XXVI do not independently authorize such relief.[89]

[Emphasis added.]

C. **What did the MAP Agreements Resolve?**

[100] Mr. Quinn stated repeatedly, and the Respondent argues, that all the CCA did in its handling of the Appellant's competent authority file was pass on to the USCA the adjustments requested by the Appellant in its voluntary disclosure and request relief from double taxation. This description echoes the general purpose

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[88] These paragraphs were added to the OECD Commentary by the 1992 report entitled "The Revision of the Model Convention". Model Convention full version pages 1035-36.

[89] The 1984 Technical Explanation does not reflect amendments to paragraphs (3) and (4) of Article IX of the Convention implemented by the Revised Third Protocol, S.C. 1995, c.34. Those amendments eliminated the requirement for a contracting state to withdraw an adjustment if certain notification requirements were not met and are not relevant to the issue in these appeals. See also, the Technical Explanation of Article 4 of the Third Protocol.

of tax treaties – to eliminate double taxation — but fails to recognize the specific reason why the MAP provision was engaged in this instance: taxation not in accordance with the Convention.

[101] Under the applicable terms of the Convention, the issue that the two competent authorities had to resolve was the adjustments permitted by paragraph (1) of Article IX or required by paragraph (3) of Article IX of the Convention. The CCA provided the USCA with a position paper which set out the Appellant's rationale for the adjustments to its income. These adjustments had been accepted by the Minister and implemented in the 2008 Reassessments.[90]

[102] In presenting the position paper to the USCA, the CCA was necessarily taking the position that the adjustments to the Appellant's income were in accordance with paragraph (1) of Article IX of the Convention. The USCA analyzed Canada's adjustments and concluded that it agreed with those adjustments. Paragraph (3) of Article IX therefore required the USCA to make a corresponding adjustment to Compass's income, which it agreed to do in the MAP agreements. The MAP agreements resolved the issue of the application of paragraphs (1) and (3) of Article IX to the Appellant and Compass respectively, and thus resulted in taxation in accordance with the Convention.

[103] The CCA and the USCA twice reached a MAP agreement, under paragraph (2) of Article XXVI of the Convention, regarding the adjustments to be made to the income of the Appellant and Compass under paragraphs (1) and (3) of Article IX of the Convention.[91] The first agreement covered the adjustments for 2003 through 2006 and the second added an adjustment for 2002. In each case, the Appellant was asked to advise the CCA whether it accepted the terms of the MAP agreement, and the Appellant responded in writing that it did accept those terms.

[104] The terms of the MAP agreements are described in the letters from the CCA to the Appellant dated November 10, 2010[92] and April 7, 2011[93] (together, the "Letters"). The Letters first identify the adjustments to the Appellant's income made by the Minister in issuing the 2008 Reassessments. The Letters then

[90] See the second paragraph of Ms. Spice's November 10, 2010 letter to Mr. Danilack: Tab L of the JBD.
[91] There is no dispute that the CCA and USCA reached two MAP agreements, which are documented at Tabs L, Q and S of the JBD.
[92] Tab M of the JBD.
[93] Tab T of the JBD.

describe the corresponding adjustments that the USCA will make to the income of Compass. The adjustments to Compass's income are in the same amounts as the adjustments to the Appellant's income except that they are decreases in income rather than increases in income.

[105] Read as a whole within the relevant factual matrix, the Letters reflect the IRS's agreement with the Minister's adjustments to the Appellant's income and describe the relief consequent on that agreement to be provided by the IRS. In other words, the Letters reflect the Minister's and IRS's agreement that the adjustments to the Appellant's and Compass's income set out in the Letters are in accordance with paragraphs (1) and (3) of Article IX of the Convention respectively. To suggest that the MAP agreements simply addressed double taxation of Compass ignores the factual context in which the agreements were reached by the Minister and the IRS through their respective representatives.

D. Did the Appellant's Acceptance of the MAP Agreements Constitute a Settlement Agreement?

[106] The Respondent argues that the Appellant's acceptance of the two MAP agreements did not create a binding contractual relationship between the Appellant and the Minister because there was no consideration, no certain terms and no communication of an intention to fix the transfer price of the Salt. The Respondent further submits that, even if there was a binding agreement between the Appellant and the Minister, it was an agreement to the relief from double taxation to be provided by the USCA. It was not a settlement agreement regarding the transfer price of the Salt.

(1) The Law on Settlement Agreements

[107] Recently, in *Apotex Inc. v. Allergan, Inc.*, 2016 FCA 155, the Federal Court of Appeal provided the following legal framework for assessing whether a settlement agreement exists (citations omitted):

> [21] First, the court must find on the evidence before it that, objectively viewed, the parties had a mutual intention to create legal relations.
>
> [22] The test is whether a reasonable bystander observing the parties would conclude that both parties, in making a settlement offer and in accepting it, intended to enter into legal relations . . .

. . .

[25] Second, like all other agreements, a settlement agreement must satisfy the requirement that there be consideration flowing in return for a promise. In settlement agreements, this is almost certainly never a problem—by definition, settlements are compromises, and so there will be consideration flowing both ways.

[26] The Court must also find, as an objective matter, that the terms of the agreement are sufficiently certain . . . . Where the parties "express themselves in such fashion that their intentions cannot be divined by the court...the agreement will fall for lack of certainty of terms" . . . . Another way of putting this is that the court must be satisfied that the parties were objectively *ad idem* or were objectively of a common mind.

[27] It is not for the courts to amend the parties' offer and acceptance and make the terms certain. The Court will not make "a new agreement for the parties" where they "were never *ad idem*" . . . .

[28] That being said, where the parties were objectively of a common mind and "intended some legal relationship to exist between them," often their reasonable expectations can be discerned and "courts will generally strive to give effect to [them]" . . . .

[29] Lack of certainty of terms leading to a finding that there was no agreement is something quite different from the presence in an agreement of words that have a range of meaning. For example, words like "disparage" or "scientific" may have a range of meaning but as long as a court can divine a meaning from those terms in the circumstances of a particular case, the agreement is not void for uncertainty . . . .

[30] An agreement does not arise until there is [a] matching offer and acceptance on all terms essential to the agreement . . . . Disagreement, objectively assessed, on an essential term will mean that there is no agreement. . . .

[31] How does a court decide what terms are essential and what terms are not?

[32] The court is to view the specific facts of the case objectively in light of the practical circumstances of the case and ask whether the parties intended to be legally bound by what was already agreed or, in other words, whether an "honest, sensible business[person] when objectively considering the parties' conduct would reasonably conclude that the parties intended to be bound or not" by the agreed-to terms. . . Put another way, looking not through the eyes of lawyers, but through the eyes of reasonable businesspeople stepping into the parties' shoes, was there something essential left to be worked out? . . . .

> Another way of putting it is to ask how "a reasonable [person], versed in the business, would have understood the exchanges between the parties" . . . .
>
> [33] When courts find that there has been an agreement on essential terms, they will often imply non-essential terms into the agreement . . . . The lack of agreement on non-essential terms will not stand in the way of a finding of an agreement.

(2) Evidence of Mutual Intention

[108] The first question to be addressed is whether there is objective evidence that the parties had a mutual intention to enter into legal relations. The Letters each set out the terms of the settlement reached by the CCA and the USCA regarding the adjustments to be made under paragraphs (1) and (3) of Article IX of the Convention, and related matters, such as the repatriation of the profits to Canada. The penultimate paragraph of each of the Letters states:

> We would appreciate your advising this office within 30 days of the date of this letter whether Sifto is prepared to accept the terms of the competent authority settlement as outlined above. Once we receive your acceptance, we will instruct our Toronto West Tax Services Office to adjust your tax returns in accordance with this settlement.

[109] Mr. Quinn testified that this paragraph was standard wording and was "wrong" as there was nothing for the Appellant to agree to because the adjustments resulting from the MAP agreement were being made only to the income of Compass. Mr. Quinn did not explain why, in reviewing the Letters, he did not amend or delete the paragraph if it was indeed "wrong" and therefore not indicative of the intention of the CCA. Mr. Quinn also appears to have overlooked the fact that the MAP agreement, if implemented, would result in the return to the Appellant, free of U.S. withholding tax, of the US$11,090,756 profit originally attributed to NASC and included in the consolidated income of Compass.

[110] In my view, the standard paragraph was not wrong but accurately reflected what had been resolved by the CCA and the USCA under paragraph (2) of Article XXVI of the Convention. The two competent authorities negotiated[94] and ultimately agreed that the adjustments to the income of the Appellant were in accordance with paragraph (1) of Article IX of the Convention. This agreement

[94] Mr. Harkin suggested a unique interpretation of the word "negotiation". Be that as it may, the CCA negotiated a resolution of the issue raised by the Appellant and Compass.

in turn required the USCA to make the corresponding adjustments to the income of Compass required by paragraph (3) of Article IX of the Convention. The MAP agreement therefore resolved the issue necessarily raised by the Appellant and Compass in order to engage the MAP provision in the first place: i.e., that there was taxation not in accordance with paragraphs (1) and (3) of Article IX of the Convention.[95]

[111] The Appellant and Compass each benefitted from accepting the MAP agreement as the Appellant would have certainty regarding the transfer price of the Salt and would receive US$11,090,756 free of US withholding tax and Compass would be allowed to reduce its income for U.S. income tax purposes to reflect the agreed-upon transfer price, thereby eliminating economic double taxation. These results belie Mr. Quinn's suggestion that the Appellant had nothing to agree too.

[112] The inclusion of the penultimate paragraph in the Letters is also consistent with the CRA's own description of the competent authority process and with commentators' understanding of that process. In his 1994 text on double taxation conventions, Philip Baker remarks:

> . . . The taxpayer may be asked whether he accepts the results of the agreement; if he does then it may be binding on him as a contract. In Canada a taxpayer is not bound by a mutual agreement unless he accepts it.[96]

[113] Mr. Baker cites paragraph 18 of Information Circular 71-17R3 for the last proposition.[97] The salient paragraphs of current Information Circular 71-17R5 state:

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[95] Although it is not determinative of the requirements imposed by the Convention, it is of interest to note that the CRA states in paragraphs 3 and 41 of Information Circular 71-17R5:

> 3. The primary purpose of Canada's tax conventions is to eliminate double taxation and to prevent tax avoidance and fiscal evasion. A tax convention will also serve, in effect, to allocate tax revenues on transactions taking place between residents of the signatory countries. To these ends, a tax convention may provide rules determining:
>
> . . .
>
> • the manner in which issues of taxation not in accordance with the tax convention are to be resolved.
>
> . . .
>
> 41. If a taxpayer believes that taxation not in accordance with the tax convention remains following an Appeals Branch decision, the taxpayer can submit the issue for competent authority consideration, or if already submitted, ask that the competent authority procedure recommence.

[96] Philip Baker, *Double Taxation Conventions and International Tax Law*, 2nd ed. (London: Sweet & Maxwell, 1994) at 25-09.

> 53. Competent authority agreements are not considered precedents for either the taxpayer or the CRA in regard to (re)assessments relating to subsequent years or for competent authority negotiations on the same issues. This is because the competent authorities have negotiated an agreement that takes into account the facts of the particular taxpayer, as well as differences in the provisions of the tax law in each country and effects of the economic indicators on the particular transactions at the relevant time. (Re)assessments of subsequent years should be based on the particular circumstances, facts and documentary evidence existing for those years.
>
> 54. A taxpayer cannot accept the terms of an agreement for only some issues or taxation years involved, since the original request by the taxpayer would have asked for assistance in respect of all issues and taxation years involved and the competent authorities would have considered all issues and years in the negotiations.
>
> 55. If a taxpayer is not satisfied with the agreement negotiated by the competent authorities, the taxpayer may reject it. If this occurs, the competent authorities will consider the case closed and advise the taxpayer accordingly. Assuming a valid notice of objection or an appeal has been filed, the taxpayer will still have the right to proceed through the appeals process and/or to the Tax Court for Canadian (re)assessments. If the Appeals Branch or the Court does not reverse the adjustment in its entirety, double taxation may remain. The Canadian Competent Authority will accept another request by the same taxpayer on the issue but will only present it to the other competent authority and will not negotiate the issue a second time.

[114] The CRA's own Information Circular clearly contemplates the taxpayer's acceptance or rejection of a competent authority agreement.[98] Ms. Spice appears to have understood the general approach set out in the Information Circular because she asked Mr. Harkin for "a copy of the taxpayer agreement to the settlement" in an e-mail to Mr. Harkin sent on May 31, 2011.[99] Mr. Harkin appears to have had a similar understanding since he responded that he would provide Ms. Spice with "copies of the taxpayer agreement to the settlement". While neither statement is relevant to contractual intent at the time the Letters were sent and signed back, it may be inferred from these statements that

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[97] Paragraph 18 has since been replaced by paragraph 55 of Information Circular 71-17R5, which does not change the general thrust of the original paragraph but provides a more detailed explanation of what occurs if the taxpayer rejects the settlement.

[98] This approach has been suggested by the OECD Commentary since 1977: *Model Double Taxation Convention on Income and on Capital, Report of the OECD Committee on Fiscal Affairs*, 1977, page 180, paragraph 28.

[99] E-mail from Ms. Spice to Mr. Harkin sent May 31, 2011 at 12:18 p.m. Exhibit A-7.

Ms. Spice and Mr. Harkin did not consider the penultimate paragraphs of the Letters to be wrong.[100]

[115] The CCA had complete control over the wording of the Letters, which were put to the Appellant on a take it or leave it basis. The wording of the Letters was not ambiguous. The language used clearly described the terms of the MAP agreement reached by the CCA and USCA and asked the Appellant to accept or reject those terms.[101] The Appellant accepted each of the offers in writing and even followed up with Mr. Quinn, after responding to the first Letter, to determine if its response had been received and if anything further was required. Mr. Quinn responded "Received in good order Craig, and it is exactly what we need. Thank you."[102] This response is at odds with Mr. Quinn's suggestion that the penultimate paragraph of the Letters was wrong and meaningless in the circumstances.

[116] There is no doubt in my mind that a reasonable person reading the CCA Letters to the Appellant and the Appellant's acceptance of the terms of the Letters would conclude that the CCA made an offer to the Appellant to accept the terms of the CCA's MAP agreement with the USCA and that the Appellant accepted that offer. The relevant factual matrix, including the mutual agreement process prescribed by the Convention and the CRA's own public explanation of the competent authority process, only serves to reinforce this conclusion. Mr. Quinn's subjective after-the-fact description of the Letters is neither relevant nor persuasive in terms of providing a basis for a different conclusion.

(3) <u>Mutual Consideration</u>

[117] The second requirement is that there must be consideration passing between the parties. The consideration flowing from the Appellant is the implicit agreement not to pursue the issue further through any other available avenues. This consideration is no different than that which exists in any case where a taxpayer agrees with the Minister to settle an outstanding income tax issue. While in some cases, such as those addressed by subsection 169(2.2), the agreement of

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[100] It is also worth noting the CCA's comments in the "Memorandum for Terrance McAuley" (Exhibit A-11): "MAP negotiations are concluded on the basis that they are final and binding on the two treaty partners, and if the taxpayers concur, on the taxpayers."

[101] Even if the wording of the letters was considered to be ambiguous, the *contra proferentem* principle would suggest that the CCA could not use its own language to suggest a meaning that the Appellant could not clearly discern from a plain reading of the language.

[102] Exhibit A-8.

the taxpayer not to object or appeal would be more explicit, the failure of the CCA to include in the Letters more explicit language does not mean that the Appellant gave no consideration in accepting the terms set out in the Letters. Subsection 169(2.2) itself is "for greater certainty" and does not mean that consideration only passes if there is a written waiver.

[118] The consideration from the CCA is the agreement to implement the competent authority settlement if the Appellant concurs. Specifically, the penultimate paragraph of the Letters states: "Once we receive your acceptance, we will instruct our Toronto West Tax Services Office to adjust your tax returns in accordance with this settlement". This statement is consistent with paragraph 55 of Information Circular 71-17R5, which indicates that if the taxpayer does not accept the settlement the competent authorities will consider the case closed and will take no further action.

[119] Upon receipt of the Appellant's acceptance of the first MAP agreement, the CASD advised Mr. Kamlesh Kumar, the Assistant Director, Audit at the Toronto West Tax Services Office, and Mr. Arun Khanna, Chief of Appeals at the Toronto West Tax Services Office, of the settlement with the IRS by memoranda dated December 17, 2010 (the "Memoranda"). The Memoranda fulfil the promise of the CCA described in the last sentence of the penultimate paragraphs of the Letters. For its part, the Appellant took no further action until the Reassessments departing from the MAP agreement were issued. A similar process occurred with the second MAP agreement.

(4) Sufficiently Certain Terms

[120] The third requirement is that the terms of the agreement be sufficiently certain. Here, as already stated, the terms of the MAP agreements are clearly stated in the Letters. The Appellant's acceptance of those terms is also clearly stated in the sign-back of the Letters to the CCA.[103]

E. Did the Settlement Agreements Fix the Transfer Price of the Salt?

[121] The Respondent submits that, even if there is an agreement between the Minister and the Appellant, that agreement does not fix the transfer price of the Salt.

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[103] Subsections 169(2.2) and (3) of the ITA contemplate settlements between the Minister and taxpayers, even if these sections are not applicable in this instance.

[122] The Letters describe in detail the adjustments made or to be made in compliance with paragraphs (1) and (3) of Article IX of the Convention. The evidence of Mr. Harkin regarding one of his conversations with the USCA indicates that the USCA was focussing on whether the adjustment of the Appellant's income was in accordance with paragraph (1) of Article IX. Specifically, according to the excerpt from the CATS entered as Exhibit R-3, Ms. Indu Subbiah stated in a telephone conversation with Mr. Harkin on May 11, 2010 that she wanted "to analyze the effect of some of the large revenue companies in the comparable set". In Mr. Harkin's handwritten notes on the same call, he writes under the heading "Indu":

> - feels in general relief is ok but wants to analyze effect of some of the large companies in the comparable set
>
> - wants to see if adj[ustments] are needed.[104]

[123] Mr. Harkin testified to much the same effect.[105] Although if presented for their truth the statements attributed to Ms. Subbiah are hearsay, Mr. Harkin's recording of the statements in his notes and in summary form in the CATS indicates that he accepted them at face value. Given the circumstances in which these communications took place (i.e., an official dialogue between the CCA and the USCA), there is in my view no reason to doubt that the USCA was doing precisely what Ms. Subbiah suggested in her conversation with Mr. Harkin – vetting the transfer pricing methodology used to determine the adjustments to the income of the Appellant.[106]

[124] The Appellant had adopted the transactional net margin method ("TNMM"), which, in general terms, determines an appropriate profit level for a taxpayer based on comparable arm's length data. Unlike, for example, the comparable uncontrolled price ("CUP") method, this approach does not rely on a specific sale price for the Salt. However, an implicit transfer price can be determined that is based on the profit earned on the sale of the Salt. Thus, by vetting the methodology, the USCA was in effect determining whether it agreed with the implicit transfer price yielded by the methodology. This is not surprising

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[104] Exhibit R-7.
[105] Lines 1 to 6 of page 281 of the Transcript.
[106] As well, Mr. Harkin's adoption and recitation of Ms. Subbiah's statements can be considered an admission and therefore an exception to the hearsay rule: see, generally, paragraphs 6.408 to 6.416 of *Sopinka, Lederman & Bryant: The Law of Evidence in Canada*, 4th ed. by Sidney N. Lederman, Alan W. Bryant & Michelle K. Fuerst (Markham, Ont.:) LexisNexis, 2014).

since the adjustments allowed by paragraph (1) of Article IX of the Convention and the transfer price that gave rise to the adjustments were inextricably linked such that an agreement to the adjustments was also an agreement to the implicit transfer price that yielded those adjustments.

[125] The direct relationship of the transfer price of the transactions between the Appellant and NASC and the adjustments to the Appellant's income is highlighted in a letter from the USCA to Compass dated January 25, 2011[107] in which the USCA states:

> We have concluded our discussions with the Canadian Competent Authority with respect to Compass Minerals International, Inc. ("Compass") request for competent authority consideration for the taxable year ended February 28, 2002 - February 28, 2007.
>
> **A mutual agreement has been reached regarding the transfer price of the transaction between Compass and Sifto Canada Inc**. ("Sifto"). As a result of our discussions, the US competent authority has agreed to provide full correlative relief in the amounts shown in the table below.

[Emphasis added.]

[126] The USCA is informing Compass that a mutual agreement has been reached regarding the transfer price of the transactions during the identified period. This correctly recognizes that the adjustments to income allowed by paragraph (1) of Article IX of the Convention are the result of a transfer price and that it is impossible to agree to the adjustments to the Appellant's income without also agreeing to the implicit transfer price that yields those adjustments.

[127] Similarly, the RATIONALE section of the CASD's internal decision summary states:

> After numerous negotiations, the IRS agreed to the adjustments presented in the voluntary disclosure. The IRS agreed the adjustments conform to the arm's length principle. The adjustments adjust Sifto's operating income to obtain a return on total cost equal to the low point of the weighted average observations obtained from the comparable company data.[108]

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[107] Tab R of the JBD.

[108] Mr. Quinn's suggestion that the paragraph employed standard language is at odds with the specific reference to the transfer pricing methodology used by the Appellant to conform to the arm's length principle.

[128] This description recognizes that the adjustments to the Appellant's income implemented by the 2008 Reassessments were in conformity with paragraph (1) of Article IX of the Convention because they conformed to the arm's length principle. In *Marzen Artistic Aluminum Ltd. v. The Queen*, 2016 FCA 34 ("*Marzen Artistic Aluminum*"), the Federal Court of Appeal described this principle in the context of Canada's domestic transfer pricing rule:

> [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 [*sic*] 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 [*sic*] had been dealing at arm's length. The Court also affirmed that a transfer pricing analysis is inherently fact driven.

[129] A similar description is found in Information Circular 87-2R dated September 27, 1999 ("IC 87-2R"):

> 7. Canada's transfer pricing legislation:
>
> - embodies the arm's length principle; and
>
> - requires that, for tax purposes, the terms and conditions agreed to between non-arm's length parties in their commercial or financial relations be

> those that one would have expected had the parties been dealing with each other at arm's length.
>
> This ensures that taxpayers, who are non-arm's length members of a group and engage in transactions with other members of the group, report substantially the same amount of income as they would if they had been dealing with each other at arm's length.
>
> 8. The OECD and Canada continue to endorse the arm's length principle as the basic rule governing the tax treatment of non-arm's length cross-border transactions.
>
> 9. The arm's length principle:
>
> - treats a group of parties not dealing at arm's length as if they operate as separate entities rather than as inseparable parts of a single unified business; and
>
> - is generally based on a comparison of:
>
> - prices or margins between non-arm's length parties on cross-border transactions ("controlled transactions"); with
>
> - prices or margins on similar transactions between arm's length parties ("uncontrolled transactions").

[130] Accordingly, the determination of whether an adjustment to the Appellant's income reflected the arm's length principle embodied in paragraph (1) of Article IX of the Convention requires the same general approach as that imposed by Canada's domestic transfer pricing rule. Simply stated, the arm's length principle requires a transfer pricing analysis. Therefore, it is not surprising that the USCA focussed on the transfer pricing analysis in the VDP Document and the CCA's position paper in determining whether to agree to the Minister's adjustments to the Appellant's income.

[131] Mr. Quinn repeatedly stated that the adjustments put to the USCA by the CCA were unusual because they resulted from a voluntary disclosure and that the CCA took no position regarding the adjustments. The Respondent argues that the CCA did nothing more than accept the Appellant's request for relief from double taxation, present the Appellant's request to the USCA, obtain the agreement of the USCA to provide relief from double taxation and communicate the result to the Appellant.

[132] The fact that the adjustments to the Appellant's income in the 2008 Reassessments resulted from a voluntary disclosure by the Appellant and the fact that the CRA chose not to audit those adjustments before issuing the 2008 Reassessments do not alter the fact that the MAP agreement between the CCA and the USCA necessarily determined the transfer price of the relevant transactions reflected in the adjustments to the Appellant's and Compass's income.

[133] If the CRA had an issue with the adjustments suggested by the Appellant in its voluntary disclosure it could easily have audited the Appellant before issuing reassessments of the VDP Taxation Years. Instead, the CRA chose to issue the 2008 Reassessments without an audit. Similarly, upon learning of the pending audit of some of the years under negotiation with the USCA, the CCA could have chosen to defer or even discontinue those negotiations. Instead, the CCA chose to continue its MAP negotiations with the USCA and concluded those negotiations with two MAP agreements. It appears the latter decision resulted from a concern that the file would be eligible for arbitration in December 2010.[109]

F. The Form of the Settlement Agreements

[134] The Respondent suggested that the Letters do not conform to a typical settlement agreement. However, as stated in *Apotex*, a settlement agreement does not have to be in any particular form:

> [23] The requirement of an objective, mutual intention to create legal relations does not mean that there must be formality. Settlements need not be reached through counsel or in pre-planned, formal discussions.
>
> [24] Indeed, many cases show that—sometimes much to the surprise of clients and lawyers alike—seemingly idle conversations can have binding, legal consequences. Binding settlements can arise from impromptu, informal communications in relaxed, non-business settings.

[135] In this case, the format of the settlement agreement with the Appellant was entirely within the control of the CCA. The CCA chose to write to the Appellant describing the terms of the MAP agreement reached with the USCA and asking the Appellant whether it accepted the terms of that agreement. As already stated, there was no ambiguity in the wording of the Letters and the Appellant clearly accepted their terms. I can see no reason why in such circumstances the Letters

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[109] Lines 15 to 25 of page 241 of the Transcript.

and the sign-back of the Letters should not be considered a settlement agreement as to the issue resolved by the CCA and the USCA: namely, the issue of the adjustments to income under paragraphs (1) and (3) of Article IX of the Convention and the transfer price of the Salt implicit in those adjustments. The USCA correctly characterized the subject of the MAP agreement as the determination of the transfer price, as evidenced by its January 25, 2011 letter to Compass.

G. Is the Minister Required to Reassess the Appellants notwithstanding the Settlement Agreements?

[136] The Respondent argues that, regardless of any agreement that may exist between the Minister and the Appellant, the Minister was required by the provisions of the ITA to reassess the Appellant for the Taxation Years once the Minister determined through an audit that the transfer price used by the CCA and USCA to determine the correct adjustments under paragraph (1) of Article IX of the Convention was not correct.

[137] This position raises three issues. First, is the settlement agreement binding on the Minister such that the Minister cannot reassess contrary to the agreement? Second, if the settlement agreement is not binding on the Minister vis-à-vis the Appellant, is the Minister nevertheless bound by the Convention to give effect to the MAP agreement in assessing the Appellant? Third, if the Convention alone does not require the Minister to assess the Appellant in accordance with the MAP agreement, what effect does section 115.1 have on the Minister's right to override the MAP agreement?

(1) <u>Are the Settlement Agreements Binding on the Minister?</u>

[138] The crux of the Respondent's argument is that the Minister is required to base the assessment of the Appellant on the application of the law to the facts and that an agreement with the Appellant cannot affect that duty. In *Galway v. M.N.R.*, [1974] 1 F.C. 600, the Federal Court of Appeal stated:

> . . . the Minister has a statutory duty to assess the amount of tax payable on the facts as he finds them in accordance with the law as he understands it. It follows that he cannot assess for some amount designed to implement a compromise settlement and that, when the Trial Division, or this Court on appeal, refers an assessment back to the Minister for re-assessment, it must be for re-assessment

> on the facts in accordance with the law and not to implement a compromise settlement.[110]

[139] Importantly, *Galway* does not preclude the possibility that the Minister may agree with a taxpayer to settle a tax case. The Court states (at page 603):

> . . . In the circumstances, there is no reason why the parties cannot re-apply on the basis of a consent to a judgment designed to implement an agreement of the parties as to how the assessment should have been made by application of the law to the true facts. . . .

[140] Nor does *Galway* suggest that every settlement is unenforceable against the Minister because of the Minister's duty to apply the law to the facts. The Court in *Galway* simply acknowledges that the terms of the settlement must be such that a court could give a judgment on the same basis as the settlement. If the court could not give such a judgment in the circumstances, then the settlement is illegal and does not bind the Minister.[111]

[141] In *CIBC World Markets Inc. v. The Queen*, 2012 FCA 3, the Federal Court of Appeal amplifies these points as follows:

> CIBC World Markets cites *1390758 Ontario Corporation v. The Queen* (2010), 2010 TCC 572 at paragraph 36 and *Smerchanski v. Minister of National Revenue*, [1977] 2 S.C.R. 23 for the proposition that courts have enforced settlements that apply tax law to agreed facts. **That is true**. But the Minister's power to agree to facts is limited by the *Galway* principle — **the Minister cannot agree to an assessment that is indefensible on the facts and the law**. Nothing in *1390758 Ontario* and *Smerchanski* undercuts the *Galway* principle.
>
> At present, the *Excise Tax Act* does not contain a provision allowing the Minister to make settlements **solely** on the basis of compromise, rather than following the facts and the law as the Minister views them or might reasonably defend them. Put another way and more succinctly, there is no legislative provision that repeals *Galway*.
>
> . . .
>
> . . . despite *Galway*, a high proportion of cases are not litigated to judgment. Often negotiations and discussions bring to light new facts, better

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[110] Page 602. See also, *Cohen (N) v. R.*, [1980] C.T.C. 318 (F.C.A.) and *Harris v. The Queen*, [2000] 4 F.C. 37 (F.C.A.).

[111] See, also, the decision in *Hammill v. The Queen*, 2005 FCA 252, which at paragraph 31 addresses admissions of fact and the ability of the parties to dictate by agreement the outcome of a tax appeal.

> characterizations of the overall situation, and richer appreciations of the applicable law. **These negotiations and discussions can culminate in a settlement that the Minister can implement by reassessing <u>on the basis of defensible views of the facts and the law</u>.**[112]
>
> [Emphasis and double emphasis added.]

[142] In this case, the Minister and the IRS agreed that the adjustments were in accordance with the arm's length principle used in paragraph (1) of Article IX of the Convention and in Canada's domestic transfer pricing rule.[113] The Appellant accepted the agreement between the Minister and the IRS. I can see no basis on which to conclude that the agreement reached by the Minister and the IRS was indefensible on the facts and the law. The CCA presented the Appellant's transfer pricing report to the USCA and the USCA reviewed the data and apparently concluded that the price for the transactions adopted by the Appellant satisfied the arm's length principle. This conclusion was reported by the CCA to the Toronto West Tax Services Office in the RATIONALE section of the two decision summaries.[114] The USCA also indicated that it would not deviate from its transfer pricing position even if the Minister chose to reassess the Appellant.[115]

[143] Although I do not have the benefit of expert evidence on the transfer price fixed by the MAP agreements, the TNMM method applied by the Appellant and accepted by the Minister and the USCA is certainly one reasonable way in which to determine an arm's length transfer price. The fact that the net margin chosen by the Appellant and reassessed by the Minister was at the lower end of the comparable range is certainly no basis on which to conclude that the price was indefensible on the facts and the law.

[144] The Minister's adjustments to the Appellant's income were accepted by the IRS even though they reduced the tax payable in the United States. It is reasonable to assume that the IRS would not accept such adjustments unless it viewed the adjustments as reflective of the arm's length principle. This

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[112] Paragraphs 24, 25 and 27.

[113] See the quotation from *Marzen Artistic Aluminum*, *supra*, and *Canada v. GlaxoSmithKline Inc.*, 2012 SCC 52, [2012] 3 S.C.R. 3 at paragraphs 17 to 23. The transfer pricing guidelines referred to in those decisions were developed by the OECD to assist in the application of Article IX of the OECD Model Convention. See, also, paragraphs 28 to 30 of IC 87-2R and the Memorandum of Understanding Between the Competent Authorities of Canada and the United States Regarding the Mutual Agreement Procedure, dated June 3, 2005, under heading 3 ("Substantive Issues in MAP Cases").

[114] Tabs O and U of the JBD.

[115] Lines 10 to 24 of page 284 of the Transcript.

assumption is consistent with the general approach to paragraph (3) of Article IX of the Convention (Article 9(2) of the OECD Model Convention) described in Part II of the 1995 OECD Transfer Pricing Guidelines at paragraph 151:

> 151. Corresponding adjustments are not mandatory, mirroring the rule that tax administrations are not required to reach agreement under the mutual agreement procedure. Under Article 9(2), **a tax administration should make a corresponding adjustment only insofar as it considers the primary adjustment to be justified <u>both in principle and in amount</u>**. The non-mandatory nature of corresponding adjustments is necessary so that one tax administration is not forced to accept the consequences of an arbitrary or capricious adjustment by another State. It also is important to maintaining the fiscal sovereignty of each Member country.

[Emphasis and double emphasis added.]

[145] In the circumstances, I can find no basis on which to conclude that the agreement reached by the CCA and the USCA and accepted by the Appellant and Compass was indefensible on the facts and the law. The fact that the CRA unilaterally chose to further reassess the Appellant to alter the transfer price is not evidence that the adjustments in the MAP agreements were indefensible on the facts and the law. On the other hand, that two arm's length tax administrations agreed to the adjustments in the Letters is in my view indicative of the fact that the adjustments in the Letters are indeed defensible on the facts and the law. Accordingly, the terms of the April 7, 2011 Letter to the Appellant are binding on the Minister and the Appellant as a settlement agreement. Those terms fix the income of the Appellant from the transactions with NASC during the Taxation Years.

(2) <u>Are the MAP Agreements Binding on the Minister?</u>

[146] If I am wrong in this conclusion, I also find that the agreements between the CCA and the USCA were binding on the Minister as mutual agreements reached under paragraph (2) of Article XXVI of the Convention and that the Minister is not permitted to assess in a manner inconsistent with the agreements.

[147] Articles 26 and 27 of the Vienna Convention (citation at footnote 85 *supra*) state:

> Article 26
>
> Pacta sunt servanda

> Every treaty in force is binding upon the parties to it and must be performed by them in good faith.
>
> Article 27
>
> Internal law and observance of treaties
>
> A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. This rule is without prejudice to article 46.

[148] Canada ratified the Vienna Convention by accession on October 14, 1970 and the treaty came into force on January 27, 1980. The United States signed the Vienna Convention on April 24, 1970 but never ratified the treaty. However, that does not alter Canada's obligations under the terms of the Vienna Convention or under the Convention.

[149] In *Divito v. Canada (Public Safety and Emergency Preparedness)*, 2013 SCC 47, [2013] 3 S.C.R. 157, the Supreme Court recognized that international treaties ratified by Canada are binding:

> The international law inspiration for s. 6(1) of the *Charter* is generally considered to be art. 12 of the *International Covenant on Civil and Political Rights*, Can. T.S. 1976 No. 47 ("ICCPR"), which has been ratified by 167 states, including Canada . . . .
>
> As a treaty to which Canada is a signatory, the ICCPR is binding.[116]

[150] The Convention and the Vienna Convention are each a treaty ratified by Canada. Moreover, the Convention was given the force of law in Canada by the *Canada-United States Tax Convention Act, 1984*, S.C. 1984, c. 20 (the "CUSTCA"). Subsections 3(1) to (2.1) of the CUSTCA state:

> 3 (1) The Convention is approved and declared to have the force of law in Canada during such period as, by its terms, the Convention is in force.
>
> (2) In the event of any inconsistency between the provisions of this Act, or the Convention, and the provisions of any other law, the provisions of this Act and the Convention prevail to the extent of the inconsistency.

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[116] Paragraphs 24 and 25. In paragraph 54 of *Crown Forest*, the Supreme Court of Canada cited the Vienna Convention as authority for the use of extrinsic materials as an aid to interpreting the Convention.

> (2.1) In the event of any inconsistency between the provisions of the *Income Tax Conventions Interpretation Act* and the provisions of the Convention, the provisions of that Act prevail to the extent of the inconsistency.

[151] Subsection 3(2) of the CUSTCA gives domestic legal effect to Article 27 of the Vienna Convention by ensuring that any conflict between the provisions of domestic law and the provisions of the Convention is resolved in favour of the provisions of the Convention. An exception is made for the provisions of the *Income Tax Conventions Interpretation Act*[117] (the "ITCIA"), but no provision of the ITCIA is relevant to the issue being addressed in these reasons.

[152] In this case, the Minister entered into two MAP agreements with the IRS under paragraph (2) of Article XXVI of the Convention. These agreements determined the income of the Appellant and Compass from transactions involving the sale and purchase of rock salt. The determinations of income were made in accordance with paragraphs (1) and (3) of Article IX of the Convention.

[153] The Minister has subsequently chosen not to honour the MAP agreements by reassessing the Appellant to increase its income from the relevant transactions with NASC. The Respondent takes the position that there is nothing in the Convention or Canada's domestic law to stop the Minister from issuing the Reassessments.

[154] I disagree. By reassessing the Appellant to increase the income attributed to Canada from the relevant transactions, the Minister has breached Canada's obligations under the Convention by failing to give continuing effect to MAP agreements reached with the United States under paragraph (2) of Article XXVI of the Convention.

[155] The Minister relies on her assessing powers under the ITA to justify this departure. It is true that the provisions of the ITA do not limit the Minister's ability to reassess the Appellant in the circumstances. However, the issuance of the Reassessments is subject to subsection 3(2) of the CUSTCA and to Article 27 of the Vienna Convention, which afford paramountcy to the provisions of the Convention. As well, Article 26 of the Vienna Convention requires Canada to perform the Convention in good faith.

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[117] R.S.C. 1985, c. I-4.

[156] In *Gladden Estate v. The Queen*, [1985] 1 C.T.C. 163, the Federal Court-Trial Division observed:

> The Treaty was adopted, approved and made part of the domestic laws of Canada by the *Canada-United States of America Convention Act*, 1943, 7 George VI c. 21. It is obvious that since a treaty is a contract, Canada cannot unilaterally amend its tax legislation contrary to the treaty except by amending that particular statute which adopted the treaty. Furthermore this general principle of law is emphasized and spelled out statutorily in section 3 of that Act which specifically provides that, should there be any inconsistency between any part of the treaty and the operation of any other law of Canada the former shall prevail.[118]

[157] It is just as obvious that the Minister cannot enter into an agreement with the IRS under paragraph (2) of Article XXVI of the Convention and then simply choose to ignore that agreement. While Article XXVI may not explicitly state that MAP agreements are binding on the parties, that does not mean such agreements are not binding. Tax treaties are not to be interpreted in such a legalistic fashion:

> Contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view of implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned.[119]

[158] The manifest object of Article XXVI of the Convention in the context of transfer pricing is to resolve by mutual agreement issues of juridical and economic taxation.[120] An issue is not resolved if it is open to one state to simply disregard the MAP agreement that resolves the issue. It is also antithetical to the very notion of an agreement between two treaty partners to suggest that either party may simply choose to ignore the agreement. Not only is such a suggestion contrary to common sense but the adoption of such a principle would effectively neuter the mutual agreement procedure not only in the Convention but in all of Canada’s tax treaties. After all, why would a treaty party agree to the resolution

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[118] At paragraph 10.

[119] *Crown Forest* at paragraph 43, quoting from *Gladden Estate*.

[120] This objective is highlighted by paragraphs 9 and 10 of the OECD Commentary on Article 25 of the 1992 OECD Model Convention (paragraphs 10 and 11 of the 2010 Commentary) and by the U.S. Treasury Department’s 1984 Technical Explanation of paragraph (2) of Article XXVI of the Convention.

of a tax treaty issue if Canada could simply ignore that resolution and assess as it sees fit?[121]

[159] On a more technical front, subsection 3(2) of the CUSTCA gives paramountcy to the provisions of the Convention when they are inconsistent with the provisions of the ITA. In this case, the power of the Minister to further reassess the Appellant under the ITA is inconsistent with the power of the CCA and the USCA to resolve cases by mutual agreement under Article XXVI of the Convention. Accordingly, the effect of the provisions of the Convention must be given paramountcy over the effect of the provisions of the ITA.

(3) Section 115.1 of the ITA

[160] The Appellant also sought to rely on section 115.1 of the ITA. An agreement described in subsection 115.1(1) is deemed to be in accordance with the ITA. Subsection 115.1(1) states:

> Notwithstanding any other provision of this Act, where the Minister and another person have, under a provision contained in a tax convention or agreement with another country that has the force of law in Canada, entered into an agreement with respect to the taxation of the other person, all determinations made in accordance with the terms and conditions of the agreement shall be deemed to be in accordance with this Act.

[161] The Letters describe the terms of the MAP agreement reached by the CCA and the USCA pursuant to Article XXVI of the Convention. The Minister expressly asked the Appellant to accept these terms as a condition of implementing the MAP agreement. For the reasons already given, the Letters represent an agreement to which the Minister and Appellant are parties by virtue of the Appellant's acceptance of the terms of the MAP agreement.

[162] Mr. Boychuk testified as to the typical form of section 115.1 agreements executed by the Minister. The implication of this testimony is that the Letters do not conform to the typical form of such agreements. In my view, this testimony

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[121] The CCA recognized the obvious consequences of a MAP agreement when describing to Terrance McAuley the issue with regard to the proposed audit of the Appellant (Exhibit A-11):

> "MAP negotiations are concluded on the basis that they are final and binding on the two treaty partners, and if the taxpayers concur, on the taxpayers."

is simply another way of suggesting that the Minister did not have a subjective intention to enter into an agreement to which section 115.1 applied.

[163] The subjective intention of the Minister is not relevant to whether an agreement was entered into by the Minister and the Appellant. Moreover, subsection 115.1(1) does not stipulate that an agreement must be in a particular form for the subsection to apply. The requirements of subsection 115.1(1) are as follows:

> 1. That the Minister and another person have entered into an agreement;
>
> 2. That the agreement have been entered into under a provision contained in a tax convention or agreement with another country that has the force of law in Canada; and
>
> 3. That the agreement be with respect to the taxation of the other person.

[164] The MAP agreements were entered into by the Minister and the IRS under paragraph (2) of Article XXVI of the Convention and the Appellant accepted and thereby agreed to be bound by the terms of the MAP agreements. The MAP agreements address the taxation of the Appellant and Compass under paragraphs (1) and (3) of Article IX of the Convention. Consequently, subsection 115.1(1) deems all determinations made in accordance with the terms and conditions of the MAP agreements to be in accordance with the ITA.

[165] While subsection 115.1(1) deems the 2008 Reassessments to be in accordance with the ITA, it does not address the Minister's ability to further reassess the Appellant to impose a transfer price different from that agreed to by the Minister and the IRS and accepted by the Appellant. Accordingly, I find that this provision is of no assistance to the Appellant regarding the question of whether the Minister could reassess the Taxation Years.

VIII. <u>Conclusion</u>

[166] On the basis of the foregoing, I have concluded that the Reassessments are inconsistent with the settlement agreements between the Minister and the Appellant and with the MAP agreements between the Minister and the IRS (collectively, the "Agreements"). The Agreements are binding on the Minister for the reasons given. Accordingly, the appeals in respect of the issue described in paragraph 3 of these Reasons for Judgment are allowed and the Reassessments

are referred back to the Minister for reconsideration and reassessment on the basis that the income of the Appellants from the sale of rock salt to NASC during the Taxation Years is to be determined so as to be consistent with the Agreements. The parties have 30 days from the date of the Judgment in these appeals to make submissions of no more than ten pages as to costs.

Signed at Ottawa, Canada, this 10th day of March 2017.

"J.R. Owen"

Owen J.

APPENDIX A

Sifto Canada Corp.

1. Sifto Canada Corp. ("Sifto") is a Canadian corporation resident in Canada for the purposes of the *Income Tax Act*, and is a resident of Canada for the purposes of the *Canada-United States Tax Convention (1980)* ("Convention"). Sifto owns and operates a salt mine in Goderich, Ontario.

2. Sifto is an indirect Canadian subsidiary of Compass Minerals International, Inc. ("Compass"), a U.S. corporation and a publicly traded company. Sifto's ultimate parent company is Compass.

3. One of Compass' indirect subsidiaries is North American Salt Company ("NASC"), a U.S. corporation resident in the United States for the purposes of the *Income Tax Act* and the *Convention*.

Sifto sells rock salt to NASC

4. During the 2002-2006 taxation years, Sifto sold approximately 50% of its annual rock salt production to NASC.

5. In its T2 returns, Sifto reported the following gross sales of rock salt to NASC during the following taxation years:

Taxation year ended	Dec 31, 2004	Nov 23, 2005 & Dec 31, 2005 combined	Dec 31, 2006
Gross sales reported	$42,840,212	$49,002,316	$48,887,869

6. The purchases of rock salt by NASC from Sifto were reported by Compass on its U.S. consolidated tax returns.

Sifto applies to the Voluntary Disclosure Program

7. By letter dated April 11, 2007, Sifto made a no-name application to the Canada Revenue Agency's ("CRA") voluntary disclosure program.

8. By letter dated April 19, 2007, the CRA acknowledged receipt of Sifto's no-name voluntary disclosure application.

9. Under cover of a letter dated August 13, 2007, Sifto made a Named VDP application (the "VDP Application"). In the VDP Application Sifto disclosed (a) an accounting error of $2,470,272 for the 2006 taxation year, and (b) the following additional amounts of income in respect of its sales of rock salt to NASC:

Taxation year ended	Additional income disclosed
December 31, 2002	$1,899,577
December 31, 2003	$4,206,408
December 31, 2004	$4,306,553
November 23, 2005 and December 31, 2005 combined	$841,745
December 31, 2006	$2,082,036

10. By letter dated March 13, 2008, the Minister of National Revenue (the "Minister") advised Sifto that its VDP Application had been accepted and that reassessments would be issued for the 2002 to 2006 taxation years to include in Sifto's income the additional amounts it had disclosed in the VDP Application.

11. As part of the voluntary disclosure program process, Sifto filed with the CRA amended T2 returns for the applicable taxation years that reported the income that Sifto had disclosed in the VDP Application.

The April 2008 Reassessments

12. On April 21 and 22, 2008 the Minister issued Notices of Reassessment for the 2002 to 2006 taxation years that included in Sifto's income the amounts

that Sifto had disclosed in the VDP Application and reported in its amended T2 returns (the “April 2008 Reassessments”).

The Mutual Agreement Procedure

13. As a result of the April 2008 Reassessments, Sifto and NASC found themselves in a situation of double taxation because Sifto had been assessed Canadian tax in respect of amounts of income that Compass had previously reported on its US consolidated income tax returns.

14. The Mutual Agreements Procedure (“MAP”) of the *Convention* allows taxpayers to apply to their respective competent authorities for assistance in resolving incidences of double taxation.

15. The Minister is Canada’s Competent Authority under the *Convention* (“Canadian Competent Authority”).

16. The Minister’s authorized representative for resolving competent authority requests for assistance pursuant to Canada’s tax conventions is the Director of the Competent Authority Services Division (“CASD”) of the CRA.

17. The Internal Revenue Service (“IRS”) serves as the United States Competent Authority under the *Convention* (“US Competent Authority”).

Sifto and Compass seek competent authority assistance

18. By letter dated April 30, 2008, Sifto made a request to the Canadian Competent Authority under Articles 9 and 26 of the *Convention*.

19. By letter dated May 13, 2008, Compass made a request to the US Competent Authority under Articles 9 and 26 of the *Convention* (“Compass MAP Request”).

20. By letter dated August 12, 2008, the US Competent Authority notified the Canadian Competent Authority that it had received the Compass MAP Request and requested the Canadian Competent Authority provide its position.

21. By letter dated November 20, 2008, the Canadian Competent Authority advised the US Competent Authority that details of its position would follow.

22. Under cover of letter dated February 16, 2009, the Canadian Competent Authority sent a position paper to the US Competent Authority.

23. Sifto was not a party to the discussions between the US and Canadian Competent Authorities.

24. NASC and Compass were not parties to the discussions between the US and Canadian Competent Authorities.

25. On July 30, 2010 the Canadian Competent Authority faxed the US Competent Authority a draft closing letter.

26. On November 10, 2010, the Canadian Competent Authority sent a letter to the US Competent Authority.

27. On November 10, 2010, the Canadian Competent Authority sent a letter to Sifto's representative.

28. On or about December 1, 2010, Sifto sent a letter to the Canadian Competent Authority.

29. On or about December 17, 2010, CASD sent a memorandum to the Assistant Director of Audit and sent a memorandum to the Chief of Appeals of the Toronto West Tax Services Office.

30. On or about January 25, 2011, the US Competent Authority sent a letter to the Canadian Competent Authority.

31. Also on or about January 25, 2011, the US Competent Authority sent a letter to Compass.

32. By letter dated April 7, 2011, the Canadian Competent Authority sent a letter to the US Competent Authority.

33. On April 7, 2011 the Canadian Competent Authority sent a letter to Sifto's representative.

34. On or about April 7, 2011 CASD sent a memorandum to Mr. Paul Kohut of the International Audit Division and sent a memorandum to the Chief of Appeals of Toronto West Tax Service Office.

35. On April 19, 2011 Sifto sent a letter to the Canadian Competent Authority.

The August 1, 2012 Reassessments

36. By Notices dated August 1, 2012, the Minister reassessed Sifto in respect of its 2004-2006 taxation years to include additional income that the CRA had determined Sifto earned by way of its sales of rock salt to NASC pursuant to subsection 247(2) of the *Income Tax Act*. Specifically, the following amounts were added to Sifto's taxable income:

Taxation years ended	Income added by August 1, 2012 reassessments
December 31, 2004	$61,179,395
November 23, 2005 and December 31, 2005 combined	$46,923,182
December 31, 2006	$26,896,235

APPENDIX B

ITA

115.1 (1) Competent authority [tax treaty] agreements — Notwithstanding any other provision of this Act, where the Minister and another person have, under a provision contained in a tax convention or agreement with another country that has the force of law in Canada, entered into an agreement with respect to the taxation of the other person, all determinations made in accordance with the terms and conditions of the agreement shall be deemed to be in accordance with this Act.

(2) Transfer of rights and obligations — Where rights and obligations under an agreement described in subsection (1) have been transferred to another person with the concurrence of the Minister, that other person shall be deemed, for the purpose of subsection (1), to have entered into the agreement with the Minister.

The Convention

Article IX — Related Persons

1. Where a person in a Contracting State and a person in the other Contracting State are related and where the arrangements between them differ from those which would be made between unrelated persons, each State may adjust the amount of the income, loss or tax payable to reflect the income, deductions, credits or allowances which would, but for those arrangements, have been taken into account in computing such income, loss or tax.

2. For the purposes of this Article, a person shall be deemed to be related to another person if either person participates directly or indirectly in the management or control of the other, or if any third person or persons participate directly or indirectly in the management or control of both.

3. Where an adjustment is made or to be made by a Contracting State in accordance with paragraph 1, the other Contracting State shall (notwithstanding any time or procedural limitations in the domestic law of that other State) make a corresponding adjustment to the income, loss or tax of the related person in that other State if:

(a) it agrees with the first-mentioned adjustment; and

(b) within six years from the end of the taxable year to which the first-mentioned adjustment relates, the competent authority of the other State has been notified of the first-mentioned adjustment. The competent authorities, however, may agree to consider cases where the corresponding adjustment would not otherwise be barred by any time or procedural limitations in the other State, even if the notification is not made within the six-year period.

4. In the event that the notification referred to in paragraph 3 is not given within the time period referred to therein, and the competent authorities have not agreed to otherwise consider the case in accordance with paragraph 3(*b*), the competent authority of the Contracting State which has made or is to make the first-mentioned adjustment may provide relief from double taxation where appropriate.

5. The provisions of paragraphs 3 and 4 shall not apply in the case of fraud, willful default or neglect or gross negligence.

Article XXVI — Mutual Agreement Procedure

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case in writing to the competent authority of the Contracting State of which he is a resident or, if he is a resident of neither Contracting State, of which he is a national.

2. The competent authority of the Contracting State to which the case has been presented shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Except where the provisions of Article IX (Related Persons) apply, any agreement reached shall be implemented notwithstanding any time or other procedural limitations in the domestic law of the Contracting States, provided that the competent authority of the other Contracting State has received notification that such a case exists within six years from the end of the taxable year to which the case relates.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular, the competent authorities of the Contracting States may agree:

(a) to the same attribution of profits to a resident of a Contracting State and its permanent establishment situated in the other Contracting State;

(b) to the same allocation of income, deductions, credits or allowances between persons;

(c) to the same determination of the source, and the same characterization, of particular items of income;

(d) to a common meaning of any term used in the Convention;

(e) to the elimination of double taxation with respect to income distributed by an estate or trust;

(f) to the elimination of double taxation with respect to a partnership;

(g) to provide relief from double taxation resulting from the application of the estate tax imposed by the United States or the Canadian tax as a result of a distribution or disposition of property by a trust that is a qualified domestic trust within the meaning of section 2056A of the *Internal Revenue Code*, or is described in subsection 70(6) of the *Income Tax Act* or is treated as such under paragraph 5 of Article XXIX-B (Taxes Imposed by Reason of Death), in cases where no relief is otherwise available; or

(h) to increases in any dollar amounts referred to in the Convention to reflect monetary or economic developments.

They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. Each of the Contracting States will endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the Convention from taxation imposed by that other State does not enure to the benefit of persons not entitled thereto. However, nothing in this paragraph

shall be construed as imposing on either of the Contracting States the obligation to carry out administrative measures of a different nature from those used in the collection of its own tax or which would be contrary to its public policy (*ordre public*).

5. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

6. Where, pursuant to a mutual agreement procedure under this Article, the competent authorities have endeavored but are unable to reach a complete agreement in a case, the case shall be resolved through arbitration conducted in the manner prescribed by, and subject to, the requirements of paragraph 7 and any rules or procedures agreed upon by the Contracting States by notes to be exchanged through diplomatic channels, if:

(a) tax returns have been filed with at least one of the Contracting States with respect to the taxable years at issue in the case;

(b) the case:

(i) is a case that:

(A) involves the application of one or more Articles that the competent authorities have agreed in an exchange of notes shall be the subject of arbitration; and

(B) is not a particular case that the competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration; or

(ii) is a particular case that the competent authorities agree is suitable for determination by arbitration; and

(c) all concerned persons agree according to the provisions of subparagraph 7(d).

7. For the purposes of paragraph 6 and this paragraph, the following rules and definitions shall apply:

(a) the term “concerned person” means the presenter of a case to a competent authority for consideration under this Article and all other persons, if any, whose tax liability to either Contracting State may be directly affected by a mutual agreement arising from that consideration;

(b) the “commencement date” for a case is the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities;

(c) arbitration proceedings in a case shall begin on the later of:

> (i) two years after the commencement date of that case, unless both competent authorities have previously agreed to a different date, and
>
> (ii) the earliest date upon which the agreement required by subparagraph (d) has been received by both competent authorities;

(d) the concerned person(s), and their authorized representatives or agents, must agree prior to the beginning of arbitration proceedings not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of such board;

(e) unless a concerned person does not accept the determination of an arbitration board, the determination shall constitute a resolution by mutual agreement under this Article and shall be binding on both Contracting States with respect to that case; and

(f) for purposes of an arbitration proceeding under paragraph 6 and this paragraph, the members of the arbitration board and their staffs shall be considered “persons or authorities” to whom information may be disclosed under Article XXVII (Exchange of Information) of this Convention.

CITATION:	2017 TCC 37
COURT FILE NOs.:	2014-895(IT)G and 2014-896(IT)G
STYLE OF CAUSE:	SIFTO CANADA CORP. and SIFTO CANADA CORP. (AS SUCCESSOR TO SIFTO CANADA INC.) v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATES OF HEARING:	July 11, 12, 13 and 14, 2016
DATES WRITTEN SUBMISSIONS RECEIVED:	August 8, 2016 and September 9, 2016
REASONS FOR JUDGMENT BY:	The Honourable Justice John R. Owen
DATE OF JUDGMENT:	March 10, 2017

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