SHOULD THE CRA BE ABLE TO PULL THE RUG OUT FROM UNDER MULTINATIONAL TRANSFER PRICING CHOICES?: A DOMESTIC CONTRACTUAL ANALYSIS

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INTRODUCTION

In the case of Eaton Corp. v Commissioner,1 the US Internal Revenue Service recently rescinded from an advance pricing arrangement (APA) entered into with the taxpayer. While the case is not directly applicable to the Canadian context, the news of this decision led the authors to ask two questions. First, will this development cause the Canada Revenue Agency (CRA) to take a similar approach to these arrangements? Second, should Canadian law view these agreements as non-binding?

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1 TC No 5576-12 (2012) [Eaton].
The first question is descriptive in nature, and is not our main concern. After all, trying to predict how any taxing authority will choose to react to any change (particularly in another jurisdiction) is an activity fraught with peril. The second question is normative in nature. More importantly, though, in the view of the authors, the answer to the second question will hopefully influence the potential actions of the CRA, which will in turn affect the answer to the first question.

In this article, the authors begin in Part I by pointing out that there are administrative statements that suggest that there is a rather facile answer to the question posed in the title to this article. However, the authors point out several reasons why these administrative statements, while helpful, are not clear, and actually make the administrative document less powerful than a contractual analysis. The internal inconsistency of the document makes reliance upon its provisions a proposition fraught with uncertainty. There are some minor terminological differences between the Canadian and US rules on transfer pricing. Nonetheless, given the international nature of transfer pricing activities, it is the view of the authors that these differences should have no impact on the analysis offered here.

In Part II, the authors set out the basic concepts that animate the use of advance pricing arrangements, notably revenue loss and the arm’s-length principle. In the following section, the authors begin a contractual analysis with a discussion of the basic elements of a contract. Part III begins by providing an analysis of a claim that a contractual analysis is inappropriate given the government policy context in which the question arises. This is true whether the matter is one of economic development, or tendering contracts with respect to public works. A number of parallels can be drawn between the use of the law of contracts in these contexts, and that of the APA context. Then, the authors analyze the case law with respect to tax settlements from both Canada and the United Kingdom. Finally, the authors examine how the government should behave if change to an APA contract is necessary through no fault of the taxpayer.
I. HAS THIS QUESTION ALREADY BEEN ANSWERED?

A. Statements by the CRA

Savvy experts in the law of international taxation may be tempted to point out that the CRA provides its own answer to the first question. In an Information Circular dealing specifically with advance pricing arrangements, the CRA writes as follows:

Part VII - Legal Effect
73. An APA is regarded as binding on the ... [CRA] and on ... [the taxpayer], subject to any qualifications stated in the APA and the comments in paragraphs 93 to 108 [of the Information Circular].
74. The mere act of requesting an APA or filing an APA submission will not, by itself, constitute “reasonable efforts” for the taxation years proposed to be covered under the APA for the purposes of section 247 of the [Income Tax Act]. When ... [the taxpayer complies with the terms and conditions of an APA, [the CRA] ... will consider that the results of applying the agreed TPMs have satisfied section 247 of the Act for the transactions and periods specified in the APA. With respect to transactions covered by an APA, no penalty will be levied under subsection 247(3) of the Act for taxation years during which the APA remains in force.

B. The Issues with the Statement

1. Procedural Issues

To some, this statement may appear to be dispositive. However, three problems remain. First, Information Circular 94-4R is, as most tax practitioners will be aware, a revision of an earlier Information Circular on the same topic. This, in itself, shows that administrative positions, such as those referred to in the Information Circular, can and do change over time. Rather, it is simply to acknowledge the reality of a possible change of administrative opinion over time.

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3 Income Tax Act, RSC 1985, c 1 (5th Supp) [the Act].
4 IC-94-4R, supra note 2 at paras 73-74.
Second, in the American Eaton case, despite language that is similar to the wording in IC94-4R, the government still sought to walk away from the APA. Therefore, even if the language continues unaltered, governments have tried to ignore the administrative position in individual pieces of litigation, where the government wishes to advance an argument contrary to the administrative language.

Third, some commentators have already suggested a distinction between an administrative statement and a binding commitment in this context. Therefore, in the view of the authors, the effect of paragraphs 73 and 74 of IC94-4R is, at the very least, not dispositive of the question posed in this paper, and, at worst, questionable.

2. The Inconsistency of the Document

Even without those issues, the fact remains that the document is internally inconsistent. IC94-4R is lengthy, but the most relevant portions of the document for present purposes are contained in paragraphs 97 through 102. Given the length of these paragraphs, they are not reproduced.

To put this into context, therefore, it appears that the CRA sees three different routes to the end of the APA. First, the taxpayer can voluntarily withdraw from the APA at the request stage or thereafter; second, an APA can be canceled; third, an APA can be revoked. Cancellation of the APA generally results from actions for which there is no particular fault on the part of the taxpayer, but where the APA needs to come to an end. Revocation, on the other hand, generally arises from misbehaviour of the taxpayer (either

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5 Eaton, supra note 1.
7 See IC94-4R, supra note 2, at paras 97-102.
8 Ibid at para 25.
9 Ibid at para 71.
10 Ibid at para 97.
11 Ibid at para 100.
12 The APA may be cancelled if (a) the taxpayer “or the non-resident entities made any material misrepresentation, mistake, or omission in the APA request, APA submission, related APA reports, or subsequent APA renewal submissions, or in supplying, or failing to supply, any relevant information under this information circular”; (b) the taxpayer “or the non-resident entities failed to comply with any material term or condition of the APA”; (c) “there has been a failure to meet a critical assumption”; (d) “there has been a change in law, including a treaty provision, that modifies the Canadian federal income tax treatment of any matter covered by your APA”; (e) “the participating foreign tax administration’s APA is not consistent with your APA or has been revised, cancelled, or revoked”; or (f) “there has been a failure to conclude or sign a revised APA, BAPA or MAPA”, ibid at para 97 [emphasis added].
carelessness or deliberate malfeasance). Each of these two alternatives results in a different termination date of the APA. If the APA was canceled, it is terminated “as of the beginning of the taxation year” in which the event that caused the termination occurred. If, on the other hand, the APA is revoked, it is as if the APA never existed. In some ways, this distinction makes perfect sense. However, as it will be shown immediately below, this may not be consistent with general principles of contract law.

The authors find the inconsistency between paragraphs 73 and 74 on the one hand, and paragraphs 97 through 102 on the other, exceptionally important to the discussion. On the one hand, the government considers itself bound by the APA. If this is so, it should generally continue to be bound, unless there is an agreement that the actions of the other party are such that this is no longer the case. In contractual terms, this is known as the breach of a condition.

Three problems are evident. First, if the taxpayer refuses to sign a revised agreement (unilateral APA, BAPA or MAPA) at the request of the government, the government has the unilateral right to cancel the APA. In other words, if the contractual terms no longer suit the government of the day, the government has the right to require the tax back to the party who would have borne it in the absence of the APA, in accordance with the Act.

13 The APA may be revoked if (a) the taxpayer “or the non-resident entities made any material misrepresentation attributable to neglect, carelessness, or willful default in the APA request, APA submission, related APA reports, or subsequent APA renewal submissions, or in supplying, or failing to supply, any relevant information under this information circular”; the taxpayer “or the non-resident entities failed to comply with any material term or condition of the APA”; or (c) “the participating foreign tax administration’s APA is not consistent with your APA or has been revised, cancelled, or revoked”, ibid at para 100 [emphasis added].

14 Ibid at para 98.

15 Ibid at para 101.

16 Ibid at para 73.

17 On this point, see the distinctions provided between the terms “warranties”, “conditions” and “innominate terms” in the decision of Lord Justice Diplock (as he then was) in *Hongkong Fir Shipping Co v Kawasaki Kisen Kaisha*, [1962] 2 QB 26, [1962] 2 WLR 474 (CA) [*Hongkong Fir Shipping*]. Essentially, “conditions” are those terms of the contract which, regardless of the circumstances in which the breach occurred, the non-breaching party should always be allowed to treat the agreement as at an end, and if the non-breaching party does so, then any obligation of further performance on the part of the non-breaching party in the future is no longer enforceable. If the term that is breached is a “warranty”, the non-breaching party should generally not be allowed to treat the agreement as at an end, and therefore, the sole remedy available is generally damages. If the term is considered “innominate”, then the categorization of the term (as either a condition or a warranty) will depend on the consequences of the breach given the overall context of the contractual relationship. The more severe the consequences of the breach, the more likely it is that in light of the breach, the term will be treated as a condition, as opposed to a warranty.

18 IC-94-4R, supra note 2 at para 97.
The authors know of no contract that begins the relationship between two parties that would say that if one party refuses to conclude a second contract (a revision of the first), the other party can refuse to continue with the first contract. It is one thing to say that an agreement to agree is not a contract. It is quite another to suggest that one party has effective control to force amendments to what is claimed to otherwise be an enforceable agreement.

Second, if the law changes, the APA can be cancelled. The important thing to remember here is that the applicable law is statutory. The idea of a change in the law causing a change to a contract is nothing shocking, or even innovative. What is surprising is an administrative arm of the government (the CRA) is attempting to use a change in the law created by the legislative arm of the same government as being sufficient to invalidate an otherwise enforceable agreement. In the view of the authors, the government should be viewed as a cohesive whole, rather than separate parts. This is not to say that the government should not be allowed to change its policy priorities. Rather, the point is that the contract should not be invalidated by the unilateral choice of the government.

Third, and perhaps more problematically, the timing of the termination of a canceled APA leaves the taxpayer no time to reorganize his affairs to reflect the fact that the APA is now no longer effective. It is virtually beyond debate that a taxpayer is entitled to organize his, her or its affairs in whatever way will reduce his, her or its liability for tax, as long as the activity chosen by the taxpayer does not violate any of the anti-avoidance provisions of the Act. This includes the general anti-avoidance rule. The reasonable taxpayer would expect that if the government maintains a right to unilaterally terminate the APA relationship, where the taxpayer has done nothing to damage that relationship, the taxpayer should be entitled to a reasonable amount of time to deal with the change so that the taxpayer has the opportunity to suffer no ill effects from the unilateral decision of the government to terminate the APA relationship.

C. The Nomenclature Issue

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19 May & Butcher v The King, [1934] 2 KB 17 at 20, [1929] All ER Rep 679 (HL).
20 IC94-4R, supra note 2 at para 97.
21 One reviewer of this article suggested that this was a conclusory paragraph, in that if its premises are accepted, this would in effect end the argument. For the authors, this is not our intention. Rather, the point was to show that in places IC94-4R is inconsistent with the assertion of the binding nature of the APA. This in turn justifies the undertaking of the contractual analysis that follows.
23 The Act, supra note 3, s 245.
There is another reason why, in the view of the authors, this article is timely. Much of the US literature would seem to use the term “advance pricing agreement”, \(^{24}\) which is at least suggestive of a contract. The technical term in Canada, as used by the CRA is an “advance pricing arrangement”, \(^{25}\) which is less suggestive of a contract. But at least one Canadian author uses the American term. \(^{26}\) The Canadian courts have also used the American term on at least two different occasions. \(^{27}\)

Despite the possible difference between the two terms, confusion is generally a bad result in tax planning. Taxpayers need to know whether and under what circumstances their planning exercise may be ineffective. \(^{28}\) By deciding the two terms to be co-extensive, any confusion would be avoided. While the use of a different pattern of expression is often an indication of different legislative intention, \(^{29}\) this rule generally applies most strongly when dealing with patterns of expression within the same statute, \(^{30}\) or at least different enactments by the same legislative body. \(^{31}\) In this case, several factors


\(^{25}\) IC94-4R, supra note 2.

\(^{26}\) Clearwater, supra note 6.

\(^{27}\) For use of the term “advance pricing agreement” see e.g. SmithKline Beecham Animal Health Inc v The Queen, 2001 CanLII 571 at para 9, 2001 DTC 192 (TCC), Bonner TCJ; CooperStandard Automotive Canada Limited (Re), 69 BLR (4th) 41 at para 9, 2009 CanLII 51188 (Ont Sup Ct).

\(^{28}\) Some observers may point out that the potential application of the general anti-avoidance rule, contained in section 245 of the Act, supra note 3, undermines the required level of certainty. However, in the view of the authors, given the jurisprudence that has developed under the section, sufficient certainty has developed to allow taxpayers and their advisors to be aware of when the tax-planning opportunities under consideration may potentially trip the application of the section. On this point, see e.g. Copthorne Holdings Ltd v Canada, 2011 SCC 63, [2011] 3 SCR 721, Rothstein J, for the Court; Lipson v Canada, 2009 SCC 1, [2009] 1 SCR 3, LeBel J, for the four-judge majority, with strong dissents by Binnie J (Deschamps J concurring) and Rothstein J. These and other cases provide the certainty that the wording of the section may lack.

\(^{29}\) Ruth Sullivan, Sullivan on the Construction of Statutes, 5th ed (Toronto: LexisNexis Canada Ltd., 2008), at 221-222 [Sullivan].

\(^{30}\) Ibid at 216-219.

\(^{31}\) See Soper v Canada, [1998] 1 FC 124 at paras 30, 40-41, 1997 CanLII 6352 (FCA), Robertson JA, for the Court on this point. In this case, the Court used a repetition of language in subsection 227.1(3) of the Act that is also found in paragraph 122(1)(b) of the Canada Business Corporations Act, RSC 1985, c C-44 to arrive at an interpretation the wording that is consistent between both statutes. Interestingly, the Federal Court of Appeal held that the duty of care was in part objective and in part subjective, ibid at para 41. The Supreme Court of Canada commented on this issue in Peoples Department Stores Inc (Trustee of) v Wise, 2004 SCC 68, [2004] 3 SCR 461, Major and Deschamps JJ, for the Court [Peoples]. It specifically disagreed with the Federal Court of Appeal on this point, though not specifically on
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weigh against an interpretation that suggests that the difference in language is intended to lead to different results.

First, the rule is at its strongest with respect to repeated patterns of expression from the same legislative body. By definition, this is not the case with respect to the meaning of the acronym "APA", drawing from Canada, the US, and other countries. Second, this difference is not found in the statute at all, given that it is drawn from administrative statements of both the IRS and the CRA. Therefore, the rule (drawn as it is from statutory interpretation) should not apply with as much force as would otherwise be the case.

Third, as discussed further below, transfer pricing is per se an international phenomenon, and therefore, to adopt an interpretation of our terminology that leads to different results than that of our major international trading partners would actually seem to undermine the certainty that a comprehensive APA process is meant to generate. Tax treaties are generally drafted in very broad language. By definition, a bilateral APA (BAPA) or multilateral APA (MAPA) - each discussed in further detail in Part II.B. below - can only be entered into with the CRA and a taxing authority from a jurisdiction with which Canada has a tax treaty. Thus, an APA process is dependent on a broad, purposive document. To suggest that an exceptionally technical argument (such as the difference between "advance pricing arrangement" on the one hand, and "advance pricing agreement", on the other) should be successful is contrary to this broad approach to the document.

Fourth, as discussed further below, there is a spirit of international comity and cooperation that underlies the APA process, especially with respect to either a BAPA or MAPA. Two or more countries are deciding an acceptable division of the taxpayer's taxable income. They should cooperate

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other points in the judgment of the Court of Appeal, ibid at para 63. For example, the Supreme Court does not specifically agree or disagree with the potential application of different standards to inside directors (executive directors) and outside directors (non-executive directors). It remains an open question whether the approach of the Federal Court is valid law after Peoples.

32 The interpretation of delegated legislation (such as regulations) is the subject of scholarly treatment separate from the interpretation of statutes. With respect to the former, see e.g. Denys C Holland & John P McGowan, Delegated Legislation in Canada (Toronto: Carswell, 1989), and John Mark Keyes, Executive Legislation, 2nd ed (Toronto: LexisNexis Canada Inc, 2010).


34 IC94-4R, supra note 2 at para 33.
when doing so. Jurisdictional squabbling over the technical meaning of minor differences in language would seem exceptionally counterproductive in such a context.

Fifth, and on a related point, as discussed below, the goal of an APA is to create certainty for both the taxpayer and the taxing authority (or authorities) involved. The authors are uncertain as to how this minor difference in nomenclature was intended to affect interpretation. Indeed, the authors are unsure whether the difference was intended at all. Therefore, attributing any substantive difference to the difference in nomenclature would create uncertainty. Certainty is a desirable goal in the context of international taxation. Therefore, until it is made clear that the difference in nomenclature was intended by the administrative bodies using the term to create a substantive difference, an interpretive approach that creates such a substantive difference should be avoided.

II. TRANSFER PRICING, REVENUE LOSS, AND THE ARM’S-LENGTH PRINCIPLE

A. What Is Transfer Pricing, and Why Is It Regulated?

Transfer pricing refers to the fact that entities are often part of a multinational enterprise (MNE). Different aspects of the business of the MNE are carried on by different member-entities of the MNE. The economic interests of the different member-entities can only be properly understood by a review of the activities of the group (the MNE) as a collective. But the different member-entities are separate taxpayers, and taxable in separate jurisdictions. Therefore, their income for tax purposes is also different, and taxable at different rates, if at all.

An example may assist here. Assume that the intellectual property of a manufacturing process is held by Entity A, resident in Jurisdiction X. The manufacturer of the product is Entity B, resident in Jurisdiction Y. The distributor of the product is Entity C, resident in Jurisdiction Z. Each of the Jurisdictions Y and Z taxes at least in part on residency (at different rates), but

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35 "Entities", for the purposes of this paper, refers to all non-individual legal entities, particularly as relevant to taxation, though the entity may or may not be a taxpayer. This would include, but would not necessarily be limited to, corporations, partnerships and trusts.

36 On this point, see the decision of the both the Federal Court, Trial Division (now the Federal Court of Canada) and the Federal Court of Appeal in De Salaberry Realities Ltd v MNR (1974), 46 DLR (3d) 100 (Fed TD), Décary J (as he then was), aff’d (1976), 70 DLR (3d) 706, 1976 CarswellNat 246 (FCA), Le Dain J (as he then was), for the Court.
Jurisdiction X has no income tax at all. Each entity is a member of the same MNE.

This of course leaves open the possibility of manipulation so that more of the income of MNE is received in a no-tax or lower-tax jurisdiction. For example, Entity B agrees to pay Entity A $5 per unit in return for the right to use the manufacturing process. The direct manufacturing cost per unit is $4.50. Entity B agrees to sell the product at $9.75 (that is, at a profit margin of 25 cents per unit to its total cost) to Entity C. Entity C then distributes the product for $10.50 (that is, at a profit margin of 75 cents per unit to its total cost). This would mean that the vast majority of the net income (or profit) would be earned by Entity A, in a jurisdiction without income tax.

Now imagine that an outside party would pay only $2 (not the $5 that Entity B paid) for the use of the intellectual property involved in the manufacturing process. Assuming all other variables remain constant, the profit (to the extent of $3 per unit) would then be earned by Entity B, and be taxable in Jurisdiction Y. By having one member-entity deliberately overpay for the asset of another member-entity, the MNE overall pays less tax.

The rules on transfer pricing are designed to minimize the revenue loss created by the planning opportunity put forward in the hypothetical fact scenario above. While there are many forms of acceptable tax planning, “jurisdiction shopping” through causing large expenses to be realized in a jurisdiction for accounting purposes (and causing income to be recognized in another) is constrained by the transfer pricing rules.37

B. What Is an APA, and How Does It Work?

An advance pricing arrangement, or APA, is an agreement between one or more taxing authorities covering the appropriateness of transfer pricing methodology employed by one or more member-entities of an MNE. The Canadian competent authority has responsibility for running the APA program and interacts with counterparts of other jurisdictions to develop the APA. Generally speaking, the competent authority acts as the Minister of National Revenue (MNR) when a taxpayer requests assistance with respect to any tax convention that Canada has with another country.

37 The Act, supra note 3 at s 247.
Where the arrangement is with the CRA alone, it is known as “unilateral”; where two different taxing authorities are involved, the arrangement is known as “bilateral”, or a “BAPA”; where there are three or more taxing authorities involved, the arrangement is known as “multilateral”, or a “MAPA”.

The taxpayer who seeks an APA must request an APA. If the request for an APA is accepted, it is subject to a charge. This charge, according to the CRA, does not currently include charges for staff time. The CRA views this charge as reimbursement for out-of-pocket expenses. As part of the submission, the taxpayer must explain the transfer pricing methodology used as part of the transaction. By requesting an APA, the taxpayer knows that the taxpayer is expected to inform the government of the method of calculating the price at which the inter-entity transaction at issue will take place. Thus, the taxpayer MNE also knows that it will be required to provide information to the government, which (absent an audit) it need not necessarily provide.

If a taxpayer wants to seek an APA, pre-filing meetings are generally part of the process. As will become important as part of our later discussion, it is thus clear that an APA is a negotiated (and thus, collaborative) process. As mentioned, if the government is willing to enter into an APA, it returns a letter to the taxpayer setting out the terms upon which the APA is granted. The taxpayer must then return a signed “APA acceptance letter” to the CRA.

38 IC94-4R, supra note 2 at para 7.
39 For the purposes of this paper, a “taxing authority” is an authority responsible for the administration of income tax (or equivalent) against entities (supra note 35) in a jurisdiction with which Canada has a valid tax treaty, IC94-4R, supra note 2 at para 7.
40 IC94-4R, supra note 2 at Para 7.
41 This is not to suggest that all APA requests are treated equally. As the CRA asserts in IC94-4R, ibid at para 22:

We [the CRA] prefer to enter into BAPAs or MAPAs. If you [the taxpayer] request a unilateral APA, you must state why you are not requesting a BAPA or MAPA, if the proposed transactions involve countries with which Canada has income tax treaties. The APA process does not limit the CCRA [CRA] from notifying a treaty partner in accordance with the relevant treaty that we have accepted a unilateral APA request.

42 Ibid at para 21.
43 Ibid at paras 21, 27.
44 Ibid at para 27.
45 Ibid.
46 Ibid at para 7 defines the term “transfer pricing methodology” as follows: “It is a basis for establishing an arm’s-length transfer price or allocation under section 247 of the Act and, when applicable, under various income tax treaties between Canada and foreign governments”.
47 Ibid at paras 17-20.
48 Ibid at para 21.
and then comes the “heavy lifting” of preparing the actual submission of the APA.49

C. The Arm’s-Length Principle

Similar to other Organisation for Economic Co-operation and Development (OECD) countries, Canada has adopted the arm’s-length principle as the basic rule governing the tax treatment of related party cross-border transactions. The arm’s-length principle holds that related persons must charge prices similar to what would be charged between parties acting at arm’s-length. The arm’s-length principle finds its origins in post-World War II Europe where, due to the size of the countries, businesses easily expanded beyond the borders of a single jurisdiction. Increasingly, the country of residence of the corporation and the country where business was carried on vied for the tax revenue earned. The OECD, formed after World War II by the League of Nations, and its predecessor, the Organisation for European Economic Co-operation (OEEC), attempted to solve this problem by introducing the concept of a permanent establishment. The OEEC, unlike the OECD, did not have one model treaty, but several. “Dealing at arm’s-length” was introduced as early as 1933 in the League of Nations Model Treaties.50 The arm’s-length principle was incorporated into Article 9 of the OECD Model Tax Convention in 1963.51 In 1980, the arm’s-length principle was adopted by the United Nations, as evidenced by Article 9 of the United Nations Model Double Taxation Convention between Developed and Developing Countries.52

Subsection 247(2), found within Part XVI.1 of the Act, provides the CRA with the authority to enforce the arm’s-length principle on related taxpayers.53 Paragraphs 247(2)(b) and (d) provide that where a taxpayer and a non-resident with whom the taxpayer does not deal at arm’s-length are

49 Ibid at para 7.
51 De Ruiter, Marlies, “Overview of the OECD work on Transfer Pricing” at 1, written contribution to the “Alternatives Methods of Taxation of Multinationals” Conference held on June 13 and 14, 2012 at Helsinki, Finland, online: Tax Justice <www.taxjustice.net/cms/upload/pdf/Marlies_de_Ruiter_1206_Helsinki_text.pdf>.
52 Ibid.
53 The arm’s-length principle has been specifically recognized in both the ITA and its predecessor since at least 1938. For example, between 1972 and 1988, subsections 69(2) and (3) of the ITA contained the arm’s-length principle.
participants in a transaction or a series of transactions and the transaction or series:

(i) would not have been entered into between persons dealing at arm’s-length, and

(ii) can reasonably be considered not to have been entered into primarily for bona fide purposes other than to obtain a tax benefit,

any amount that, but for section 247 (and the general anti-avoidance rule), would be determined in respect of the taxpayer for a taxation year shall be adjusted to reflect the amounts of an arm’s-length transaction.\textsuperscript{54} As stated in a report entitled “The Administration of Canada’s Transfer Pricing Rules: Issues and Recommendations”, “[a]n adjustment to the nature of the affected transactions (commonly referred to as “recharacterization”) is only exercisable when the transaction falls within paragraph 247(2)(b) and then only if there is demonstrable purposive tax avoidance.”\textsuperscript{55}

A taxpayer may request the CRA to make a transfer pricing adjustment in order to reduce the taxpayer’s income under subsection 247(10). This is subject to the Minister’s discretion. Subsection 247(3) imposes a penalty equal to 10 percent of the transfer pricing adjustment. This is a compliance penalty and does not apply if a taxpayer makes reasonable efforts to determine and use arm’s-length transfer prices or allocations. A taxpayer will be deemed by subsection 247(4) “not to have made reasonable efforts to determine and use arm’s-length transfer prices or allocations”, unless this taxpayer “has prepared or obtained and updated contemporaneous documentation and provided the documents to CRA within three months of the receipt of a written request.”\textsuperscript{56}

III. ANALYSIS

A. The Basic Elements of a Contract


\textsuperscript{56} Ibid.
Before turning to the primary concern of this paper (that is, whether the Canadian courts ought to use the law of contracts to treat an APA as binding), a preliminary point must be addressed. Are the basic elements of a contract present in an APA? If the answer is in the negative, then even a positive answer to the normative question would likely be irrelevant, absent clear legislative intervention. There are three basic elements: (a) offer; (b) acceptance; and (c) consideration.

The offer here is contained in the APA letter of the government, which, as discussed above, sets out the terms under which the APA is put forward by the government. Where the option to enter into a relationship put

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57 One area where there has been clear legislative intervention to redefine the meaning of the term “contract” away from its common law roots is in the area of pre-incorporation transactions. On this point, see 199418 Ontario Ltd v 1310210 Ontario Inc (2002), 57 OR (3d) 607, 2002 CanLII 19996 (Ont CA), where Carthy JA held for the Court that when a pre-incorporation transaction has yet to be adopted by the corporation, and where there is a specific exclusion of liability of the other party (often called the “promoter”), the application of s 214(4) of the Business Corporations Act, RSO 1990, c B.16, meant that there was a “statutory contract” to which only one party was bound, namely, the third party who was dealing with the promoter.

Similar language to that found in the Business Corporations Act is found in the following statutes: Canada Business Corporations Act, RSC 1985, c C-44, s 14; Corporations Act, CCSM c C225 s 14; Corporations Act, Business Corporations Act, SNB 1981, c B-9.1, s 12; RSNL 1990 c C-36, s 26; Business Corporations Act, SNWT 1996 c 19, s 14; Business Corporations Act, SNWT (Nu) 1996 c 19, s 14, as adopted pursuant to the Nunavut Act, SC 1993 c 28, s 29; Business Corporations Act, RSS 1978 c B-10, s 14; Business Corporations Act, RSY 2002 c 20, s 17.

58 It is important to note that there is also a fourth element to be considered, that is, the intention to create a contract. In Jones v Padavatton, the Court of Appeal of England and Wales held that the intention to create a contract is a matter of subjective intention, but subjective intention is to be determined by the objective facts, [1969] 2 All ER 616 at 621, [1969] 1 WLR 328, Salmon LJ. Here, while Part VII of IC94-4R is not determinative of the issue (see Part I of this paper), it does provide evidence of intention. Second, this is not a familial or other relationship (such as a close friendship) where the creation of a contract would be inappropriate because it would be unexpected by the parties. As a result, where there is a commercial-type relationship, in the absence of evidence to the contrary, an agreement between the parties will generally be seen as being intended to create a contract. As Stone J explained:

Moreover, as has been pointed out, the onus of proof in a case of this kind “is on the person who asserts that no legal effect was intended, and the onus is a heavy one”: Edwards v. Syways Ltd., [1964] 1 All ER 616 at 621, [1964] 1 WLR 328, Salmon LJ. Here, while Part VII of IC94-4R is not determinative of the issue (see Part I of this paper), it does provide evidence of intention. The non-governmental actor involved in the APA, and the transfer pricing issues that it attempts to address, are inherently commercial in nature. As a result, the presumption referred to with respect to commercial relationships would, in the view of the authors, be apposite here. Since the onus is a heavy one, in the view of the authors, the circumstances of an APA do not justify the discharge of this onus.
forward is limited to a single offeree, it is more likely to be an offer, as opposed to an invitation to treat. While the distinction between an invitation to treat, on the one hand, and an offer, on the other can be highly fact-dependent, the distinction is a pragmatic one. Anything that is capable of acceptance cannot be an invitation to treat. The CRA itself calls the reply of a taxpayer to the APA sent by the CRA an "acceptance." If the parties themselves use contractual language, this is objective evidence of a subjective intention.

Consideration is something of value, in the eyes of the law, moving from the promisee (usually but not necessarily to the promisor) in return for the promisor's promise. This can include the conferral of a benefit, or the avoidance of negative consequences. As will be discussed further below, there are consequences for the parties concerned with an APA. Most clearly, the main reason that an MNE would want to enter into an APA would be to provide certainty of the tax treatment of important transactions within the corporate group. For the tax authorities involved, it assures that the tax authority has a certain amount of say as to what percentage of the income of the MNE is earned in the relevant jurisdiction. For all involved, it substitutes pre-transactional negotiation for post-transactional litigation.

59 Canadian Dyers Association Ltd v Burton (1920), 47 OLR 259 (Lexis and QL) (S.C.), Middleton J (as he then was).
60 An invitation to treat for these purposes is an indication of willingness to hear offers from the party or parties to whom the invitation is addressed or sent, or a willingness to negotiate a contract with that party. An invitation to treat is a communication which is not capable of acceptance by the party to whom it was addressed or sent. For cases dealing with this issue, see e.g. Johnston Brothers v Rogers Brothers (1899), 30 OR 150 (Lexis and QL) (Div Ct), Armour C, for the Court; Harvey v Facey, [1893] AC 552 (PC, Jamaica), Lord Morris, for their Lordships.
61 On this point, see Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd, [1953] 1 QB 401 (Lexis and QL) (CA), where the English Court of Appeal held that the indication of a price in a self-service store was not an offer, but rather an invitation to treat, where the offer is made by the customer bringing the items to the cash register and paying for them.
This approach was adopted by the Canadian courts in many cases, such as R v Danwood, [1976] 1 WWR 262 (CanLII) (CA), McDermid JA, for the majority. For an alternate approach to the distinction between the two concepts, see Sanchez-Lopez v Fedco Food Corp, 211 NYS (2d) 953 (NYSC 1961).
62 IC94-4R, supra note 2 at para 21.
64 Thomas v Thomas, (1842) 2 QB 851 (QBD).
65 Williams v Roffey Bros & Nicholls (Contractors) Ltd, [1990] 1 All ER 512 (Lexis and QL) at 522 (CA), Gidewell LJ, for the majority.
66 As will be discussed further below, MJB Enterprises Ltd v Defence Construction (1951) Ltd, [1999] 1 SCR 619, 1999 CanLII 677, Iacobucci J, for the Court [MJB Enterprises Ltd] makes it clear that such an approach is both possible and relevant to the contractual analysis.
Even without all of these points to support the conclusion that an APA constitutes a contract, the reasonable expectations of the parties would appear to support a finding of a contractual relationship. The following appears at paragraph 26 of IC-94-4R:\textsuperscript{67}

\begin{verbatim}
If you withdraw an APA request, neither you nor the CCRA [\textsuperscript{68}] will have any obligations to each other. Any previous undertakings and understandings relating to your APA request will be of no further force and effect.
\end{verbatim}

At least three related conclusions can be drawn from this text. First, "obligations" generally refers to legally-enforceable obligations.\textsuperscript{69} Second, if the withdrawal of an APA ends all obligations between the parties prior to such withdrawal, obligations exist. Third, if an APA request can be withdrawn by the taxpayer, it follows that the obligations undertaken pursuant to the APA are voluntary in nature. The combination of these two realities is the essence of a contract. A contract means voluntary obligations that are legally enforceable.

According to at least one Canadian legal commentator, enforcement of the reasonable expectations of the parties is thought to be an "organizing principle" of contract.\textsuperscript{70} The authors, like certain other writers,\textsuperscript{71} have some problems with the idea that all of the law of contracts can be reduced to any single entirely coherent principle. But the authors do agree that the attempt to give effect to the reasonable expectations of the parties is an important part in many areas of contracts. As will be discussed in more detail below, one such area is that of promissory estoppel. Promissory estoppel will figure prominently in the resolution of the issues discussed here.

B. Contracts in the Context of Government Policy

\textsuperscript{67} IC94-4R, supra note 2 [emphasis added].
\textsuperscript{68} As most readers will already be aware, the government agency responsible for the collection of tax revenue at the federal level in Canada has changed names several times over the last two decades. For current purposes, it is sufficient to say that Revenue Canada, the Canada Customs and Revenue Agency, and the Canada Revenue Agency are equivalent to one another.
\textsuperscript{69} In \textit{R v CAE Industries Ltd}, the word "assurances" was used to describe the undertakings given in a letter agreement, \textit{R v CAE Industries Ltd}, [1986] 1 FC 129 at 157, [1985] 5 WWR 481 (FCA), Stone J [CAE]. Despite this choice of language, the Court found an enforceable contract, \textit{ibid} at 157-159, 169. If this language is sufficient to find an enforceable contract, in the view of the authors, "obligations" is far indicative of an enforceable contract.
\textsuperscript{70} See Angela Swan, \textit{Canadian Contract Law}, 2nd ed (Toronto: LexisNexis Butterworths, 2009) at §1.27.
\textsuperscript{71} See Geoff R Hall, "A Study in Reasonable Expectations" (2007), 45 CBLJ 150.
The first objection that may be levied against the analysis put forward here is that this is a service offered by the government. The government, such an argument would run, does not intend to be bound by a service program created and operated in the public interest. However, the case law says that the two areas (government program, on the one hand, and contract, on the other) can coexist.

In *Grant v. Province of New Brunswick*, there was a surplus supply of potatoes in both Canada generally and New Brunswick specifically. There was a federal program essentially paying farmers for destroying barrels of potatoes. The government of New Brunswick was supplementing the federal program. In order to access payment under the program, the potatoes had to be destroyed, which the potatoes belonging to the plaintiff were. His application to the Board set up to administer the program was rejected, on the basis that the applicant was not the owner of the potatoes put forward under program. Chief Justice Hughes wrote as follows:

The plaintiff replied protesting he was in fact the owner of the potatoes offered. Later he appeared before the committee but was unable to satisfy its members that he owned the potatoes which he had offered. Later, he brought the present action claiming the price of 4,000 barrels of potatoes at $1.20 per barrel. At the trial he testified he owned the potatoes and his evidence was accepted by the learned trial Judge who directed that judgment be entered against the Province for the price claimed. On this appeal the Province did not challenge the trial Judge's finding that the plaintiff was the owner of the potatoes which he offered for purchase but contended that payments made to applicants under the potato price stabilization programme constituted subsidies, the payment of which the applicant had no legal right to enforce.

Put more concisely, the argument of the government was that there was no enforceable claim against the Province in contract, and thus, it was not bound to pay the applicant farmer. Chief Justice Hughes disagreed. He held as follows, in the final paragraph of his judgment:

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22 *Grant v Province of New Brunswick* (1973), 6 NBR (2d) 95, 35 DLR (3d) 141 (NBSC, App Div), Hughes CJNB, for the Court.
I am not satisfied that the trial Judge erred in finding that the Province offered to purchase potatoes at the support price from all eligible growers resident in New Brunswick who offered their potatoes for purchase within the guidelines set out in the information. Indeed, I accept the view that a reasonable person in the position of the plaintiff would be entitled to assume that if he complied with the conditions set out in the general information and disposed of his potatoes to the satisfaction of the inspector appointed by the Province, he was entitled to sell his potatoes to the Province and that the Province was legally bound to purchase and pay for them. I would accordingly affirm the decision 1 with costs.\textsuperscript{26}

The fact that the Province thought that it was engaged in a program of government largesse to deal with a social issue did not deter the Court from finding a contract on the facts, to ensure that the government had to follow through on the program's objective when dealing with individuals making application under the program.

In a similar vein, one finds \textit{CAE}.\textsuperscript{77} In that case, the government was delivering a letter signed by three federal Ministers in an effort to encourage the purchase of a property by a business in Winnipeg.\textsuperscript{78} Once the property was purchased, the government tried to argue that the agreement was not intended to be a legally-enforceable contract.\textsuperscript{79} The Court disagreed. Justice Stone, speaking for the majority, wrote as follows:

The government of the day was faced with a decision by Air Canada to phase out its aircraft maintenance base at Winnipeg. The initiative to find a buyer in the private sector was taken by the government itself and it was the government that approached the respondent as a potential buyer. It was seeking through the respondent a solution for a particular problem. It was eager and anxious to find a buyer so that the maintenance base and associated employment in Winnipeg could be preserved.

In my view the circumstances in which the letter was written distinguish this case from others where it has been found that no intention to contract was present [...].\textsuperscript{80}

The most relevant provisions of the letter were as follows:

\textsuperscript{26} \textit{Ibid} at para 14.
\textsuperscript{77} \textit{CAE}, supra note 69.
\textsuperscript{78} \textit{Ibid} at 140.
\textsuperscript{79} \textit{Ibid} at 142.
\textsuperscript{80} \textit{Ibid} at 503.
(c) The Department of Defence Production can guarantee no more than 40,000 to 50,000 direct labour man-hours per year in the period 1971-1976 as "set-aside" repair and overhaul work, but the Government of Canada will employ its best efforts to secure the additional work required from other government departments and crown corporations to meet the target level of 700,000 direct labour man-hours.

(d) In fulfilling the commitment set out in (c) above, the Government of Canada agrees that any additional work allocated to the Winnipeg Maintenance Base will not be taken from government contract work presently carried out by Northwest Industries in Edmonton.

(e) It further agrees that the existing Air Canada lease from the Department of Transport will be assigned to NWI under present financial terms and conditions for a period of ten years.\footnote{Ibid at 491-492 [emphasis added].}

In the view of the authors, since this language was sufficient to find an intention to contract with a commercial party in CAE, the language of a standard APA request\footnote{IC94-4R, supra note 2, Appendix II.} and the standard response thereto by CRA\footnote{Ibid at Appendix III.} should be more than sufficient to meet this same test. Note that the Ministers were trying to achieve a public purpose (of ensuring that one party to a proposed transaction would complete the deal, protect the use of the property as a commercial space, and protect the employment created thereby).\footnote{CAE, supra note 69.} Yet the Court still finds it to be a commercial transaction.\footnote{Ibid at 517.} In the same way, though an APA is a government device that attempts to encourage business, this is not necessarily inconsistent with the finding of a contractual relationship.

C. The Tendering Cases

1. The Holdings in the Cases

The courts have already considered the issue of contracts in the public tendering context. Some may question how this is relevant to the issue at hand. But, for the authors, the connection is an important one. The question is whether the law of contracts can be applied to government, as a
means of encouraging positive government action, or by binding individuals to uphold their commitments. In *The Queen in Right of Ontario v. Ron Engineering (Eastern) Ltd.*, the respondent had made a bid to the appellant. When the bids were opened the respondent claimed that there was an error in their calculation, and since they withdrew their offer upon discovering the error, the offer could not be accepted. Therefore, there was no breach of contract, according to the appellant. Estey J held otherwise. He wrote that in tendering situations like this one, there was not a single contract, but several. Each bidder, by making their bid, enters into “Contract A”. Justice Estey held that this is a unilateral contract, meaning that there would be a promise in return for an act of the other party. A simple example used by Estey J may assist here. A unilateral contract is:

[A] contract which results from an act made in response to an offer, as for example in the simplest terms, “I will pay you a dollar if you will cut my lawn”. No obligation to cut the lawn exists in law and the obligation to pay the dollar comes into being upon the performance of the invited act. Here the call for tenders created no obligation in the respondent or in anyone else in or out of the construction world.

The Court continued as follows, explaining the consequences of its “Contract A/Contract B” approach:

When a member of the construction industry responds to the call for tenders, as the respondent has done here, that response takes the form of the submission of a tender, or a bid as it is sometimes called. The significance of the bid in law is that it at once becomes irrevocable if filed in conformity with the terms and conditions under which the call for tenders was made and if such terms so provide. There is no disagreement between the parties here about the form and procedure in which the tender was submitted by the respondent and that it complied with the terms

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87 Ibid at 121.
88 Ibid at 120-121.
89 Ibid at 121.
90 Ibid at 119.
91 Ibid at 122.
and conditions of the call for tenders. Consequently, contract A came into being.92

Once the person who requested the bids (often called the “owner” in the jurisprudence93) selects the winning one, the winning bidder and the owner are bound to the second contract (for the main undertaking referenced in the request for bids, such as the construction of a building or other undertaking) known as “Contract B”.94 Since Contract A was formed, one of the terms of this contract was that if the bid was selected and the bidder withdrew, as happened here, the bidder’s deposit would be forfeited.95

The effect of this decision was, among other things, to cause the bidder to be bound to a contract earlier in the tendering process than would otherwise be the case, in an effort to protect the integrity of the tendering system.96 The Supreme Court of Canada made a change to the law of contracts to protect a socially useful institution. The use of the device of “Contract A/Contract B” allowed a deposit in a public tendering construction situation to serve its intended function, that is, to provide a financial disincentive against the withdrawal of a bid.

Ron Engineering was concerned with whether the bidder had obligations to the owner prior to the entering into of the main construction contract. The Supreme Court of Canada held that it did, in the form of “Contract A”. In M.J.B. Enterprises Ltd.,97 the Court was confronted with whether the owner could owe obligations under “Contract A” as well. Looking solely at Ron Engineering, the answer first appeared to be in the negative. With a unilateral contract, the owner should owe nothing to the bidder. But in M.J.B. Enterprises Ltd.,98 the Court held that the tender documents might expressly contain a term as to the obligations of the owner.99 Alternatively, such an obligation could be implied.100

The Court then justifies its approach by referring to the policy implications of the decision for the tendering system. On this point, Iacobucci J held as follows:

92 Ibid [emphasis added].
93 MJB Enterprises Ltd. supra note 66 at para 1.
94 Ron Engineering, supra note 86 at 119.
95 Ibid at 123.
96 Ibid at 121.
97 Supra note 66.
98 Ibid.
99 Ibid at paras 25-26 (though no such explicit term was found on the facts of the case).
100 Ibid at paras 27-40.
The rationale for the tendering process, as can be seen from these documents, is to replace negotiation with competition. This competition entails certain risks for the appellant. The appellant must expend effort and incur expense in preparing its tender in accordance with strict specifications and may nonetheless not be awarded Contract B. It must submit its bid security which, although it is returned if the tender is not accepted, is a significant amount of money to raise and have tied up for the period of time between the submission of the tender and the decision regarding Contract B. As Bingham L.J. [as he then was] stated in Blackpool and Fylde Aero Club Ltd., [1990] 3 All E.R. 25, at p. 30, with respect to a similar tendering process, this procedure is "heavily weighted in favour of the invitor". It appears obvious to me that exposing oneself to such risks makes little sense if the respondent is allowed, in effect, to circumscribe this process and accept a non-compliant bid. Therefore I find it reasonable, on the basis of the presumed intentions of the parties, to find an implied term that only a compliant bid would be accepted.101

2. The Principles from the Tendering Cases

The principles that may be drawn from the tendering cases are as follows:

A. The law of contract can be applied flexibly in order to protect socially useful relationships, such as the tendering process in public procurement (Ron Engineering);
B. The effect of this in the tendering process is that parties are bound earlier in the process, rather than being able to walk away later in the process (Ron Engineering);
C. Both parties may owe obligations to the other, including government itself, using a contractual model (M.J.B. Enterprises Ltd);
D. The contract can and often does allocate the risks of failure of the relationship (M.J.B. Enterprises Ltd);
E. Either negotiation or competition could arise, depending on the circumstances, and the use of a particular type of contractual model may alter which of these is at play (M.J.B. Enterprises Ltd).

101 Ibid at para 41 [emphasis added].
In the view of the authors, each of these principles has some application to the context of an APA. Therefore, below, each principle will be discussed.

3. The Application of the Principles

a. An APA is a socially useful institution

Conflict is regretfully often a natural outgrowth of disagreement, and disagreement is likely when a payment is involuntary. Taxes are by definition involuntary payments required of taxpayers to the state, for a public purpose. This conflict can only be more difficult to resolve where there are multiple jurisdictions involved in the matrix of taxation of a single taxpayer, as would be the case in any BAPA or MAPA. As will be discussed in more detail below, one of the primary advantages of an APA is that conflict is replaced with a cooperative approach. Thus, an APA reduces conflict.

In terms of the goals of substantive taxing provisions, the goals of the tax system are to be equitable, neutral and simple. It appears to the authors that Parliament has decided that double (or subsequent) taxation of the same income in different jurisdictions is inequitable. One of the primary determinants of an equitable tax burden is the ability to pay. In fact, a tax treaty between Canada and the other jurisdictions covered by the APA is a prerequisite for either a BAPA or MAPA. One of the primary purposes of a tax treaty is the avoidance of double taxation. The same is true of the foreign tax credit. Therefore, both from the perspective of conflict avoidance and the perspective of furthering the policy goals that Parliament has set, the APA is a useful social institution.

b. The determination of an APA as contractual will bind the parties earlier in the process


\[\text{Ibid. at 65.}\]

\[\text{Ibid. at 67.}\]

\[\text{Edgar, Sandler & Cockfield, supra note 33 at 195.}\]

\[\text{Ibid.}\]
Just as in the tendering cases, binding parties earlier in the process has a positive effect. Taxpayer MNEs are far more likely to consider the use of an APA if they see economic advantage in such a decision. If the economic advantage of the APA could be removed because the government could walk away at any time, the economic certainty incentive for the taxpayer to do the work to enter into an APA is concomitantly reduced. To take the tax concept of profit, in order to assess the viability of any economically-based activity for a business one will typically look at the revenue expected to be produced from the activity, and subtract the expenses laid out to earn the revenue. There is nothing terribly controversial in these statements. In the scenario presented in this paper, of course, there is no specific revenue produced. Rather, as mentioned earlier, the goal of an APA is to arrive at a stable and thus predictable set of rules for the recognition of income (profit) in a jurisdiction (unilateral APA) or between (BAPA) or amongst (MAPA) jurisdictions.

If the goals of the APA process include stability and predictability, if the government is not bound in law to carry through on its APA, these twin goals are undermined. The payment of the fee (an asset in the view of the government, and an expense in the view of the MNE) necessary to begin the APA process is payable up front. Yet, the tax savings (an asset in the view of the MNE) are to be achieved over time. Therefore, if the government changes its position on the acceptability of the use of the MNE's transfer pricing methodology, it has already been compensated for the work done with respect to the APA. For the taxpayer, however, significant outlays may have already been made to show its operations to the authorities and demonstrate the reasonableness of its transfer pricing methodology. If the government can make it less certain that the benefits of the APA will be long-lasting, taxpayers are less likely to request them and expend the funds necessary to fulfill the requirements to access this socially-useful tool.

But, if we treat the APA as contractual in nature, the length of the contract would be a term with respect to which the parties could negotiate. If they do not do so, and the APA remains silent on this issue, there are mechanisms in the law of contracts to fill this gap. These are discussed in more detail later in this paper.

c. Obligations on the Government

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107 See the Act, supra note 3, s 9.
108 Edgar, Sandler & Cockfield, supra note 33 at 309.
Finding that the APA is contractual (as opposed to government largesse) means there can be obligations placed on the government. These might include an obligation of fair dealing and even-handedness,¹⁰⁹ good faith negotiation¹¹⁰ and possibly others. One could see the obligation of even-handedness as being highly important. Assume, for example, that a unilateral APA is granted with respect to the manufacture of a particular widget for Taxpayer A, and the cost of the widget is reasonable (in the APA) at Y cents per unit. Yet later, with Taxpayer B, the CRA refuses to accept a cost of Y cents per unit on an identical widget. At the very least, this discrepancy would need an explanation. Yet, if there is no contract, on what basis would the taxpayer be able to challenge the refusal? Thus, finding the elements of a contract in these circumstances would enforce the general public expectation of fundamental fairness from its government.¹¹¹

d. Contractual Risk Allocation

Given the general rule of freedom of contract, the parties to an APA may decide where the risks involved in the contract may lie. Assume for example, in a MAPA, one of the other taxing authorities chooses to withdraw

¹⁰⁹ MIB Enterprises Ltd, supra note 66, at para 43.
¹¹⁰ Between arm’s-length parties, there is rarely an obligation of good faith implied in contractual negotiations. This is based on the fact that parties, in negotiating their contract are entitled to take positions, reasonable or not. On this point, see e.g. Courtney Ltd v Tolaini Bros Ltd, [1975] 1 WLR 297 (Lexis and QL) (CA), Lord Denning, MR, for the Court on this point [Courtney]. Interestingly, the words “good faith” do not appear in the judgment in Courtney. The judgment itself was focused on whether an agreement to agree was capable of enforcement. However, there was a clear agreement to negotiate. The Master of the Rolls held that such an agreement was not enforceable. In Watford v Miles, [1992] 2 AC 128 (Lexis and QL) at 132, 136-138, 140 (HL), Lord Ackner, for their Lordships, cited Courtney to support the principle that good faith cannot be implied into contractual negotiations.

On the other hand, where there is a clear contractual relationship already in existence, a duty of good faith may be implied in limited circumstances. On this point, see the judgment of Lambert JA, speaking for the majority of the British Columbia Court of Appeal in Re Empress Towers Ltd and Bank of Nova Scotia (1990), 50 BCLR (2d) 126, 73 DLR (4th) 400. While the issue of good faith in contractual negotiations may be somewhat unclear, a recent judgment of the Supreme Court of Canada makes clear that good faith is an organizing principle in contractual performance. See Bhasin v Hrynew, 2014 SCC 71 (CanLII) at paras 33, 63, Cromwell, J., for the Court.

¹¹¹ A decision of an administrative agency (such as the CRA) may be subject to attack on either procedural fairness or substantive grounds. See Gus Van Harten, Gerald Heckman, & David Mullan, Administrative Law: Cases, Text, and Materials, 6th ed (Toronto: Emond Montgomery Publications, 2010). While the expectation of fairness may not rise to the level of a legally-enforceable obligation in certain circumstances, the authors are speaking more broadly, seeking to allow legal doctrine to reinforce the non-legal perception that government is, and should be, fair to the individual citizen when interacting with him or her.
from the agreement. Should the MAPA be automatically converted to a BAPA, or a unilateral APA? This is something that the parties themselves should be able to decide, as opposed to having it imposed on them. If both parties are aware of the contractual nature of the APA that is being proposed, the ability to negotiate the allocation of certain risks should be evident.

e. Negotiation v. Competition

As mentioned above, in *M.J.B. Enterprises Ltd.*, Iacobucci J wrote that using a tendering system would trade negotiation with competition. The paragraph at issue contains the following:

The rationale for the tendering process, as can be seen from these documents, is to replace negotiation with competition. This competition entails certain risks for the appellant. The appellant must expend effort and incur expense in preparing its tender in accordance with strict specifications and may nonetheless not be awarded Contract B. It must submit its bid security which, although it is returned if the tender is not accepted, is a significant amount of money to raise and have tied up for the period of time between the submission of the tender and the decision regarding Contract B.

In the case of APA, a similar trade is at issue. As mentioned earlier, it is virtually beyond debate that a taxpayer is entitled to structure its affairs so as to minimize its liability to tax. In a unilateral APA, the taxpayer trades the ability to control and structure its affairs to push their ability to reduce as much as the Act might otherwise allow. The taxpayer is foregoing the ability to challenge the government to prove that the Act would disallow what was done. The government is foregoing the ability to strictly enforce the provisions of the Act to the fullest extent allowable by law. Where a BAPA or a MAPA is undertaken, the trade-off is even clearer to see. There has been a proliferation of tax treaties not only between developed countries, but also

112 *MIB Enterprises*, supra note 66.
113 *Ibid* at para 41.
114 *Duke of Westminster*, supra note 22.
between Canada and developing countries.\textsuperscript{116} Earlier in this paper,\textsuperscript{117} the threat of the negative impacts of double taxation was mentioned. Even once the negative impacts of double taxation are acknowledged, there is a related benefit to a multiple tax authority APA. All of the jurisdictions involved in the APA have a say in how the tax revenue generated from income earned by the MNE is to be divided between them. This allows the government to accomplish two related goals. First, the government avoids double taxation on the income of its residents earned in other jurisdictions. Second, it encourages and enhances international cooperation and comity.

D. Enforcing the Statements of the Tax Authority

The discussion above does not finally resolve whether the taxing authorities ought to be bound. However, there is some case law on this issue. Admittedly, the case law revolves around tax settlements between a taxpayer and the government. As will be made clear in the discussion of Goldstein below,\textsuperscript{118} none of these cases dealt with either advance tax rulings or APAs. Therefore, while the case law is helpful to illuminate the issues that drive the decision on whether or not to enforce a settlement, it is not binding with respect to an APA. The case law discussion below should be read with this in mind.

1. Canada

While the following are not necessarily a fully comprehensive list of all of the cases that might reasonably be considered relevant to the issues addressed here, the goal of the authors is to set out the relevant principles, while still keeping this paper within a reasonable compass for the reader.

The basic idea to be drawn from this case law is very simple. There is certainly some language in these cases that at the very least suggests (and perhaps goes beyond suggestion) that there is a serious divide and potential inconsistency in the jurisprudence. Notwithstanding this language, in the view of the authors, there is a thread that would allow the cases to be read in a way that would extract a consistent set of principles from the jurisprudence.


\textsuperscript{117} See Part III.C.3.b., above.

\textsuperscript{118} See Part III.D.1.d. of this article.
In an effort to give the reader a flavour of the debate, the authors deal with the cases one at a time. The cases are considered in chronological order, largely because the later cases refer to the earlier ones. The same basic caution applies to the discussion of the UK case law below. Immediately following the exposition on the case law, the authors lay out a set of principles that we believe brings together the case law, notwithstanding the potential contradictions among the various cases.

a. Galway

In *Galway v. Canada (Minister of National Revenue - M.N.R.)*,\(^\text{119}\) the parties had come to a settlement agreement, and they wished to have it entered as a consent judgment. The Court of Appeal refused to refer the matter back to the Federal Court - Trial Division with an instruction to implement the settlement. The Court held that the settlement could not be enforced. The reason for this was that the Minister could not agree to assess a taxpayer on a basis other than the facts and law as the Minister understood each of them.\(^\text{120}\)

Thus, the government cannot use the Courts to implement a different scheme than that provided for in the Act. But in the view of the authors, the statement has no application in the case of an APA. As far as it goes, the authors have no quarrel with the approach that the Minister cannot simply invent a scheme and apply it in the name of a compromise. To do so would be to decrease certainty for those taxpayers who follow the rules.

However, this principle has no general application in the case of an APA. The CRA is not refusing to apply the legislative scheme here. Rather, the purpose of the APA is to give operational effect to the concept of the arm's-length principle. Section 247 demands exactly that. Therefore, the statement is of limited help here, since an APA simply puts a regulatory "meat" on the statutory "bones" of the Act. The regulatory statements make clear what will qualify as appropriate transfer pricing. The taxpayer may govern their transfer pricing choices so as not to run afoul of section 247.

\(^{119}\) *Galway v Canada (Minister of National Revenue - MNR)*, [1974] 1 FC 600, [1974] FCJ No 80 (FCA), The Court (Jackett CJ, and Justices Thurlow, and Pratte (as he then was)) [*Galway*].

\(^{120}\) *Ibid* at 602.
b. Smerchanski

In *Smerchanski v Canada*, the taxpayers (an individual and a company under his control) had signed waivers of the ability to challenge assessments made by the Minister. The grounds for challenge were as follows: (a) it would be illegal at common law for the consideration for a contract to be a promise not to prosecute for criminal behaviour; (b) there was coercion or undue influence by the government; and (c) the agreement was contrary to public policy in that it would stifle the right of the taxpayer to challenge in the courts government assessment of tax.

Clearly, the use of the term "consideration" and "undue influence" have particular meaning in the contractual context. Therefore, there is no denying that at least *prima facie* the case is dealt with on the basis of contract. But the most powerful statement (of the majority) that the case was decided by treating the waiver as a contractual document is found in the final paragraph of the judgment of Chief Justice Laskin. After referring to American and British legislation allowing settlements of tax litigation, he writes as follows:

"I do not regard these provisions as necessarily pointing to the common law invalidity of all contractual settlements made in the knowledge of probable prosecution and in order to avoid it. Rather they represent an acknowledgement of practice by seeking to put beyond dispute the power of the tax collector to settle or compromise tax liability, even if there be wilful evasion leaving the taxpayer open to possible or probable prosecution."

Oddly enough, the Court found that the appellant taxpayer had waived his right to challenge the assessment of the Minister. What is

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121 *Smerchanski v Minister of National Revenue*, [1977] 2 SCR 23, 1976 CanLII 174 (SCC), Laskin CJC for the majority [*Smerchanski cited to SCR*].
122 *Ibid* at 25.
123 *Ibid*.
124 For consideration, see the discussion in Part III.A., above, with respect to the basic elements of a contract. Undue influence is a ground upon which a contract may be invalidated. See *Bank of Montreal v Duguid*, 47 OR (3d) 737, 2000 CanLII 5710 (Ont CA), Osborne ACJ, for the majority; *Morrison v Coast Finance Ltd et al* (1965), 55 DLR (2d) 710, 54 WWR 257 (BCCA), Davey JA.
125 *Smerchanski*, *supra* note 121 at 34 [*emphasis added*].
126 *Ibid*. 
problematic about this case is that a settlement with the government can be viewed as a contract that binds the taxpayer only. This is most problematic because, in essence, only one party will be bound to the contract (i.e., the taxpayer), while the other potential party (i.e., the government) will not be bound. This will be dealt with in more detail below. But the underlined words make clear that the public policy at stake in Smerchanski ("common law invalidity of all contractual settlements made in the knowledge of probable prosecution and in order to avoid it"\textsuperscript{127}) should not necessarily make all tax settlements unenforceable. The authors agree that civil liability and criminal sanction ought to be kept separate absent specific statutory authorization to do otherwise.

For current purposes, however, it is quite clear that the acceptance of settlements is viewed through a contractual lens. It is true that such contracts are perhaps subject to greater restraint than are other contracts. This is due in part to the legislative restrictions that are placed on administrative government actors, such as the need for a perception of fairness in public administration. However, once these public goods are taken into account, the law of contract can be applied.

c. Cohen

In this case,\textsuperscript{128} the Minister had agreed to assess a certain accretion to wealth as a capital gain. When the Minister sought to reassess, the taxpayer claimed that this was beyond the powers of the Minister.\textsuperscript{129} The Court disagreed, relying on Galway.\textsuperscript{130} Justice Pratte wrote as follows:

In my view, the Trial judge correctly dismissed that argument. "... 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 ...". The agreement whereby the Minister would agree to assess income tax otherwise in accordance with the law would, in my view, be an illegal agreement.\textsuperscript{131}

\textsuperscript{127} Ibid at 34.
\textsuperscript{128} Cohen v The Queen, [1980] CTC 318, 80 DTC 6250, 1980 CarswellNat 252 (WL Can) (FCA), Pratte J [Cohen].
\textsuperscript{129} Ibid at 318.
\textsuperscript{130} Galway, supra note 119; Cohen, supra note 128 at 319.
\textsuperscript{131} Cohen, supra note 128 at 319.
This is perhaps the strongest statement of an argument in favour of \textit{per se} invalidity of any settlement made by the Crown in the taxation context. However, if one looks at the reasons for this holding, it is the avowedly statutory duty of the Minister to enforce the tax law as she or he understands it that prevents the Court from accepting that the Crown is bound to follow through on the negotiated assurances with the taxpayer.\footnote{Ibid.} As was mentioned above, and as will be discussed further below, the law demands that the Minister apply the law. But an APA does not deviate from the law. Rather, it is a factual and legal agreement whereby the taxing authority or authorities involved discuss with both each other and the taxpayer (using, among other information, the information provided by the taxpayer as to the transfer pricing methodology used to explain why the pricing used by the member-entities of the MNE are appropriate) and devise what is "reasonable" for the purposes of section 247. Viewed in this light, an APA is consistent with the avowed statutory duty of the Minister, and thus, in the view of the authors, does not run counter to Cohen.

\textit{d. Ludmer}

In this case, the taxpayers had a certain portion of their income assessed in a particular way prior to 1981.\footnote{Ludmer v Canada (1994), [1995] 2 FC 3 (FCA) at 7, leave to appeal to SCC refused, [1995] SCCA No 71 [Ludmer].} Much later, the taxpayers were reassessed for the period from 1981 to 1985 inclusive in a way that was contrary to the way that the taxpayers had been assessed previously.\footnote{Ibid.} In challenging the reassessments for 1981 to 1985 inclusive, the taxpayers wanted to point to their earlier assessments as proof of an admission by the Minister.\footnote{Ibid at 8.} The Court held (quite rightly, in the view of the authors) that the prior actions of the Minister are not an admission by him.\footnote{Ibid at 8-9.} It would also run immediately contrary to the express provisions of the Act.\footnote{Ibid at 9.} The authors agree with this assessment. However, it is only marginally connected with the point made in this article. The parties in \textit{Ludmer} were trying to bind the Minister to continue past practice with respect to their treatment of certain types of income and deductions without a specific agreement to that effect,
while at the same time unjustifiably nullifying reassessment rights provided to
the Minister under the Act if their arguments were accepted.\textsuperscript{138}

Then, Deputy Justice Chevalier considered the alleged application of
the doctrines of both promissory estoppel and reasonable expectation on
these facts. Both were rejected.\textsuperscript{139} The Deputy Justice cited the judgment of
Marceau JA in \textit{Canada (Minister of Employment and Immigration) v Lidder}\textsuperscript{140} for
the propositions that:

(a) promissory estoppel cannot dictate non-compliance with an
otherwise applicable statutory duty;\textsuperscript{141} and
(b) “the misstatement, the negligence or the simple
misrepresentation of a government worker” would generally be
irrelevant to the tax liability of the taxpayers.\textsuperscript{142}

With respect to the doctrine of reasonable expectations, the Court
again cited \textit{Lidder} (which in turn cited \textit{Reference re Canada Assistance Plan
(B.C.)})\textsuperscript{143} in holding that the doctrine did not confer substantive rights on the
taxpayers:

It was suggested in the course of the argument that, if the
doctrine of estoppel could not apply, maybe the related doctrine
of "reasonable or legitimate expectation" could. The suggestion
was to no avail because this doctrine suffers from the same
limitation that restricts the doctrine of estoppel. A public
authority may be bound by its undertakings as to the procedure it
will follow, but in no case can it place itself in conflict with its
duty and forego the requirements of the law. As was repeated by
Sopinka J. recently in writing the judgment of the Supreme Court
in \textit{Reference re Canada Assistance Plan (B.C.)} ... :

There is no support in Canadian or English cases for the
position that the doctrine of legitimate expectations can
create substantive rights. It is a part of the rules of
procedural fairness which can govern administrative
bodies. Where it is applicable, it can create a right to
make representations or to be consulted. It does not

\begin{itemize}
  \item \textsuperscript{138} \textit{Ibid} at 8-9.
  \item \textsuperscript{139} \textit{Ibid} at 9-12.
  \item \textsuperscript{140} \textit{Canada v Lidder}, [1992] 2 FC 621, 1992 CarswellNat 31 (FCA) \textit{[Lidder]}.
  \item \textsuperscript{141} \textit{Lidder}, supra note 133 at 10-11.
  \item \textsuperscript{142} \textit{Ibid} at 11.
  \item \textsuperscript{143} \textit{Re Reference re Canada Assistance Plan (B.C.)}, [1991] 2 SCR 525 at 557-558, 58 BCLR (2d) 1 \textit{[Canada Assistance Plan]}.
\end{itemize}
The reason that this is relevant to our analysis is as follows: First, the statutory duty of the Minister can be complied with within the context of the APA. Therefore, the first element (breach of a statutory duty) is absent. Second, the Supreme Court talks about the difference between procedural protections, on the one hand, and substantive rights on the other. In the suggestions made in Part III.E., below, the authors are discussing a right to react to the decision of the government in structuring their affairs. Therefore, even accepting the “no substantive rights” language of the Supreme Court of Canada, this does not preclude a contractual analysis.

e. Goldstein

In Goldstein v The Queen, the taxpayer had received informal assurances from government officials about the particular treatment of a piece of his income. After setting out the applicable facts, Justice Bowman (as he then was) of the Tax Court of Canada wrote at some length about the ability of government officials to bind government to a particular course of action in the tax context. Relying on the judgment of Martland J in Canadian Superior Oil Ltd v Paddon-Hughes Development Co Ltd, Justice Bowman sets out the elements of estoppel. Then he held that estoppel is not merely a rule of evidence and can apply substantively. The doctrine does bind the government. Although the Court did not say so directly, the rule of law applies to government as well. The Court then decided against the taxpayer, holding that the doctrine cannot require an interpretation contrary to law.

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144 Lidder, supra note 140 at 625 [citation omitted]; Ludmer, supra note 133 at 10-11 [citation omitted].
145 Goldstein v R, 96 DTC 1029 at 1031-1032, 1995 CarswellNat 438 (TCC) [Goldstein].
146 Ibid at 1033.
148 The three elements of estoppel are: (a) “[a] representation or conduct amounting to a representation intended to induce a course of conduct on the part of the person to whom the representation is made”; (b) “[a]n act or omission resulting from the representation, whether actual or by conduct, by the person to whom the representation is made”; and (c) [d]etriment to such person as a consequence of the act or omission”, Goldstein, supra note 145 at 1034; Canadian Superior Oil, supra note 147 at 939-940.
149 Goldstein, supra note 145 at 1034.
150 Ibid.
151 Ibid. The Court held that the application of the doctrine was inappropriate, not “because such representations give rise to an estoppel that does not bind the Crown, but rather, because no estoppel can arise where such representations are not in accordance with the law”, ibid [emphasis added].
The Court says that it is not the responsibility of the Crown that is at issue, but rather the obligation of the Court, once the case gets to it, to apply the law.\textsuperscript{152}

Several elements come out of this analysis. First, the doctrine of estoppel can apply to the government. Second, the elements of the doctrine are three-fold: (a) a representation by someone with the legal power to make it, intended to induce action by another party; (b) action or inaction by the other party in reasonable reliance on the representation; (c) detriment to the other party that would result if the first party were allowed to contravene its earlier representation. Third, the doctrine can affect not only evidentiary issues, but can affect the substantive rights of the representor. Fourth, the doctrine is unlikely to apply where the representation is contrary to law as found by a court. Fifth, a court cannot be bound to give effect to an interpretation that is contrary to law. Sixth, and related to the previous two points, the taxing authorities cannot be prevented from taking a position in court that is contrary to what was said to the taxpayer. The lawyers for each of the parties, as officers of the Court, must put forward their best understanding of the law, so that the Court may decide in accordance with the law. Therefore, even if the party (the Minister) was bound to put forward or promote the statement made to the taxpayer, the Court cannot be bound to accept it.

The statement in \textit{Goldstein} would seem to negate the idea of a contractual underpinning to an APA. However, in the view of the authors, this is not the case. In a footnote at the conclusion of the excerpt provided above, Justice Bowman, as he then was, wrote as follows:

\begin{quote}
I leave aside entirely the question of advance rulings which form so important and necessary a part of the administration of the \textit{Income Tax Act}. These rulings are treated by the Department of National Revenue as binding. So far as I am aware no advance ruling that has been given to a taxpayer and acted upon has ever been repudiated by the Minister as against the taxpayer to whom it was given. The system would fall apart if he ever did so.\textsuperscript{153}
\end{quote}

\textsuperscript{152} \textit{Ibid.} The Court held as follows: "The question is not whether the Crown is bound by an earlier interpretation upon which a taxpayer has relied. It is more to the point to say that the courts, who have an obligation to decide cases in accordance with the law, are not bound by representations, opinions or admissions on the law expressed or made by the parties", \textit{ibid} [emphasis added].

\textsuperscript{153} \textit{Ibid.}
Again, several elements come out of this excerpt. First, advance rulings are outside of the general principles to which Justice Bowman, as he then was, referred in the more extensive excerpt reproduced earlier in this paper. Second, the Department of National Revenue treats these rulings as binding. Third, these rulings are critical to the proper functioning of the Act and its administrative structure. What is unclear is whether there is a legal basis for the assertion that the rulings of the Department are in fact binding. As the cases so far make clear, what appears to be binding may or may not be, depending on the circumstances. We will discuss this further below.

\[f. \text{ Consoltex}\]

In this case, the issue was the proper interpretation of expenses and revenue related to scientific research and experimental development. In particular, there was a settlement reached with respect to the treatment of certain revenue received by the taxpayer, where the underlying expenses to earn that revenue were already subject to treatment as scientific research and experimental development expenses. Even though the parties had reached a settlement, the taxpayer wished to repudiate it.

The Court was directly confronted with the strongest possible interpretations of the \textit{Smerchanski} and \textit{Cohen} cases. The Court clearly saw a problem with the approach that would suggest that the Minister can never be bound to a settlement. At paragraph 35, the Court quoted Professors Peter W. Hogg and Joanne Magee:

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\text{The effect of the \textit{Smerchanski} and \textit{Cohen} cases is that the taxpayer is bound by a settlement agreement, but the Minister is not. Of course, a settlement of litigation that was implemented by a formal entry of judgment would then have the force of a court judgment, which is binding on both parties. However, in Galway \textit{v. Minister of National Revenue} (1974), the Federal Court of Appeal refused an application for a consent judgment to implement the terms of a settlement agreement between the Minister and a taxpayer. According to the Court, the Minister has no power to assess in accordance with a "compromise settlement", and the Court should not sanctify an \textit{ultra vires} act. The Minister's duty is}
\]

\[\text{154 Consoltex Inc \textit{v Canada}, 1997 CarswellNat 196 (WL Can) at para 2, 97 DTC 724 (TCC), Bowman TCJ (as he then was) [Consoltex].}\]
\[\text{155 Ibid at paras 22-28.}\]
\[\text{156 Ibid at paras 25, 30.}\]
to assess in accordance with the law, and the only kind of settlement that the Court would be prepared to implement by a consent judgment would be one in which the parties were agreed on the application of the law to the facts.

The attitude of the Federal Court of Appeal in Cohen and Galway is far too rigid and doctrinaire. If the Minister were really unable to make compromise settlements, he or she would be denied an essential tool of enforcement. The Minister must husband the Department’s limited resources, and it is not realistic to require the Minister to insist on every last legal point, and to litigate every dispute to the bitter end. Most disputes about tax are simply disputes about money which are inherently capable of resolution by compromise. Presumably, the Minister would agree to a compromise settlement only on the basis that it offered a better net recovery than would probably be achieved by continuance of the litigation. It seems foolish to require the Minister to incur the unnecessary costs of avoidable litigation in the name of an abstract statutory duty to apply the law.157

Similar sentiments were expressed by Professors Hogg, Magee and Li in the eighth edition of the same text.158 The Court in Consoltex adopts these sentiments in the next paragraph of the judgment.159

Thus, in the view of the authors, Tax Court Judge Bowman, as he then was, implicitly rejects the strong version of both Smerchanski and Cohen. Secondly, he clearly does not like any of the options open to him on his reading of the case law.160 Third, Justice Bowman, as he then was, does not state that Cohen is the law; rather, he assumes it to represent the law.161 Finally, he chooses the least unpalatable alternative of the choices that remained.162

Several points need to be made here. First, an APA is not extra-statutory settlement. It is a recognition that the Act must operate within a global context. The Act itself contemplates a tax credit for the amount for the tax assessed on the taxpayer’s worldwide income otherwise taxable in

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158 Hogg, Magee & Li, supra note 102 at 569-570.
159 Consoltex, supra note 154 at para 36.
160 Ibid at paras 36-38.
161 Ibid at para 37.
162 Ibid at para 36.
Canada. Therefore, the Act generally seeks to avoid double taxation. Tax treaties serve the same purpose, among others.

Second, the concept of transfer pricing itself contemplates collaboration between related business entities. Some of this is acceptable from a tax perspective; too much is not a good thing due to excessive revenue loss. Collaboration between taxing authorities in a global economy is an effective mechanism to allow acceptable collaboration and curb the unacceptable consequences. Collaboration between taxing authorities is only possible if the system does not demand that every taxing authority has to take every dollar to which it may be entitled under its own rules. Therefore, these first two points make it clear that there is a significantly different policy context at play with the collaborative approach to transfer pricing versus other settlement discussions (given that in the latter, there is already a significant adversarial context between the parties).

Third, when reading between the lines, it appears to the authors that, if left to his own devices, Tax Court Judge Bowman would not have applied *Cohen* at all. However, it appears he felt, based on the doctrine of *stare decisis*, that he was obligated to apply it. Therefore, he expressed disagreement with the precedent, but moved on to apply it in spite of his own misgivings. This is consistent with the approach put forward by Justice Rothstein on behalf of the unanimous Supreme Court of Canada in *Craig*. 164

Thankfully for the authors of this article, *stare decisis* does not apply here. *Galway* did not arise in an APA context. Therefore, it does not control the answer here. Furthermore, as mentioned earlier, even if a Court were inclined to apply the *Galway* standard, the point of an APA is to ensure compliance (for both the government and the taxpayer) with s. 247 of the Act. Therefore, unlike a settlement that may be outside of the powers of the Minister, the ability to enforce an APA represents a specific attempt by the parties to determine what the Act would reasonably require. In this sense, it is the antithesis of the problem addressed in much of the case law.

g. *Enterac*

In this case, the taxpayer, in objecting to an assessment, raised an agreement made with the agent of the Minister as part of settlement

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163 *The Act*, supra note 3, s 126(1). See also Edgar, Sandler & Cockfield, *supra* note 33 at 195.

negotiations. The Minister sought to delete any reference to the agreement as being irrelevant to the proceedings. The Court (speaking through the oral judgment of Justice MacDonald) held as follows in a short judgment:

It is not plain and obvious to us that the alleged agreement is irrelevant to the issues which must be resolved. Should it be determined on the evidence that the alleged agreement was within the power of the Minister to make, and providing its agent was acting within the scope of his or her authority and in accordance with the law, the Minister might be bound by the agreement.

We are all of the view that whether the Minister is bound by the agreement or indeed the existence of an agreement are matters that are best left to a Judge at a trial ...


The breadth of the Cohen and Smerchanski decisions has thus been questioned by both the Tax Court of Canada and the Federal Court. At the very least, the matter is not yet settled. The court in Enterac clearly wanted to allow parties to make submissions on the correctness of the strongest versions of Cohen and Smerchanski. The Federal Court of Appeal in this case said that it was not plain and obvious that an agreement is irrelevant to the obligations of the Minister of National Revenue. At the very least, this leads to questions about the inability of a contractual relationship to be formed with, and enforced against, the Minister.

h. Garber

In this case, the government sought to recoil from a settlement regarding allegedly improper tax losses from investment in partnership by the

165 Enterac Property Corp v Canada, 1998 CarswellNat 214, 98 DTC 6202 (FCA) [Enterac].
166 Ibid at paras 1-3.
taxpayers. The government withdrawal occurred after there was significant negotiations and agreement. The Court found that this was not in and of itself an abuse of process. Chief Justice Bowman holds the following (a) he is bound by the Cohen decision, based on Consolco; (b) there is a view of the case that no settlement is ever binding; nonetheless, such an approach would mean that the tax court system would break down; (d) there is case law to support the idea that the straight view of Cohen is controversial (including Enterac); (e) however, on these facts, the Department of Justice could repudiate the agreement, and it did so; and (f) factually, once the Department repudiated the agreement, the taxpayer moved to negotiate again. Therefore, there was no abuse.

From the point of view of the authors, the most salient point for current purposes is that the Chief Justice of the only court in the country that deals exclusively with tax disputes believes that a per se rule against the enforceability of tax settlements as against the government is, at best, highly problematic.

i. 1390758 Ontario Corp.

In this case, the taxpayer had entered into an agreement with the government. The agreement was also connected with agreements for the spouse of the taxpayer and a company of which the taxpayer was the controlling shareholder. Justice Bowie of the Tax Court, after a fairly exhaustive review of the case law, wrote as follows:

35 I agree with Bowman C.J. and the authors Hogg, Magee and Li that there are sound policy reasons to uphold negotiated settlements of tax disputes freely arrived at between taxpayers and the Minister's representatives. The addition of subsection 169(3) to the Act in 1994 is recognition by Parliament of that. It is not for the Courts to purport to review the

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167 Garber v Canada, 2005 TCC 635 (CanLII) at para 21.
168 Ibid at paras 38-39.
169 Ibid at para 23.
170 Ibid.
171 Ibid.
172 Ibid at para 24.
173 Ibid at paras 36-37.
174 1390758 Ontario Corp v Canada, 2010 TCC 572 (CanLII) [1390758 Ontario Corp].
175 Ibid.
propriety of such settlements. That task properly belongs to the Auditor General.

36 The reality is that tax disputes are settled every day in this country. If they were not, and every difference had to be litigated to judgment, unmanageable backlogs would quickly accumulate and the system would break down.

37 The Crown settles tort and contract claims brought by and against it on a regular basis. There is no reason why it should not settle tax disputes as well. Both sides of a dispute are entitled to know that if they invest the time and effort required to negotiate a settlement, then their agreement will bind both parties.176

This, in the view of the authors, is a strong commitment to fairness in two different senses. Would a taxpayer be less likely to enter into settlement discussions with the Canada Revenue Agency if the taxpayer was told unequivocally that the government could walk away from a settlement without consequence? Fairness to the courts could be said to demand that those disputes that can be settled without the intervention of a neutral arbiter should be settled by the parties themselves. Second, fairness to the taxpayer could be said to demand that those who set the rules (the government) should not be able to exploit ambiguities in their own drafting. In contractual terms, this is known as “contra proferentem”.177 Where a settlement is clearly contrary to the Act, the authors agree that different policy considerations apply.

Immediately following the excerpt above, the Court found that Galway and Cohen could to an extent be reconciled with Smerchanski, as essentially flip sides of the same coin.178 The Court found that the agreement made could have been a result reached after a trial.179 The Court stated the following:

176 Ibid at paras 35-37.

Section 169(3) of the Act states the following: “(3) Notwithstanding section 152, for the purpose of disposing of an appeal made under a provision of this Act, the Minister may at any time, with the consent in writing of the taxpayer, reassess tax, interest, penalties or other amounts payable under this Act by the taxpayer”. See the Act, supra note 3, s 169(3).

177 See Tercon Contractors Ltd v British Columbia (Ministry of Transportation and Highways), 2010 SCC 4 at paras 61-62, [2010] 1 SCR 69, Cronwell, J.

178 1390758 Ontario Corp, supra note 174 at paras 38-40.

179 Ibid at para 40.
I have come to the conclusion, contrary to the views of Bowman C.J. and Professor Hogg to which I have referred, that it is possible to reconcile the decision in Smerchanski and Cohen.

The decisions in Galway and Cohen are grounded in the perceived illegality of the assessments that the Minister would have to make in order to consummate those settlements. In Smerchanski there was no suggestion that the assessments were anything other than the result that flowed from the application of the law to the facts that were revealed by the audit. It is obvious, surely, that in the course of the litigation process additional facts may come to light, and some facts that the Minister may have thought to be true turn out not to be. It is even possible that the Minister may, in the course of negotiations, be persuaded that his initial view of the law was not totally correct.

In the present case, I have no reason to believe that the reassessments that the Minister has already made of both the corporation and Peter Tindall, or the redeterminations that will be made of Susan Tindall's CTB [Child Tax Benefit] entitlements, are not justifiable on the facts and the law. Put another way, the results agreed to are results that could be arrived at following the trial of all three cases on their merits. That being so, it is Smerchanski, and not Cohen and Galway, that applies.

A question arose during the hearing of the motion before me as to whether there was consideration for the settlement in this case. The appellant was entitled by subsection 111(1) of the Act to carry forward its prior years' losses. The elimination of the interest and the failure to file penalty were, as I understand it, eliminated by the application of those losses to the years under appeal.\textsuperscript{180}

Clearly, the Court believed that the enforceability of a settlement is the product of a contractual analysis.\textsuperscript{181} Perhaps even more importantly, the Court also believed that the various strands of jurisprudence could be rationalized.\textsuperscript{182} The authors will attempt to explain one possible approach to rationalize the case law below.\textsuperscript{183}

\textit{j. CIBC World Markets Inc.}

\footnotesize{\textsuperscript{180} Ibid at paras 38-41.\\ \textsuperscript{181} Ibid at paras 41-42.\\ \textsuperscript{182} Ibid at paras 38-39.\\ \textsuperscript{183} See Part III.D.3. below.}
In this case, the taxpayer was seeking higher than normal costs because it had made an offer of settlement that was greater than received by the government at the end of the trial. Two arguments were made in response. Firstly, on a procedural basis, the taxpayer had not complied with the requirements to make a demand for higher costs related to the proceedings from an appeal. Secondly, the government argued that the offer of settlement could not be accepted “on the facts and the law of this particular case”. The Court accepted both arguments of the government. With respect to the second of these, Justice Stratas held that the question before the Minister was capable of only a “yes/no” answer. Therefore, based on this, the Court found that the 90/10 split proposed in the offer of settlement was not in accordance with the Excise Tax Act, because there was no provision that allowed for a settlement contrary to the Act. Justice Stratas continued by pointing to Galway and Cohen as justifications for not allowing a settlement outside of the terms of the Act or the facts agreed by the parties. He then held that where the settlement is consistent with the law and facts, it can be enforced based on Smerchanski and 1390758 Ontario Corporation. The Court then dismissed the policy problems of the ability of the tax system to operate without enforceable settlements; the Court sidesteps the issue, pointing out that such an issue needed to be considered in the context of a “forest” of other policy issues.

The most interesting part of this most recent decision is that it does not take a strong position against the enforceability of compromise settlements. Rather, the settlement agreed to must be consistent, not only with the law (at least as understood by the Minister in making an assessment), but also with the facts as agreed. Since the parties here had never discussed any factual difference between the inputs that would be accepted as part of the settlement, on the one hand, and those that would not, on the other, the facts did not accord with the settlement. Therefore, the settlement could not be accepted.

184 CIBC World Markets Inc v Canada, 2012 FCA 3 (CanLII) at paras 1-4, Stratas JA, for the Court [CIBC].
185 Ibid at paras 6-7.
186 Ibid at para 16.
187 Ibid at paras 16-17.
189 CIBC, supra note 184 at paras 18-21, 25.
190 Ibid at paras 22-23.
191 Ibid at para 24.
192 Ibid at paras 26-28.
2. The UK

a. A Cautionary Tale

Below, the authors discuss some of the leading cases on fairness in British income tax law. This is not a lengthy discussion. There are two reasons for this. First, as the title of the article points out, this is a domestic analysis of the application of the law of contracts to an APA context. Therefore, an extensive discussion would expand this article beyond the parameters set by the authors. Second, care must be taken before applying them to the Canadian context. As the excerpt below from Ludmer makes clear, some of the basic underpinnings of the systems of taxation are different, and the amount of discretion is one such difference. Deputy Justice Chevalier puts it as follows (at para. 43):

In Preston (at page 337), Lord Templeman wrote concerning the remedies available to British taxpayers:

In most cases in which the commissioners are said to have fallen into error, the remedy of the taxpayer lies in the appeal procedures provided by the tax statutes to the General Commissioners or the Special Commissioners. This appeal structure provides an independent and informed tribunal which meets in private so that the taxpayer is not embarrassed in disclosing his affairs and the commissioners are not inhibited by their duty of confidentiality. The commissioners and the tribunal established to hear appeals from the commissioners have wide knowledge and experience of fiscal law and practice. Appeals from the General Commissioners or the Special Commissioners lie, but only on questions of law, to the High Court by means of a case stated and the High Court can then correct all kinds of errors of law including errors which might otherwise be the subject of judicial review proceedings: see Edwards (Inspector of Taxes) v Bairstow [1955] 3 All ER 48, [1956] AC 14. Judicial review process should not be allowed to supplant the normal statutory appeal procedure. ...

The situation in Canada is fundamentally different. Neither the Minister of National Revenue nor his employees have any discretion whatever in the way in which they must apply the

\[\text{Ludmer, supra note 133.}\]
Income Tax Act. They are required to follow it absolutely, just as taxpayers are also required to obey it as it stands. The institution of Commissioners equipped with broad powers and an extensive discretion to deal with particular cases does not exist here. Accordingly, it is not possible to judge their actions by varying and flexible criteria such as those required by the rules of natural justice. In determining whether their decisions are valid the question is not whether they exercised their powers properly or wrongfully, but whether they acted as the law governing them required them to act.\textsuperscript{194}

The authors agree that these differences are present between the Canadian and British systems of taxation. Despite these differences, however, some concepts have a certain amount of purchase in this context. In particular, the concept of fairness can, in the view of the authors, be an effective tool in Canada where such fairness does not contravene the Act.

b. \textit{MFK Underwriting Agencies Ltd}

The first case that we wish to discuss is \textit{R v Board of Inland Revenue, ex parte MFK Underwriting Agencies Ltd and others and related applications}.\textsuperscript{195} The case turned on the tax treatment of certain payments related to indexation. The applicants claimed that there was a representation by the Revenue that the payment would be treated as capital.\textsuperscript{196} Lord Justice Bigham, as he then was, held as follows:

The Revenue could not without breach of statutory duty agree or indicate in advance that it would not collect tax which, on a proper construction of the relevant legislation, was lawfully due.\textsuperscript{197}

The authors have no disagreement with this statement as far as it goes. As was pointed out in the discussion of \textit{Galway},\textsuperscript{198} the use of an APA does not contradict the choices of Parliament by administrative action. Rather, it simply allows for the negotiation between the taxpayer and the

\textsuperscript{194} \textit{Ibid} at 17.
\textsuperscript{195} \textit{R v Board of Inland Revenue, ex parte MFK Underwriting Agencies Ltd and others and related applications}, [1990] 1 All ER 91 (Lexis and QL) (QBD) [MFK Underwriting Agencies Ltd].
\textsuperscript{196} \textit{Ibid} at 94.
\textsuperscript{197} \textit{Ibid} at 108.
\textsuperscript{198} \textit{Galway, supra note} 119.
taxing authority to determine what is a reasonable arm’s-length price for the
good or service which is subject to transfer within the members of the MNE.
What is also important is the following statement by the same Lord Justice:

So if, in a case involving no breach of statutory duty, the
Revenue makes an agreement or representation from
which it cannot withdraw without substantial unfairness to
the taxpayer who has relied on it, that may found a
successful application for judicial review.¹⁹⁹

He continued with the following:

I am, however, of opinion that in assessing the meaning,
weight and effect reasonably to be given to statements of
the Revenue the factual context, including the position of
the Revenue itself, is all important. Every ordinarily
sophisticated taxpayer knows that the Revenue is a tax-
collecting agency, not a tax-imposing authority. The
taxpayers’ only legitimate expectation is, prima facie, that
he will be taxed according to statute, not concession or a
wrong view of the law (see R v A-, ex p Imperial Chemical
Industries plc (1986) 60 TC 1 at 64 per Lord Oliver). Such
taxpayers would appreciate, if they could not so pithily
express, the truth of Walton J’s aphorism: ‘One should be
taxed by law, and not be untaxed by concession’ (see Vestey
v IRC (No 1) [1977] 3 All ER 1073 at 1098, [1979] Ch 177
at 197). No doubt a statement formally published
by the Revenue to the world might safely be regarded as binding,
subject to its terms, in any case falling clearly within them.
But where the approach to the Revenue is of a less formal
nature a more detailed inquiry is, in my view, necessary.²⁰⁰

Quite clearly, to create a reasonable expectation in the taxpayer, there
must be a clear and unambiguous statement by a public authority on which
reasonable reliance is placed.²⁰¹

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¹⁹⁹ MFK Underwriting Agencies Ltd, supra note 195 at 109 [emphasis added].
²⁰⁰ Ibid at 110.
²⁰¹ Re Croft’s Application, [1997] NI 1 at 18 (Lexis and QL) (QBD), Carswell LCJ; R v Jockey Club, ex parte
RAM Racecourses Ltd, [1993] 2 All ER 225 (Lexis and QL) at 236, Stuart-Smith LJ.
Much of the rest of the judgment is focused on the elements the presence of which would allow the taxpayer to rely on an informal statement of the taxing authority. Again, these elements are not at the heart of the argument. There can be little doubt that a publicly available missive of the CRA should be considered a “formal statement.” Therefore, the “more detailed inquiry” referred to by Lord Justice Bingham need not be made.

Thus, the jurisprudence of the United Kingdom is quite clear that, though the administrative arm of government cannot decide not to collect tax due, if there is a specific formal statement that does not contradict the legislative scheme, that is reasonably relied upon, the statement may not be withdrawn to the detriment of the taxpayer. We return to this theme below.

c. Argyll House Developments Ltd

In R (on the application of Argyll House Developments Ltd) v Revenue and Customs Commissioners, Lord Woolman for the Court held that though it could enforce what it referred to as “an extra-statutory concession”, it refused to do so where it was not clear that the taxpayer fell within the terms of the concession. The Court cited MFK Underwriting Agencies Ltd for the proposition that the reasonable expectation is to be taxed in accordance with law.

3. Rationalizing the Case Law

The authors believe that, despite some of the broad and often contradictory language of the various cases, their holdings can be rationalized into a relatively cohesive whole. The principles of such a cohesive whole might be seen as follows:

1. Unlike the British taxation system, where there is some discretion, in Canada, there is very little discretion (Ludmer). The United States Tax Code provides for statutory discretion to settle claims;

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202 MFK Underwriting Agencies Ltd, supra note 195 at 110.
204 MFK Underwriting Agencies Ltd, supra note 195.
205 Argyll House Developments Ltd, supra note 203 at para 25.
206 Ludmer, supra note 133.
2. However, a number of cases have held that settlements are a necessary part of the Canadian tax system (Goldstein;\textsuperscript{207} Enterac;\textsuperscript{208} Consoltex;\textsuperscript{209} 1390758 Ontario Corp;\textsuperscript{210});

3. The legal construct that supports the enforceability of a settlement is that of a contract (Smerchanski;\textsuperscript{211});

4. Without the basic elements of a contract, any statement by the taxing authorities will ordinarily not bind the Minister. This includes prior treatment of accretions to wealth by the taxpayer and related parties (Ludmer;\textsuperscript{212});

5. Generally, it is not acceptable to have a single party bound to a contract, while the other party is not bound (Consoltex;\textsuperscript{213});

6. While there are more restrictions on the ability of the government to enter into such contracts, the government can be bound to these contracts under the correct circumstances (1390758 Ontario Corp;\textsuperscript{214});

7. However, it is possible as a matter of law for the taxpayer to waive rights of appeal where they willingly do so (Smerchanski;\textsuperscript{215});

8. Any settlement cannot contravene the Act. The Minister has a statutory duty to apply the Act. For example, if a settlement called for Canadian income tax to be imposed on a non-resident without any connection to Canada, this would be indefensible as the Act provides no means by which such tax could be imposed, even if the non-resident were to agree to pay such tax if imposed (Galway;\textsuperscript{216} Cohen;\textsuperscript{217});

9. However, this does not mean that the Minister must extract every penny of revenue to which the government may legitimately be entitled in order to comply with the Act (Garber;\textsuperscript{218});

\textsuperscript{207} Goldstein, supra note 145.
\textsuperscript{208} Enterac, supra note 165.
\textsuperscript{209} Consoltex, supra note 154.
\textsuperscript{210} 1390758 Ontario Corp, supra note 174.
\textsuperscript{211} Smerchanski, supra note 121.
\textsuperscript{212} Ludmer, supra note 133.
\textsuperscript{213} Consoltex, supra note 154.
\textsuperscript{214} 1390758 Ontario Corp, supra note 174.
\textsuperscript{215} Smerchanski, supra note 121.
\textsuperscript{216} Galway, supra note 119.
\textsuperscript{217} Cohen, supra note 128.
\textsuperscript{218} Garber, supra note 167.
10. Instead, it requires that the settlement be defensible in light of both the law (as understood by the Minister) and the facts as agreed by the parties (CIBC World Markets Inc\(^{219}\));

11. The more carefully negotiated and detailed a settlement, the less likely it is that the Court should interfere, as long as the settlement does not contravene the Act; (Smerchanski\(^{220}\));

12. The law of estoppel can apply to government (Goldstein\(^{221}\));

13. The law of estoppel cannot mandate the breach of a statutory duty (Ludmer\(^{222}\));

14. The law of estoppel generally does not create substantive rights to a result. However, procedural rights such as consultation may be created and enforced (Ludmer\(^{223}\));

15. While we have discussed these cases in great detail, none of them revolve around an APA. As such, the doctrine of *stare decisis* has no application.

E. Can the Government End an APA?

The quick answer is “of course.” This begs the following questions: first, how should the taxpayer be treated to end the APA if the government chooses to do so? Second, what would be the legal mechanism to achieve this? It is to these questions that the authors now turn their attention.

However, it should be made clear at the outset that if the APA is “revoked” for misdeeds of the taxpayer (either negligence or intentional conduct), the analysis offered here would be far less likely to apply. For example, if the taxpayer materially misleads the taxing authority or authorities in the negotiation of the APA, the taxpayer should not receive the tax benefit until the true state of affairs is discovered. To do so would be to provide a perverse economic incentive\(^{224}\) for dishonesty where honesty in self-reporting is a precondition to the appropriate functioning of the system. If the taxpayer

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\(^{219}\) CIBC, *supra* note 184.

\(^{220}\) Smerchanski, *supra* note 121.

\(^{221}\) Goldstein, *supra* note 145.

\(^{222}\) Ludmer, *supra* note 133.

\(^{223}\) Ibid.

\(^{224}\) An economic incentive is perverse in this sense where it promotes behaviour that is counter to the proper functioning of the system. Canadian tax law relies on self-reporting. If taxpayers were to benefit even temporarily from dishonesty, this encourages dishonesty even though the system depends on the honesty and forthrightness of the taxpayer. Therefore, we need to remove the economic incentive that would promote dishonesty.
knows or ought to know that telling the truth would mean that the Minister
would be unlikely to enter into an APA, the taxpayer might be tempted to
give false information to attempt to secure the more favourable tax treatment
of an APA. However, upon discovering the dishonesty of the taxpayer, there
is a prophylactic purpose to removing the economic incentive to be
dishonest. This may be done by removing any and all economic gain that
might result from the dishonest behaviour. Thus, the analysis offered here
does not seek to protect the taxpayer who is dishonest. Rather, it seeks to
protect the innocent taxpayer who is caught “flat-footed” by a unilateral
government decision to which the actions of the taxpayer did not contribute
to ensure that the taxpayer has a reasonable opportunity to arrange his, her or
its affairs in light of the government decision.

1. The Treatment of the Taxpayer

If there were a single word to explain the level of treatment that the
taxpayer should be entitled to expect, it is “fair.” The cases, particularly from
the UK, are replete with the concept of administrative law fairness being
owed to the taxpayer. Quite clearly, if the taxpayer is led to adopt a series of
transactions after specific consultation with officials of the Revenue, it may be
so unfair as to necessitate a remedy. As dealt with in the review of Canadian
case law, unfairness is not an independent ground of review. However, if
there is a legal mechanism by which the courts can achieve substantive
fairness to the taxpayer without violating either the common law or the Act,
the authors see no reason for unfairness simply because the language of the
Act might be broad enough to allow for such a result.

2. The Legal Mechanism

On this point, see Struthers v 3464920 Canada Inc, 2007 SCC 24 at paras 75-77, [2007] SCC 24, Binnie J, for the majority. Admittedly, the case itself dealt with an alleged breach of fiduciary duty in the partnership
case, rather than the breach of a contract in the taxation context. Nonetheless, in the view of the
authors, given the public nature of the contractual actors at play, a prophylactic purpose is most decidedly
justified as a means of protecting the public purse.


In fact in at least two cases, two different Courts have allowed for the possibility that third parties may
be able to challenge what is perceived as preferential treatment of taxpayers by the Minister. See Harris v Canada, [2000] 4 FC 37 (CA) and Longley v Minister of National Revenue (1992), 66 BCLR (2d) 238 (CA).
There are two legal constructs at play here. The first of course is a contract. The second is estoppel. If one party makes a representation to the other party that the first party intends to behave in a particular way, and the second party relies to its detriment on the representation, then the second party must provide a reasonable opportunity for the first party to recover its position *status quo ante*. One can see this fairly clearly in the facts of the seminal case of *Central London Property Trust Ltd v High Trees House Ltd.*

In the case, the plaintiff was the landlord of the defendant. As war broke out in England, the defendant was short on cash, and the plaintiff apparently wanted to keep the tenants that it had. Therefore, an arrangement was made to reduce the rent. Then, after the war, the plaintiff sued to recover the full rent. Justice Denning, as he then was, wrote as follows:

> In each case the court held the promise to be binding on the party making it, even though under the old common law it might be said to be difficult to find any consideration for it. The courts have not gone so far as to give a cause of action in damages for breach of such promises, but they have refused to allow the party making them to act inconsistently with them. It is in that sense, and in that sense only, that such a promise gives rise to an estoppel. ...

> The time has now come for the validity of such a promise to be recognised. The logical consequence, no doubt, is that a promise to accept a smaller sum in discharge of a larger sum, if acted on, is binding, notwithstanding the absence of consideration, and if the fusion of law and equity leads to that result, so much the better.

As discussed above, this approach can be binding on the government, at least insofar as giving effect to the estoppel does not mandate the Minister or his or her officials or other representatives to violate the Act by acting inconsistently with their understanding of the law.

What the excerpt also makes clear is that a promissory estoppel does not create substantive rights. The breach of the APA does not create a right to damages. The taxpayer cannot sue the government for financial compensation. Rather, the estoppel creates a procedural right in the taxpayer...
to have a reasonable opportunity to comply with the law without the agreement. For the purposes of this argument, assume that the APA provided for middle-of-the-road transfer pricing methodology that the taxpayer believed that the government would tolerate on a given set of transactions. The taxpayer wanted to adopt a more aggressive transfer pricing methodology which it believes complies with the Act, but took the less aggressive approach in order to obtain the greater certainty offered by an APA with the government. The government later cancels the APA. In the view of the authors, the taxpayer must be given the reasonable opportunity to take the more aggressive transfer pricing methodology for transactions following the cancellation of the APA. To do otherwise is to allow the government to play “bait and switch.” The taxpayer has the absolute right to take the more aggressive stance as long as it is within the bounds of the law. To obtain and maintain certainty of treatment, the taxpayer chooses to forego the more aggressive stance, even though there is a defensible argument that the more aggressive stance is within the bounds of the law. In this sense, the government has negotiated a “better deal.” But, the government should not be able to enter into an agreement, get concessions from the taxpayer, and then rescind the agreement, while holding the taxpayer to the concessions made to negotiate the agreement.

Under the analysis offered in this article, there is a contract between the parties, the government is seeking to resile from it, and not pay damages to the taxpayer. While the contract is in effect, each contracting party owes obligations to the other. The obligation of the government, in the view of the authors, is to abide by the APA unless and until one of three things happens:

1. The taxpayer fails to abide by the terms of the APA either in terms of (i) utilizing the transfer pricing methodology agreed to in the APA, or (ii) breach any other term of the APA; or
2. To do so would be to place the Minister or his officials or other representatives in the position of having to breach the statutory duty to follow the Act in order to comply with the APA; or
3. The Minister has decided to end the APA, and has allowed the taxpayer sufficient time to reorganize his or her tax affairs to get as close as possible to the status quo ante.

Clearly, if there is a breach of the agreement by the taxpayer, ending the agreement is a likely outcome. After all, the Act does not provide for the payment of a penalty for breach of an APA, as the Act makes no reference to
an APA at all. Therefore, the majority of breaches of an APA are likely to be dealt with as breaches of condition that entitle the government to terminate the contract.\textsuperscript{234}

As to the second point, the authors find it unlikely that any Canadian government will “go its own way” with respect to transfer pricing issues. As mentioned earlier, these are global in scope. As a result, if Canada gets out of step with its major trading partners or developing economies on transfer pricing, it risks the competitiveness of Canada as a destination for firms, products and services, as well as Canada’s competitiveness in overseas markets. Therefore, given the work produced by the OECD and its predecessors, it is unlikely that the Act will take a completely new approach to transfer pricing. Therefore, the authors find it unlikely that a reasonable APA would ever directly contravene the Act. In the event that this does in fact occur, the duty of the Minister is to follow the law.

Finally, the third outcome seems plausible. As long as sufficient notice is given, the taxpayer has no substantive right to the continuation of the APA. However, he/she does have a procedural right to demand sufficient time to allow himself/herself to structure his/her affairs to adjust to the cancellation of the APA. This is consistent with both the law of estoppel and the rights of government, as mentioned above.\textsuperscript{235}

\textbf{CONCLUSION}

In the end, the authors have attempted to put forward a defensible approach to the application of advance pricing agreements (also called “advance pricing arrangements”). While there is significant case law on the enforcement of settlements in the taxation context, there is a dearth of case law and commentary on advance pricing agreements. The authors believe that the case law on the enforcement of settlements can be rationalized, but even if it cannot, in the view of the authors, this case law does not bind in the context of advance pricing agreements. The importance of advance pricing agreements cannot be overstated. These agreements promote certainty both for the taxpayer and the taxation authority or authorities involved. This ensures both long-term appropriate taxation for the member-entities of the multinational enterprise involved, and an appropriate division of the tax

\textsuperscript{234}For a discussion of the distinction between "conditions" and "warranties" in the contractual context, see Hongkong Fir Shipping, supra note 17.

\textsuperscript{235}Canada Assistance Plan, supra note 143; Lidder, supra note 140 at 625; Ludmer, supra note 133 at 10-11.
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revenue generated by the multinational enterprise among the jurisdictions to which it is connected for tax purposes.

The approach offered here attempts to balance the need of both the legislative and executive branches to make tax policy, while still being fair to the taxpayer. While, unlike other jurisdictions, fairness *per se* is not an independent ground of review of decisions in tax law, when applying the common law, rules that produce manifestly unfair results are rarely promulgated. Therefore, the approach offered in this article never requires the government to tax on any basis other than that provided for in the *Income Tax Act*, while protecting the reasonable expectations of the taxpayer by allowing the taxpayer time to react to the withdrawal of the advance pricing agreement and organize his, her or its affairs to the *status quo ante* (for example, by giving time for the implementation of a more aggressive tax planning strategy, should the taxpayer so choose).

It remains to be seen whether, like our neighbours to the south, the Canada Revenue Agency will attempt to extricate itself from one or more of its advance pricing agreements. Hopefully, it will not use American developments as an excuse to “test the waters” in Canada. But, if and when the Canada Revenue Agency chooses to do so, the authors believe that there is a legally defensible way (taken from the law of contracts) for the courts to protect the taxpayer and uphold the reasonable expectations of the parties to the advance pricing agreement, while allowing the government to make policy choices. Only time will tell what the taxation authorities and the courts will choose to do.