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Cameco vs. the taxman: The squabble that keeps on growing

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Uranium prices have been on the downswing. That has challenged the earnings of Saskatoon-based Cameco Corp., one of the world's biggest sellers of the product.

One thing that's getting bigger, however, is the size of the company's squabble with the Canada Revenue Agency over its income tax bill. It's a dispute that Cameco increasingly needs to win, for its shareholders' sake.

We first wrote about the matter just a year ago. To review: In 1999, Cameco set up a subsidiary, Cameco Europe Ltd., in low-tax Zug, Switzerland. Cameco then signed a 17-year deal to take the uranium it produces in Canada and sell it to Cameco Europe before it made its way to the end customer.

By injecting a middleman into the transaction, Cameco is able to sell the uranium to Cameco Europe at the low prices reflective of 1999. As a result, Cameco is recording little to no profit in Canada. Instead, all the profits appear in Zug, where the tax rate is lower.

A year ago, Cameco estimated it had avoided declaring \$4.9-billion in Canadian income, saving it \$1.4-billion in taxes, over 10 years. The company's latest disclosure, accompanying its first-quarter earnings in late April, now show the numbers have grown to \$5.7-billion in income it was able to avoid declaring, and \$1.6-billion in tax savings for the 11 years ended in 2013. The tax-saving deal runs through 2016, so the numbers could continue to grow.

The scope of the dispute wasn't terribly clear until a year ago, because Cameco was using accumulated losses to cover the assessments CRA was making. The agency requires large corporations to remit 50 per cent of the disputed tax bill, as well as half of the interest and penalties, until the matter is decided. So, prior to 2013, Cameco submitted just \$13-million to the taxman. The number grew to \$46-million last year, and has been \$58-million so far in 2014. Cameco now estimates it may have to submit somewhere between \$625-million and \$650-million to cover the disputed tax bills through 2013.

Cameco, it should be said, believes it has done its taxes properly and expects to prevail in the CRA court case and get all its money back. "We continue to believe the ultimate resolution of this matter will not be material to our financial position, results of operations and cash flows in the year(s) of resolution," the company said in its updated disclosure in April.

The analysts at **Veritas Investment Research** are not so sure. The dispute is twofold. The CRA is disputing both the corporate structure of the arrangement, saying it exists only for tax avoidance, and has no real business purpose. CRA also contests the prices used in the deal. Cameco needs to win on both to prevail.

While Cameco says Cameco Europe has its own board of directors and a full-time CEO, documents in the case reveal the European company had no other full-time employees, and no stand-alone office, instead renting space from the law firm performing its legal work. Cameco's Canadian employees performed nearly all the functions for Cameco Europe. "It is therefore difficult to see a reasonable business purpose to [Cameco Europe's] existence, beyond tax minimization," **Veritas' Pawel Rajszel** and **Dimitry Khmelnitsky** say in their recent report.

As for the pricing issue, Cameco says its contract prices are "generally comparable to those established in sales contracts between arm's-length buyers and sellers entered into at that time." However, it has begun recording tax provisions "where an argument could be made that our transfer price may have fallen outside of an appropriate range of pricing." The **Veritas** analysts, having looked at past CRA cases, say Cameco's method "requires a very high degree of comparability."

The **Veritas** analysts say that "based on our analysis of the Canadian tax code, court documents, and legal precedents, we continue to believe that the CRA has a strong case." Regardless of the resolution, though, the CRA has begun to accelerate its review of past filings, and could hit Cameco with bills for 2009 and 2010 this year, a faster schedule than the company has previously anticipated.

"If anything, the situation is getting worse for Cameco," **Mr. Rajszel** says in an e-mailed comment. "Based on our review of Cameco's [first quarter] results, the dispute with the CRA may force the company to borrow funds and/or cut its dividend in order to finance the back tax payments."

We maintain our punning view that it's a taxing situation for Cameco shareholders.