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Court Rejects Challenge to Transfer Pricing Information Request

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Court Rejects Challenge to Transfer Pricing Information Request

The Federal Court of Canada on March 20 ruled against a company's challenge of a request for information about its foreign business operations that was issued in connection with a transfer pricing audit.

Soft-Moc, a Canadian footwear retailer, had challenged the Canada Revenue Agency's foreign-based information requirement, claiming that the information sought was confidential and proprietary and that releasing the information to the CRA would harm the company's competitive advantage.

Case Background

Canadian taxpayer Bert Krista owns a 90 percent interest in Soft-Moc. In 2004, he established residence in the Bahamas and registered four new companies — ITPC Inc., Manser Inc., MWF Inc., and SoftPOS Inc. — naming himself as the sole shareholder of each. In 2005 and 2006, Soft-Moc paid what the court characterized as ''substantial amounts'' to the four Bahamian companies for merchandising services, information technology consulting, business development services, and software licensing fees. In its 2009 audit, the CRA sought information about where and how the services were provided by the Bahamian companies.

Soft-Moc provided information on its domestic operations, but Krista's counsel objected to a December 21, 2011, requirement notice, issued under subsection 231.6(2) of the Canadian Income Tax Act, seeking information about the company's foreign operations. The requirement notice contained 74 questions, including asking for information relating to the organizational structure and financial records of the Bahamian companies, the names of the companies' agents and independent buyers, the names of IT specialists used by the companies, the names and contact information for employees hired by Manser, documentation of payments made to a U.S.-based company, and any information about services provided by Manser and SoftPOS to arm's-length customers.

Asserting that it could not obtain the information requested by the CRA, Soft-Moc challenged the requirement, saying it was too broad and ''unreasonable.'' The company claimed that the scope of the requirement notice indicated that it was a ''fishing expedition.'' Soft-Moc argued that a finding that it had failed to ''substantially comply'' with the requirement notice would be ''unfairly prejudicial'' because it could bar the company from presenting any of the evidence requested in the notice.

In his judgment, Judge James Russell explained that earlier cases established a ''low threshold'' for courts to uphold a requirement by finding that it is ''relevant and reasonable.'' He also noted that Soft-Moc failed to support its claim that the information sought by the CRA is confidential, proprietary, or sensitive. Russell further stated that following the court's decision in *Fidelity Investments Canada Ltd. v. Canada* (2006 FC 551), the mere fact that documentation is confidential does not make the requirement unreasonable.

''Given the corporate relationship between the Applicant and the four Bahamian companies, and the control that resides in Mr. Krista, this is equivalent to saying that Mr. Krista refuses to divulge information to the Applicant — a company he controls — from four companies he also controls,'' Russell wrote. ''In any event, the proprietary or sensitive character of information is not a reason for finding a notice of requirement unreasonable.''

Russell also rejected the company's claim that a ruling against it would be ''unfairly prejudicial,'' noting that the severe consequences for noncompliance have no relevance on the requirement's reasonableness.

''Mr. Krista and the four Bahamian companies he controls are not compellable, but they have to realize that the Applicant's inability to substantially comply with the Requirement at this stage could lead to future negative consequences for the Applicant,'' Russell wrote. ''This is, in essence, the purpose behind the issuance of a requirement under the ITA, and the consequences seem wholly appropriate in this case.''

Cheryl Gibson QC, a partner at Fraser Milner Casgrain LLP, said that while the court seems to shut the door completely on arguments aimed at protecting confidential information, that the court did consider Soft-Moc's contention that the four Bahamian companies

would be harmed by the disclosure of information relating to business strategies and practices implies that there may still be an opening.

''In this case, the Court quickly dispensed with the issue by noting that no evidence was presented to support the assertions. I suggest that under the right set of facts, properly supported with evidence, a Court may be prepared to consider this issue in addressing reasonability of the requirement,'' she noted.

Gibson said she also believes that the decision could ''embolden the CRA in its use of foreign-based information requirements.''

''In the domestic context, the CRA has used requirements not only to access information readily available, but also to require the information to be collected and formatted in a form suitable to the CRA. If that trend moves to the foreign context, complying with such requirements could be particularly challenging for the Canadian taxpayer,'' Gibson explained. ◆

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