THE GLOBE AND MAIL

The Cameco booth at the Prospectors and Developers Association of Canada's convention in Toronto in March.

Cameco's $800-million tax battle

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Did you know one of the largest sellers of uranium in Switzerland is Saskatoon-based Cameco Corp.? The Canada Revenue Agency has been aware for some time. And now Cameco shareholders are getting more details about the potential problems it may cause the company – as in more than $800-million in back taxes.

It wasn't supposed to work out this way, of course. 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, sell it to Cameco Europe, and have Cameco Europe make the final sale to the end customers all across the world.

Why inject a middleman into the transaction? Well, Cameco is selling the uranium to Cameco Europe at the low prices reflective of 1999, when the deal was signed. Cameco is recording little to any profit in Canada; instead, all the profits appear in Zug, where the tax rate is lower.

This has been a boon to Cameco's bottom line. The uranium producer estimates it has avoided declaring $4.9-billion in Canadian income, saving it $1.4-billion in taxes, over the last 10 years.

We know this because Cameco has been fighting the Canada Revenue Agency since 2008 over this matter. The CRA has been slowly reassessing Cameco's tax returns; it's finished with 2007 now, and has five more – 2008 to 2012 – to go.

Until Wednesday, when Cameco released its first-quarter earnings, the fight seemed a relatively minor matter, because the company had enough accumulated losses to shield it from exposure to back taxes for the disputed returns of 2003 to 2007.

Each time the CRA reassesses a return, however, the taxpayer owes 50 per cent of the disputed bill. The taxpayer only gets it back if the CRA loses the case. Cameco has now run out of accumulated losses to cover these disputed taxes, as evidenced by a cash payment late last year to cover the 2007 return.

With Wednesday’s earnings, Cameco has provided new disclosure, in which it estimates it may need to cough up $400-million to $425-million in the short term as it waits to find out if it will prevail. (The full tax bill, if Cameco loses the fight, would be $800-million to $850-million, or more than $2 per share.)

The company says it is “confident that we will be successful in our case.” But the analysts of ***Veritas Research Corp.***, who accurately predicted the numbers in Wednesday’s disclosure, disagree.

Pawel Rajszel, Dimitry Khmelnitsky and ***Diana Akmal*** reviewed the motions filed by the CRA in tax court. The CRA objects both to the structure of Cameco’s Swiss subsidiary and the “transfer prices” between the two.

Canada requires transfer prices – prices set between related parties – to be within a range that would be charged by independent parties dealing at arm’s length.

Helpfully, Cameco also has a deal in place, struck in 2001 with the Russian company Tenex, in which Cameco Europe is obtaining uranium from a third party at prices that have turned out to be below current market conditions.

Cameco said Wednesday the contracts of Cameco Europe are “generally comparable” to arm’s-length deals of the time. However, the company has recorded a provision of $65-million “where an argument could be made that our transfer price may have fallen outside of an appropriate range of pricing.”

That may not be the end of it, however. The ***Veritas*** analysts note that Cameco Canada “performed virtually all operating functions” for Cameco Europe, “while also providing performance guarantees – which we believe makes the contract incomparable to other market transactions.”

If the appropriate method for allocating profits is the relative contributions of Cameco Canada and Cameco Europe, the ***Veritas*** analysts say, “the profit allocation method would suggest all profits should be allocated to [Cameco Canada], which supports the CRA’s view that all of [Cameco Europe’s] income should be taxed in Canada.”

Grant Isaac, Cameco’s CFO, retorts that Cameco Europe has its own board of directors and a full-time CEO, Gerhard Glattes, who has no other duties with the company. Cameco Europe provides Cameco with compensation for the management duties – like legal advice – it does not have its own staff for. “It was established in accordance with all relevant laws and regulations when it was set up.”

In addition, he adds, “a transfer price dispute cannot be assessed in hindsight … to go back and say ‘Oh, well the future wasn’t what we thought’ – well, that’s not an appropriate way to do transfer-price analysis.”

A loss in the tax case – which may not occur until 2015 – would have even larger implications than a one-time $800-million tax bill; it will wipe out one of the key drivers of Cameco’s bottom line. ***Veritas*** estimates the company paid just $36-million in cash taxes for 2012 on $680-million pre-tax cash flow from operations, or a 5-per-cent rate. The difference between that and the statutory rate of 27 per cent would come right out of cash flow – a cut of more than 20 per cent, ***Veritas*** says.

If you’ll pardon the pun, it’s becoming quite the taxing situation for Cameco shareholders.