Federal Court  Cour fédérale

Date: 20200707

Docket: T-272-19

Citation: 2020 FC 750

Ottawa, Ontario, July 7, 2020

PRESENT: The Honourable Mr. Justice Fothergill

BETWEEN:

BAYER INC.

Applicant

and

ATTORNEY GENERAL OF CANADA

Respondent

JUDGMENT AND REASONS

I. Overview

[1] The Applicant, Bayer Inc [Bayer Canada], is a Canadian corporation and a wholly-owned subsidiary of Bayer AG [Bayer Germany]. Bayer Germany is the publicly-traded parent corporation of a multinational group of companies in the pharmaceutical and life sciences industry [collectively, the Bayer Group].

[2] Since 2016, the Canada Revenue Agency [CRA] has been auditing Bayer Canada's 2013-2015 taxation years. One issue that has arisen in the audit is the manner in which Bayer Canada determined "transfer pricing" between its pharmaceutical division and non-resident members of the Bayer Group.

[3] Transfer pricing is the amount paid by Bayer Canada to obtain goods and services from other members of the Bayer Group internationally. Transfer pricing agreements are not negotiated at arm's length. They may be used to maximize profits in low-tax jurisdictions while minimizing profits in high-tax jurisdictions. The CRA does not currently allege that Bayer Canada engaged in improper transfer pricing, but this is one aspect of the ongoing audit.

[4] Pursuant to s 247(1) of the *Income Tax Act*, RSC, 1985, c 1 (5th Supp) [ITA], corporations must adhere to the arm's length principle when determining transfer pricing. This means that the terms and conditions of commercial or financial transactions between related entities must be the same as those that would be obtained if the parties were dealing at arm's length. If the terms and conditions differ, there may be tax consequences.

[5] Between December 2017 and August 2018, the CRA made a series of requests to Bayer Canada for copies of agreements that had been negotiated at arm's length with respect to the activities that are being examined in the audit. Bayer Canada took the position that the requested documents were irrelevant to the audit and were neither in its possession nor under its control. Discussions between the parties resulted in a narrowing and refining of the request, but ultimately failed to resolve the impasse.

[6] On November 14, 2018, the Minister of National Revenue [Minister] issued a Requirement to provide foreign-based information or documents [Requirement] pursuant to 231.6(2) of the ITA. The Requirement was significantly broader in scope than the previous requests.

[7] The Requirement demands that Bayer Canada produce the following:

> […] all contracts (with amendments), license agreements, royalty agreements and/or other legal agreements between Bayer AG, or any other member of the Bayer Group, and a third party related to the purchases and/or sale of pharmaceutical products, where advertising, promotion, detailing, marketing and/or distribution functions were undertaken.

[8] The Requirement specifies that the information produced must include agreements between Bayer AG or other members of the Bayer Group and 21 named pharmaceutical and life sciences companies that operate at arm's length from the Bayer Group. The Requirement is not limited to the specified agreements. Nor is it limited by time or geographic region.

[9] Bayer Canada seeks judicial review of the Requirement pursuant to s 231.6(4) of the ITA.

[10] The Minister has wide-ranging powers under s 231.6 of the ITA to gather information. It is the CRA's prerogative to determine whether to audit a taxpayer, and the scope of that audit. It is for the CRA to decide what information is necessary to administer and enforce the ITA. But the Minister's powers are not unlimited. By enacting s 231.6(4), Parliament has sought to protect

taxpayers from abusive use of the provision through the power of a judge to review requirements to provide foreign-based information or documents.

[11] The CRA has offered no explanation for the dramatic increase in the scope of the information sought in the Requirement. No reasons or rationale may be discerned from the record. The CRA's failure to explain its abandonment of the pragmatic limits placed on the scope of the preceding requests renders the Requirement unreasonable. The application for judicial review is allowed.

II. Background

[12] On December 7, 2017, the CRA issued Query No 12 to Bayer Canada with the following request:

> Please provide any agreements in force during the audit period and entered into between any member of the Bayer Group and a third party related to the purchases and/or sale of pharmaceutical products, where advertising, promotion, detailing, marketing and or distribution type functions were undertaken (collectively referred to as "distribution functions").

[13] The CRA repeated this request in Query No 15, issued on June 11, 2018.

[14] On July 18, 2018, representatives of the CRA and Bayer Canada met to discuss the requests. The CRA's lead auditor explained that the requested documents would demonstrate what Bayer Canada paid for distribution functions in arm's length transactions, and would enable the CRA to evaluate Bayer Canada's transfer pricing agreements with other members of the

Bayer Group. Bayer Canada's representatives took the position that the requests were overbroad, and the information contained in the documents was irrelevant to the audit.

[15] On August 21, 2018, the CRA issued Query No 17 to Bayer Canada, in which it revised its previous requests as follows:

> Pursuant to our discussion on July 18, 2018, we would like to audit agreements made between any member of the Bayer Group with third party(s) in force during the 2013 and 2014 taxation years that perform some or all of the following activities in regards to pharmaceutical products:
>
> - Are located in an Organization for Economic Cooperation and Development ("OECD") member nation;
> - Perform research and development (clinical trial level stage II, III and/or IV, inclusive);
> - Perform regulatory compliance activities (notice of compliance, product labelling verification, etc.);
> - Perform client and corporate product support;
> - Perform quality control and assurance activities;
> - Regional marketing and sales activities (e.g. detailing, medical affairs);
> - Chain supply management activities (e.g. purchasing. distribution);
> - Price negotiations with local regulatory bodies;
> - Price negotiations with the public (e.g. provincial formularies) and private (e.g. insurance companies) funding bodies.
>
> Please provide a matrix of no less than 50 contracts that meet some or all of the criterion [*sic*] listed above, and make sure activities contemplated in the agreements are highlighted, so that CRA can select contracts for further review.

[16] Bayer Canada responded to the request by letter dated September 13, 2018. It repeated its assertion that the requested documents were not sufficiently relevant to the transfer pricing audit. Bayer Canada also maintained that it could not produce documents that were not in its possession, and to which it had no legal right of access.

[17] A second meeting between representatives of the CRA and Bayer Canada took place on September 26, 2018, but no progress was made. The Requirement was issued soon afterwards.

III. Issues

[18] This application for judicial review raises the following issues:

A. What is the standard of review?

B. Was the Requirement procedurally fair?

C. Was the Requirement reasonable?

D. What is the appropriate remedy?

IV. Analysis

A. *What is the standard of review?*

[19] Procedural fairness is a matter for the Court to decide. The standard for determining whether the decision maker complied with the duty of procedural fairness is generally said to be correctness; however, attempting to shoehorn the question of procedural fairness into a standard of review analysis is an unprofitable exercise (*Canadian Pacific Railway Company v Canada (Attorney General)*, 2018 FCA 69 at paras 34-56, citing *Mission Institution v Khela*, 2014 SCC 24 at para 79). The ultimate question is whether the applicant knew the case to meet, and had a full and fair chance to respond.

[20] The scope of the Requirement is subject to review by this Court against the standard of reasonableness. The Court will intervene only if it is satisfied that there are sufficiently serious shortcomings in the decision such that it cannot be said to exhibit the requisite degree of justification, intelligibility and transparency (*Canada (Minister of Citizenship and Immigration) v Vavilov*, 2019 SCC 65 [*Vavilov*] at para 100).

[21] Where formal reasons have not been provided, the reviewing court must look to the record as a whole to understand the decision, and will often uncover a clear rationale (*Vavilov* at para 137). Without reasons, the analysis is likely to focus on the outcome rather than on the decision maker's reasoning process. This does not mean that reasonableness review is less robust; only that it takes a different shape (*Vavilov* at para 138).

B. *Was the Requirement procedurally fair?*

[22] Bayer Canada asserts that the dramatic increase in the scope of the Requirement demonstrates the CRA wholly disregarded the legitimate concerns it raised. According to Bayer Canada:

> […] it was incumbent on the CRA to diligently consider Bayer Canada's specific concerns and its particular circumstances as against: the remoteness of the information sought to Bayer Canada's actual transactions and transfer pricing determinations; the overbreadth of what was being sought compared to any such materials' potential usage; and the time and efforts that would be required to substantially comply with the Requirement.

[23] Bayer Canada therefore maintains that it was denied a reasonable opportunity to be heard.

[24] The Minister replies that the Requirement was issued in the ordinary course of administering and enforcing the ITA. The statute grants the Minister broad information-gathering powers. The decision to issue the Requirement was neither quasi-judicial nor consultative, and conferred minimal procedural rights upon Bayer Canada. Because the ITA provides for a right of judicial review in this Court, fewer procedural protections were owed to Bayer Canada at the time the decision to issue the Requirement was made (citing *Baker v Canada (Minister of Citizenship and Immigration)*, [1999] 2 SCR 817 at para 24).

[25] According to the Minister, Bayer Canada's argument that the Minister failed to properly consider or give effect to its submissions wrongly presupposes that Bayer Canada had a right to make submissions before the Requirement was issued. Instead, the Minister characterizes the

meetings of representatives and exchanges of correspondence as good-faith efforts to resolve the dispute amicably. The Minister notes that Bayer Canada was given numerous opportunities to express its concerns during the meetings of July 18 and September 26, 2018. Despite the CRA's efforts to narrow and refine the requests for information, the Respondent says these were rejected "out of hand".

[26] The Minister and her auditors are "entitled to determine the scope and manner of an audit" (*Canada (National Revenue) v Cameco Corporation*, 2019 FCA 67 at para 43). In *Ark Angel Foundation v Canada (National Revenue)*, 2019 FCA 21 [*Ark Angel*], the Federal Court of Appeal said the following about the right to be heard afforded a taxpayer who is undergoing an audit (at para 73):

> The question is whether the [taxpayer] has had an opportunity to respond to the CRA's concerns. This obligation is satisfied when the decision-maker considered the submissions that the [taxpayer] presented. In this regard, "a decision maker is assumed to have weighed and considered all the evidence presented to it unless the contrary is shown" (*Boulos v. Canada (Public Service Alliance)*, 2012 FCA 193 at para. 11).

[27] Bayer Canada had the right to know what information the CRA was seeking, and the consequence of non-compliance. This was accomplished by Query Nos 12 and 15, issued on December 7, 2017 and June 11, 2018. Bayer Canada was given an opportunity to be heard in the July 18, 2018 meeting. This resulted in the revised Query No 17 issued on August 21, 2018. A further meeting between CRA and Bayer Canada representatives occurred on September 26, 2018.

[28] The risk that the Minister might issue the Requirement would have been clearly understood by Bayer Canada, which was represented by competent counsel throughout. The consequence of failing to comply is stated in s 231.6(8):

Consequence of failure	**Conséquences du défaut**
(8) If a person fails to comply substantially with a notice served under subsection 231.6(2) and if the notice is not set aside by a judge pursuant to subsection 231.6(5), any court having jurisdiction in a civil proceeding relating to the administration or enforcement of this Act shall, on motion of the Minister, prohibit the introduction by that person of any foreign-based information or document covered by that notice.	(8) Si une personne ne fournit pas la totalité, ou presque, des renseignements ou documents étrangers visés par la mise en demeure signifiée conformément au paragraphe (2) et si la mise en demeure n'est pas déclarée sans effet par un juge en application du paragraphe (5), tout tribunal saisi d'une affaire civile portant sur l'application ou l'exécution de la présente loi doit, sur requête du ministre, refuser le dépôt en preuve par cette personne de tout renseignement ou document étranger visé par la mise en demeure.

[29] The Requirement is significantly broader than the requests that preceded it. Nevertheless, as the Federal Court of Appeal noted in *Ark Angel*, a decision maker is presumed to have weighed and considered all of the evidence presented. Bayer Canada was given numerous opportunities to express its concerns regarding relevance, overbreadth, and the burden of compliance.

[30] I therefore conclude that the Minister's delegate respected Bayer Canada's right to be heard, and considered Bayer Canada's objections to providing information before causing the Requirement to be issued. The broad scope of the Requirement is more a question of reasonableness than procedural fairness. This is addressed below.

C. *Was the Requirement reasonable?*

[31] The Requirement was issued pursuant to ss 231.6(1) and (2), which provide as follows:

Definition of "foreign-based information or document"	**Sens de « renseignement ou document étranger »**
231.6 (1) For the purposes of this section, "foreign-based information or document" means any information or document that is available or located outside Canada and that may be relevant to the administration or enforcement of this Act, including the collection of any amount payable under this Act by any person.	**231.6** (1) Pour l'application du présent article, un renseignement ou document étranger s'entend d'un renseignement accessible, ou d'un document situé, à l'étranger, qui peut être pris en compte pour l'application ou l'exécution de la présente loi, y compris la perception d'un montant payable par une personne en vertu de la présente loi.
Requirement to provide foreign-based information	**Obligation de fournir des renseignements ou documents étrangers**
(2) Notwithstanding any other provision of this Act, the Minister may, by notice served personally or by registered or certified mail, require that a person resident in Canada or a non-resident person carrying on business in Canada provide any foreign-based information or	(2) Malgré les autres dispositions de la présente loi, le ministre peut, par avis signifié à personne ou envoyé par courrier recommandé ou certifié, exiger d'une personne résidant au Canada ou d'une personne n'y résidant pas

document.	mais y exploitant une entreprise de fournir des renseignements ou documents étrangers.

[32] Bayer Canada says that the Requirement is unreasonable because the connection between the information sought and the subject-matter of the audit is too remote. Bayer Canada also complains that the scope of the Requirement is unreasonably broad.

[33] According to Bayer Canada, no comparable requirement may be found in the jurisprudence, and the breadth of the Requirement is unprecedented. For example, in *Soft-Moc Inc v Canada (National Revenue)*, 2013 FC 291 [*Soft-Moc*], aff'd, 2014 FCA 10, this Court found that the third party corporations from which information was sought transacted business only with the taxpayer, and were wholly owned by the taxpayer. Here, the information sought is outside Bayer Canada's control, and exclusively concerns transactions to which Bayer Canada was not a party.

[34] Given the consequence of non-compliance specified in s 231.6(8), Bayer Canada says it is placed in an "extremely difficult position". If this Court upholds the Requirement, then Bayer Canada will have to consider the implications for hypothetical transfer pricing litigation that may never arise.

[35] The ITA provides in s 231.6(6):

Idem	**Précision**
(6) For the purposes of paragraph 231.6(5)(c), the requirement to provide the information or document shall not be considered to be unreasonable because the information or document is under the control of or available to a non-resident person that is not controlled by the person served with the notice of the requirement under subsection 231.6(2) if that person is related to the non-resident person.	(6) Pour l'application de l'alinéa (5)c), le fait que des renseignements ou documents étrangers soient accessibles ou situés chez une personne non-résidente qui n'est pas contrôlée par la personne à qui l'avis est signifié ou envoyé, ou soient sous la garde de cette personne non-résidente, ne rend pas déraisonnable la mise en demeure de fournir ces renseignements ou documents, si ces deux personnes sont liées.

[36] According to the Respondent, Canadian transfer pricing legislation and administrative guidelines are generally consistent with those of the OECD. The guidelines describe the manner in which adherence to the arm's length principle may be assessed. The sole consequence of non-compliance with the Requirement is that Bayer Canada will not be able to rely on the information in future litigation. If Bayer Canada genuinely has no control over or access to the information, then this should be of no concern.

[37] In *Saipem Luxembourg SA v Canada (Customs and Revenue Agency)*, 2005 FCA 218 [*Saipem*], the Federal Court of Appeal held that "reasonableness" under s 231.6(5) is the normal standard of reasonableness, considering "the extent of the demand and the reasons for which it is made" (at para 31). Documents requested in a foreign-based requirement must be both "relevant and reasonable" (*Soft-Moc* at para 82; *Chad v Canada (National Revenue)*, 2019 FC 1456 [*Chad*] at paras 8-12).

[38] The central question is whether the information sought pursuant to s 231.6(5) is relevant to the enforcement and administration of the ITA (*Soft-Moc* at para 81). This is a low threshold, given the Minister's wide-ranging powers to gather information in the course of an audit (*Canada (National Revenue) v Kitsch*, 2003 FCA 307 at para 29; *Soft-Moc* at para 82).

[39] It is the CRA's prerogative to determine whether it will conduct an audit and what form that audit will take (*Saipem* at para 36). Information may be reasonably sought in a requirement even if it ultimately turns out to be irrelevant. However, a rational connection must exist between the information sought and the administration and enforcement of the ITA *(Saipem* at para 26).

[40] In this case, the Requirement is for disclosure of:

> […] all contracts (with amendments), license agreements, royalty agreements and/or other legal agreements between Bayer AG, or any other member of the Bayer Group, and a third party related to the purchases and/or sale of pharmaceutical products, where advertising, promotion, detailing, marketing and/or distribution functions were undertaken.

[41] The information sought includes all distribution agreements with 21 named companies that operate at arm's length from the Bayer Group of companies. The list includes several major pharmaceutical and life sciences companies that compete globally with the Bayer Group.

[42] The affidavit sworn by the CRA's lead auditor on the file says only the following about the rationale for the dramatic increase in the scope of the Requirement:

> 30. The information requested in the requirement is for the purpose of internal comparables for the transfer pricing audit of goods, services or properties transferred between the Applicant and non-resident, non-arm's length parties.
>
> 31. Contracts entered into by Bayer AG with companies at which it operates at arm's length may be relevant to determining whether the arrangements between Bayer Inc. and non-resident, non-arm's length parties are in accordance with the arm's length principle.

[43] No explanation has been provided for the absence of any time limits on the information sought in the Requirement, although the previous requests were all restricted to the taxation years under audit. No explanation has been provided for the absence of any limit on the number of agreements to be produced, the identities of the contracting parties, or the geographic regions to which they apply. The list of the 21 named arm's length pharmaceutical and life sciences companies is not exhaustive. It is unclear how the list was derived. Counsel for the Respondent said only that internet searches suggested the distribution agreements with the 21 named companies likely exist.

[44] The Minister has wide-ranging powers under s 231.6 of the ITA to gather information. It is the CRA's prerogative to determine whether to audit a taxpayer, and the scope of that audit. It is for the CRA to decide what information is necessary to administer and enforce the ITA. But the Minister's powers are not unlimited. By enacting s 231.6(4), Parliament has sought to protect taxpayers from abusive use of the provision through the power of a judge to review the requirement (*Saipem* at para 8*; Merko v Minister of National Revenue*, [1991] 1 FC 239 (TD)).

[45] The CRA's first request for information was made in Query No 12 dated December 7, 2017, and repeated in Query No 15 dated June 11, 2018. These requests sought "[any]

agreements in force during the audit period and entered into between any members of the Bayer Group and a third party related to the purchases and/or sale of pharmaceutical products, where [distribution functions] were undertaken". The request was limited to agreements in force during the audit period.

[46] Following representations made on behalf of Bayer Canada, the CRA narrowed and refined the request to encompass only "agreements made between any member of the Bayer Group with third party(s) in force during the 2013 and 2014 taxation years", and only with respect to certain activities. Nine criteria were provided, including location in an OECD member state, and the performance of tasks related to research, development and distribution. Bayer Canada was asked to provide a matrix of no fewer than 50 contracts that met some or all of the criteria to enable the CRA to select certain contracts for further review.

[47] The CRA has offered no explanation for the dramatic increase in the scope of the information sought in the Requirement. No reasons or rationale may be discerned from the record. The CRA's failure to explain its abandonment of the pragmatic limits placed on the scope of the preceding requests renders the Requirement unreasonable.

D. *What is the appropriate remedy?*

[48] The powers of this Court on hearing an application pursuant to s 231.6(4) of the ITA are prescribed in s 231(6)(5):

Powers on review	**Pouvoirs de révision**
(5) On hearing an application under subsection 231.6(4) in respect of a requirement, a judge may	(5) À l'audition de la requête, le juge peut:
(a) confirm the requirement;	a) confirmer la mise en demeure;
(b) vary the requirement as the judge considers appropriate in the circumstances; or	b) modifier la mise en demeure de la façon qu'il estime indiquée dans les circonstances;
(c) set aside the requirement if the judge is satisfied that the requirement is unreasonable.	c) déclarer sans effet la mise en demeure s'il est convaincu que celle-ci est déraisonnable.

[49] This Court is not well-placed to determine a suitable variation of the Requirement that would be reasonable and further the work of the CRA in conducting the audit. Neither party proposed a variation of the Requirement that might be mutually acceptable.

[50] The CRA was previously content to limit its request for information in accordance with the nine criteria included in Query No 17. Counsel for Bayer Canada indicated during the hearing of this application that if the Requirement were limited to the agreements with the 21 named pharmaceutical and life sciences companies, then its scope would be more manageable.

[51] The Minister is not constrained in the number of requirements she may issue pursuant to s 231.6(2) of the ITA. A variation of the existing Requirement to restore the criteria previously applied by the CRA, and limiting its scope to the agreements with the 21 named pharmaceutical

and life sciences companies, will not foreclose further requests or requirements for information as the audit continues. The sole constraint placed on the Minister is that a rational connection must exist between the information sought and the administration and enforcement of the ITA (*Saipem* at para 26).

V. Conclusion

[52] The application for judicial review is allowed. The Requirement is varied to include the nine criteria identified in Query No 17 dated August 21, 2018. In addition, the scope of the Requirement is limited to the agreements with the 21 named pharmaceutical and life sciences companies that operate at arm's length from the Bayer Group.

[53] By agreement of the parties, Bayer Canada shall have 60 days from the date of this judgment in which to comply with the Requirement, as varied by this Court.

[54] As success is divided, each party shall bear its own costs.

JUDGMENT

THIS COURT'S JUDGMENT is that:

1. The application for judicial review is allowed.

2. The Requirement is varied to include the nine criteria identified in Query No 17 issued on August 21, 2018.

3. The scope of the Requirement is further limited to the agreements with the 21 named pharmaceutical and life sciences companies that operate at arm's length from the Bayer Group.

4. Bayer Canada shall have 60 days from the date of this judgment in which to comply with the Requirement, as varied by this Court.

5. No costs are awarded.

"Simon Fothergill"

Judge

FEDERAL COURT

SOLICITORS OF RECORD

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