Pre-Merger Notification Interpretation Guidelines 14 (Duplication from Transactions between Affiliates) and 15 (Assets and Sales in Canada)

NATIONAL COMPETITION LAW SECTION
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PREFACE

The Canadian Bar Association is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Competition Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Competition Law Section of the Canadian Bar Association.

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I. SUMMARY

The proposed Draft Interpretation Guidelines #14 and #15 (Draft IG #14 and Draft IG #15) change the way in which assets and revenues are determined for the purposes of assessing whether the thresholds under Part IX of the *Competition Act* (the Act) have been exceeded. The CBA Section recommends that the Bureau adhere to the clear and plain language of the Notifiable Transactions Regulations (Regulations), which require that these determinations be made in accordance with generally accepted accounting principles.

The CBA Section recommends that Draft IG #14 be revised to indicate that paragraph 4(1)(a) and subsection 5(2) of the Regulations will be given their plain meaning that all assets arising from transactions between affiliates and all gross revenues from sales between affiliates represent duplication for purposes of the merger notification threshold provisions and will not be included in such calculations. The CBA Section believes this interpretation reflects sound enforcement policy and generally accepted accounting principles and is entirely supportable under the Act and the Regulations.

The CBA Section recommends that Draft IG #15 be substantially revised to interpret the Act consistently with the requirement in the Regulations that parties calculate their assets according to their audited financial statements prepared in accordance with generally accepted accounting principles, and not require that complex audits and calculations be performed only for the determination of the potential application of Part IX of the Act.

II. STATUTORY INTENT

The merger notification provisions are intended to set out bright-line financial tests that allow businesses to easily and readily determine their Part IX filing obligations. As stated in the 1999 Regulatory Impact Analysis Statement accompanying amendments to the Regulations:

> The intent of the *Notifiable Transactions Regulations* is to enable business persons to determine readily whether the thresholds required for notification are exceeded. (Canada Gazette Part I, May 15, 1999, p. 1431).

Similarly, the Regulatory Impact Analysis Statement accompanying the original publication of the Regulations notes:

> The Regulations minimize business compliance costs by relying on definitions based on standard accounting practices and by making use of information readily available.
>
> …The Regulations rely on information used by business persons on a regular basis and would therefore minimize paper burden. (Canada Gazette Part II, Vol. 121, No. 14 (July 8, 1987), p. 2431)

The Draft IGs do not accomplish these goals but instead propose to add considerable complexity and uncertainty to the task of determining merger notification obligations.

III. DRAFT GUIDELINE #14 – DUPLICATION FROM TRANSACTIONS BETWEEN AFFILIATES

The practical implications and difficulties of the proposed approach in draft Guideline #14 include the following:

- A more complex, time consuming and detailed analysis of the financial statements of each Canadian subsidiary (in cases where it is not clear that the financial thresholds would be exceeded).
- The possibility that the acquisition of a U.S. or other non-Canadian company with few, if any, sales in Canada to third parties could trigger notification based only on intra-group transactions between that company and its Canadian subsidiary.
- The possibility that the acquisition of a Canadian company with almost no revenue-generating assets in Canada (and thus no significant economic presence in Canada) could nonetheless trigger a notification based only on intra-group transactions (such as loans) between that company and its foreign affiliates.
- An inability to rely on publicly available and audited consolidated financial statements since the statements do not include intra-group transactions. The approach proposed by Draft Guideline #14 could lead to the absurd result that the "Canadian" assets or sales of an entity (whether incorporated or organized in Canada or elsewhere) exceeds the total assets or sales of the entity as reported on its audited consolidated financial statements because the statements will have eliminated intra-group transactions and fees.[1]

[1] This observation is separate from the question of reliance on geographic segmentation in audited financial statements, although applicable accounting principles may require entities to report geographic segmentation in certain circumstances, including where more than a certain percentage of its assets or sales are in a particular jurisdiction.

- An increased inability to assess the application of Part IX to unsolicited transactions. Undisclosed intra-group financing arrangements, unconsolidated financial statements and/or shareholding structures could easily result in surpassing the Part IX thresholds under the Bureau's proposed approach, even where the target's Canadian operations have a very limited presence and the potential acquirer would have no way to determine its filing obligations.
- Complex interpretation issues where the facts are not as straightforward as a resale of "widgets" (as used in the draft guideline), for example:
    - an intermingling of "widgets" at a central facility in the U.S. from both Canadian and other sources where some (but not all) are resold in Canada (and duplicated), and it is not clear whether the products resold in Canada were products that originated in Canada;
    - a sale from a Canadian company to a U.S. parent of an ingredient or a part used in the manufacturing process for different products, some of which are resold in Canada; or
    - a fee for services provided by Canadian subsidiary A to its U.S. parent B – what, if any, portion of the fee can be considered duplicated in respect of any sales by B into Canada? – a similar issue arises in respect of management fees paid by a U.S. subsidiary to its Canadian parent or a management fee paid by one Canadian corporation to an affiliated Canadian corporation.
- Effectively, a haphazard decrease in the merger notification thresholds, capturing more transactions and imposing filing fees and delays on more transactions.

Draft IG #14 also represents a dramatic departure from the practice of most competition counsel over the past 26 years.[2] To date, the prevailing approach in assessing whether the size of transaction and size of parties thresholds are exceeded for the purposes of Part IX of the Act has been to focus on the consolidated financial statements of an entity and, in general, not engage in a subsidiary by subsidiary analysis of intra-group transactions between affiliates. That approach is consistent with the perspective that it should be clear and straightforward to determine whether a proposed transaction is or is not subject to Part IX.[3]

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2 See for example, Neil Campbell "Merger Law and Practice The Regulation of Mergers under the Competition Act" (Carswell, 1997) at p. 187: "Assets are to be measured at net book value after allowing for depreciation and removing duplication resulting from intra-group transactions or ownership interests, but without deduction of any liabilities. Revenues are to be measured after removal of intra-group transactions but before deduction of any expenses."

3 The Commentary to the International Competition Network's Recommended Practices for Merger Notification Procedures states that: "Clarity and simplicity should be essential features of notification thresholds so as to permit parties to readily determine whether a transaction is notifiable. Given the increasing incidence of multi-jurisdictional transactions and the growing number of jurisdictions in which notification thresholds must be evaluated, the business community, competition agencies and the efficient operation of capital markets are best served by clear, understandable, easily administrable, bright-line tests." The Recommended Practices also state that: "Notification thresholds should be based on information that is readily accessible to the merging parties". The accompanying commentary notes that: "The information needed to determine whether notification thresholds are met should normally be of the type that is available to the parties in the ordinary course of business."

A. The Concept of Duplication

Draft IG #14 relates to sections 4 and 5 of the Regulations which provide that, in determining the aggregate value of assets, "any amount that represents duplication arising from transactions between affiliates" shall be deducted. Similarly, in determining the gross revenues from sales, "any amount that represents duplication arising from transactions between affiliates shall be deducted".

The prevailing approach has been not to include amounts or values that represented "duplication" from the perspective of consolidated financial reporting of an entity and its affiliates because they are eliminated in consolidated financial statements. (Section 4(1)(b) of the Regulations provides for the deduction of "any amount that represents duplication arising from an ownership interest of one person in another person".) In contrast, Draft IG #14 proposes to treat an amount or value as "duplicated" only if it is counted twice towards the Part IX thresholds.

The difference is illustrated in example 3 in Draft IG #14: Canadian corporation A sells $100 of widgets to its U.S. parent B, which in turn resells those widgets to customers in the United States for $150.[4]

On the current prevailing approach, the $100 in sales from A to B would be treated as duplicated within the corporate financial reporting and not counted as revenues in or from Canada. However, the approach proposed in Draft IG #14 is that there is no duplication because the $150 of sales from B to U.S. customers does not count towards Part IX thresholds (it is not a sale, in, from or into Canada). The $100 of A's sales to B would count towards the Part IX threshold. Thus, the threshold could be exceeded even where the B corporate group (i.e., B including its subsidiaries) has few, if any, sales in or from Canada to third parties.

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4 While it is possible to identify some sales or assets, such as in example 3, which may have a potential impact on competition in Canada but are not counted towards the Part IX threshold under the prevailing approach, that does not advance the interpretation of the concept of "duplication" in the Regulations. Part IX and the regulations thereunder are not intended to capture every possible merger that could raise a substantive issue. If they were, there would be no notification threshold at all and every merger would require pre-merger notification. In addition, Part IX counts only sales in, from or into Canada even though the relevant market may be North American or even global in scope. (Of course, the fact that a transaction is below the Part IX threshold does not exempt it from substantive challenge under section 92 of the Act in any event.)

A similar result follows in example 4 with respect to assets. In that example, Canadian corporation A lends its U.S. parent B $100 million. The loan is recorded on the financial statements of A as an asset and is considered an asset in Canada. Under Draft Guideline #14, because the corresponding cash on the books of the U.S. parent B is not an asset in Canada (and therefore does not count towards Part IX thresholds), the book value of A's receivable would count towards the Part IX thresholds. Again, A's receivable represents duplication for consolidated financial reporting purposes, but there is no duplication in the sense of two amounts being both counted towards a Part IX threshold.

B. Consistency with other Provisions of Competition Act

The requirement of Draft IG #14 to include intra-group transactions and sales is inconsistent with the sound enforcement approach found elsewhere in the Act. Substantially, transactions between affiliates do not have any competitive implications and this is consistently recognized through exemptions from application of the Act for agreements or arrangements between affiliates in ss. 45(8), 47(3), 76(4), 77(4) and 90.1(7). Importantly, transactions between affiliates are also exempt from merger notification pursuant to s. 113(a). Transactions between affiliates are exempt because it is well recognized that they do not involve third parties, and thus are not significant for a competition analysis. The financial thresholds in the merger notification provisions are intended to be a proxy for the independent economic significance of the merging parties in Canada. Including intra-group transfers in Part IX thresholds would distort the economic significance of the parties to a proposed merger.

C. Scope of Notification Obligations Should Not Be Expanded by Interpretation Guidelines

The Competition Policy Review Panel noted in its final report of June 2008:

> To ensure that the merger notification provisions of the *Competition Act* are up-to-date and do not impose regulatory obligations on parties to proposed mergers that are disproportional to their potential to raise substantive competition issues, there should be a narrowing of the scope of these provisions by increasing the financial thresholds that trigger the notification obligation. …. In addition to or in lieu of increasing financial thresholds, consideration should be given to creating more exemptions for merger notification for classes of merger transactions that do not raise competition concerns. Such changes can be effected relatively expeditiously by prescribing regulations under section 124 of the *Competition Act*. (page 57)

Instead of narrowing the scope of the regulatory obligations to focus on only those transactions likely to raise substantive competition concerns, the approach advocated in Draft IG #14 needlessly expands the scope of the notification obligation while adding uncertainty and additional complexity to the task of determining the obligation to notify. This adds an unwarranted burden on Canadian businesses, particularly smaller businesses that do not clearly exceed the Part IX thresholds.

The prevailing approach to duplication of revenues and assets is appropriate and should not be altered by the Bureau. We are not aware of any basis for concern that the current notification thresholds are underinclusive. Indeed, the Bureau's merger performance reports confirm the vast majority of mergers notified to the Bureau are cleared quickly and without a remedy.

D. Prevailing Practice Reflects Supportable Interpretation of the Regulations

The prevailing practice of eliminating intra-group transactions and accounts is supported by the Regulations in a number of ways.

First, paragraphs 8(2) and 9(2) of the Regulations require that merging parties calculate their assets and revenues under Part IX "as stated in their audited financial statements".

Second, paragraph 3(a) of the Regulations requires that audited financial statements be used.

Third, paragraph 3(a) of the Regulations prescribes how audited financial statements shall be prepared. Parties to a proposed merger are to use statements prepared "in accordance with accounting principles that are normally used by the person… and that are generally accepted for the type of business carried on by the person". For consolidated statements, such accounting principles require the elimination of all intra-group accounts and transactions in preparing audited financial statements. Unaudited, non-consolidated balance sheets and income statements often do not exist except in an informal Excel spreadsheet format, often including entries that reflect historical anomalies or transactions between affiliated entities that have little to do with the operations or productive capacity of the firm on an ongoing basis.

Fourth and most importantly, a plain reading of paragraph 4(1)(a) indicates that, in valuing assets, any amount that represents duplication arising from transactions between affiliates be deducted. The Bureau's suggested approach in Draft IG #14 requires reading in the words "…duplication *in Canada*". If this was intended, the Regulations would have included those words. Instead, paragraph 4(1)(b) of the Regulations reflects the intent that all double counting be eliminated when assessing the asset value of a party for the purposes of Part IX.

Similarly, section 5(2) of the Regulations requires that, in determining the gross revenues from sales, any amount that represents duplication arising from transactions between affiliates shall be deducted. Again, the suggested interpretation in Draft IG #14 would require reading in "in respect of gross revenues from sales in or from Canada" after duplication. This is not what the section says and, if the drafters intended to include those words, they would have done so.

We understand that the Bureau has suggested that the interpretation in Draft IG #14 is supported by the fact that the size of transaction test requires a calculation of gross revenues of sales in or from Canada generated from the assets in Canada and, if intra-group sales are not included, some sales from Canada which would be intra-group sales might not be included. However, this begs the question of whether only third party sales should be counted towards the thresholds. As noted above, the notification thresholds were never intended to capture all merger transactions, but only a certain subset of merger transactions that are of sufficient financial size. Third party sales are more meaningful than intra-group sales for competition purposes and therefore it makes sense to use them for the notification threshold. For all the reasons noted above, good enforcement policy indicates that only sales to third parties should be counted for these purposes and it is entirely consistent with the notification provisions of the Act and the Regulations to exclude such intra-group transactions.

IV. DRAFT GUIDELINE #15 – ASSETS AND SALES IN CANADA

Draft IG #15 creates similar difficulties by adding unnecessary complexity and uncertainty that is not contemplated by the Act or the Regulations. As with Draft IG #14, it would require a more complex and time consuming analysis, introduce additional challenges for unsolicited bidders to be able to determine the application of Part IX and haphazardly capture more transactions, thereby imposing additional fees and delays on more transactions than contemplated by the Act and the Regulations. Draft IG #15 also proposes an approach inconsistent with the prevailing practice in Canada since Part IX was enacted.

A. Relevant Provisions of Regulations

Sections 8 and 9 of the Regulations provide that the aggregate value of assets and revenues under ss. 109 and 110 of the Act "shall equal" the amount stated in a party's audited financial statements. The aggregate value of assets is determined as of the last day of the period covered by the most recent audited financial statements in which those assets are accounted for (s. 6). Gross revenues from sales are determined for the annual period ended on the last day of the period covered by the most recent audited financial statements in which those gross revenues are accounted for (s. 7), provided the statements are sufficiently current.

Section 3 of the Regulations states that audited financial statements shall be prepared in accordance with accounting principles normally used by the person with respect to whom the statements were prepared and generally accepted for the type of business carried on by the person, and may include working papers and other records used to prepare audited financial statements if such reference is necessary to obtain information required for making a determination of the aggregate value of assets or the gross revenues from sales.

Sections 12 and 13 provide that, if the aggregate value of a person's assets or gross revenues cannot reasonably be determined in accordance with other provisions in the Regulations, the relevant value shall equal the amount stated in the books of the person with adjustments as necessary to ensure that the determination is made in accordance with the accounting principles referred to in s. 3.

The Regulations and the regulatory impact analysis statements noted above are clear: generally accepted accounting standards are the guiding principle to determine asset values and gross revenues.

B. Specific Comments

Canadian Entities

The introductory paragraph in section 2.1 of Draft IG #15 states that "except as set out below, all assets on the audited financial statements of a Canadian entity are assets 'in' Canada." This sentence (and similar references in Draft IG #15) is inconsistent with the Act and the Regulations in several ways. First, there is no basis for a presumption that all assets of an entity incorporated in Canada are "in" Canada. Second, and more fundamentally, there is no basis for distinguishing the location of assets based on the jurisdiction of incorporation or formation of the entity. Third, the concept of a "Canadian entity" introduced in Draft IG #15 has no basis in the Regulations and adds an unnecessary complication to the analysis. The Regulations simply refer to the assets in Canada, and gross revenues in, from or into Canada, of parties and their affiliates.

Moveable Tangible Assets

Section 2.1.1 states that "a moveable tangible asset, such as inventory, equipment or vehicles of a Canadian entity is considered to be 'in' Canada, unless the asset was physically located outside Canada throughout the entire relevant fiscal period". This approach is inconsistent with the Regulations and general accounting principles, and should not be adopted by the Bureau.

First, requiring that assets be treated as "in Canada" as a result of an event that occurred at any time in the relevant fiscal period is inconsistent with s. 6 of the Regulations, that "the aggregate value of assets of a person shall be determined as of the last day of the period covered by the most recent audited financial statements in which those assets are accounted for."

Second, we understand that when preparing geographically segmented financial disclosure, auditors apply a "predominant use" test to allocate an asset to a jurisdiction, which is typically the jurisdiction in which the asset was mainly used and deployed. On that basis, the presence of a moveable, tangible asset in Canada for a brief period during a fiscal year would not be sufficient for that asset to be allocated to Canada pursuant to generally accepted accounting principles.

Third, conducting an audit on the geographic location of moveable tangible assets throughout a fiscal period to confirm the application of Part IX of the Act – over and above records maintained and analyses conducted for financial reporting purposes – would impose a level of complexity and burden clearly not contemplated by the Act or Regulations.

Finally, Section 2.1.1 could be read to imply that the determination of assets in Canada should include any inventory owned by the party at any time during the fiscal year that was physically located in Canada at any time in the relevant fiscal year. Draft IG #15 should be clear that the only inventory that could qualify for inclusion in a s. 109 or 110 asset value threshold is that owned by the relevant entity on the last date of the relevant fiscal year. (Typically, only inventory physically located in Canada on that date would be considered an asset in Canada.)

Section 2.1.1 also states "where a moveable tangible asset of a foreign entity is physically located in Canada at any time during the relevant fiscal period, parties are expected to determine what proportion of the value of that asset is attributable to Canada, and include that amount in calculating the value of assets in Canada."

In addition to our comments on assets of Canadian entities, we understand that accountancy rules do not in most instances apportion the value of an asset between jurisdictions on a proportionate basis. Instead, when preparing segmented financial disclosure, auditors apply the "predominant use" test to assign an asset to one jurisdiction, typically the jurisdiction in which it was mainly used and deployed. The proportional assignment of value between jurisdictions suggested by section 2.1.1 is not contemplated by the accountancy standards incorporated by ss. 6 and 8(2) of the Regulations, or elsewhere in the Act or Regulations. Nor is it clear on what basis the value would be proportionately attributed to Canada. It would likely often be impractical, burdensome and ultimately arbitrary for foreign entities to proportionally allocate the value of assets between jurisdictions. Practical issues would arise to make that allocation (which may not be required for any other purpose). For example, is the length of the time an asset was in Canada determinative for the purposes of attributing value? How should goods temporarily in Canada but accounted for in other currencies be treated as a result of currency fluctuations throughout the year? How should commodities in Canada for part of the year be valued where their value fluctuates in world markets during and after their time in Canada? Any proportional allocation would ultimately be arbitrary and would not necessarily result in a more meaningful outcome than a geographic allocation in accordance with generally accepted accounting principles.

Intangible Assets

Section 2.1.2 proposes guidance for attributing an intangible asset to a jurisdiction for valuation purposes. Intangible assets appear as assets (and are attributed values) on balance sheets only where they have been acquired from third parties. We understand that parties registering their own patents or trademarks, for example, will not attribute value to these as assets on their audited financial statements. Draft IG #15 is ambiguous on whether it would require intangible assets that do not appear on a balance sheet to be valued and attributed to a jurisdiction for the purposes of applying ss. 109 and 110. The CBA Section believes this obligation would be impracticable and inconsistent with s. 8(2) of the Regulations.

The proposal that parties determine what proportion of the value of a group of patents is attributable to the Canadian patents in the group is not practicable. Separate from the question of whether those Canadian patents are accounted for on a balance sheet, valuing individual patents that form part of a group of patents is inherently contentious. Where a group of patents is treated as a single asset on the audited financial statements, it would be more consistent with the Regulations to geographically attribute that group of patents to the same jurisdiction as has been or would be attributed in accordance with generally accepted accounting principles (which may or may not attribute to Canada a greater value than the Bureau's proposed interpretation).

Finally, Draft IG #15 does not provide any justification for attributing to Canada all private intangible legal rights belonging to Canadian entities. On a non-consolidated basis, private legal rights will be attributed to their legal owner, which may or may not be a Canadian entity. On a consolidated basis, we understand that auditors would attribute them to the jurisdiction with which the rights are most closely associated. There is no statutory or other justification for deviation from the manner of allocating these assets to a jurisdiction in audited financial statements. The Bureau's proposed treatment is particularly confusing given how Draft IG #15 proposes to treat goodwill: it correctly provides that goodwill of a Canadian entity generated by an event that occurred outside of Canada is not an asset "in" Canada for the purposes of ss. 109 and 110 of the Act. For the same reasons that goodwill generated outside Canada is not an asset "in Canada", Canadian companies that own foreign property and lease it to third parties should not have the asset value of those leases treated as "in Canada" for the purposes of ss. 109 and 110 of the Act. For example, it is hard to see how exploration or mineral extraction rights relating to real property in a country in Africa should be considered to be assets in Canada even if they are held by a Canadian entity.

Creation of Unclear Classes of Intangible Assets

Draft IG #15 unnecessarily calls for the categorization of intangible assets into various categories that are not readily determinable: intangible legal rights "conferred by statute" as opposed to "private or contractual", and a separate category of "financial" assets. For example, is a license of a patent pursuant to a contract a private or statutory right? Is a futures contract on an agricultural commodity a "financial asset"? Is everything issued by a bank considered to be conferred pursuant to the *Bank Act*? None of these distinctions are required on a plain reading of the Regulations, previous practice and clear intent to incorporate and adopt allocations for the audited consolidated financial statements and pursuant to generally accepted accounting principles for the business carried on by the relevant party.

Financial Assets

Section 2.1.3 treats all financial assets with rights and privileges conferred pursuant to a Canadian statute as assets "in" Canada. Since Draft IG #15 also treats cash as an asset (assuming cash is considered a financial asset with rights and privileges conferred by statute) the effect would be to deem all holdings of Canadian dollars by foreign entities (whether held in Canadian or foreign accounts) to be assets "in Canada" for the purposes of ss. 109 and 110. Similarly, all holders of Government of Canada Treasury Bills would be deemed to hold financial assets "in Canada". This result is not consistent with generally accepted accounting principles, which we understand would attribute cash (regardless of the currency) to the entity that owns the cash, regardless of the jurisdiction of the entity, rather than the jurisdiction of the statute conferring the legal rights and privileges associated with the asset. The attribution proposed by Draft IG #15 is impractical and would likely produce arbitrary results. For instance, foreign holders of derivatives contracts for Canadian currency or Treasury Bills would not be considered to have assets "in" Canada, but they would have assets in Canada if they held the currency or Treasury Bills directly. With similar effect, arguably a holder of Canadian currency or Treasury Bills could convert those holdings into foreign derivatives contracts and avail itself of s. 14 of the Regulations, and potentially avoid Part IX of the Act.[5] Such arbitrary results are of particular concern given that these types of financial assets are immaterial for the purposes of a substantive competition law analysis. Cash is not included at all in the calculation of thresholds for the U.S. *Hart-Scott-Rodino Act*.

The statement that shares in a foreign company are not assets in Canada (presumably even if held by a Canadian entity) is helpful and appropriate, but it is hard to see how it is consistent with other assertions in section 2.1.3 (e.g., a private partnership interest in a U.S. partnership held by a Canadian entity would be an asset in Canada under Draft IG #15).

[5] Both Draft IG #14 and #15 would raise many complex issues under s. 14 of the Regulations and potentially enable avoidance of a Part IX notification obligation where some of the distinguishing features or criteria proposed in the Draft IGs change following the end of the relevant fiscal period – e.g., moveable assets transported from Canada to a foreign jurisdiction, export of a company or other entity to a foreign jurisdiction of organization, or repayment of a loan between affiliates. These complexities are further evidence that many of the distinctions proposed in the Draft IGs were not intended by the Act or the Regulations.

Gross Revenues from Sales "In, From or Into" Canada

Section 2.2 states that the jurisdiction of incorporation of a purchaser is relevant to a geographic allocation of sales. This adds unnecessary complexity and deviates from our understanding of generally accepted accounting principles. For example, a U.S. corporation might sell goods to or perform a service for A Corp. in North Dakota and send its invoice to A Corp at the address to which it delivered the goods or performed the service. It would be impractical for a U.S. corporation to conduct due diligence on each of its customers to determine their jurisdiction of incorporation. Instead, the sales should be allocated in accordance with generally accepted accounting principles, which we understand would normally treat the sales as being in the jurisdiction in which the company delivered the goods or performed the services.

The comment in the last paragraph of section 2.2 is helpful and appropriate regarding sales to a Canadian purchaser delivered to a facility located outside Canada not counting as sales into Canada, particularly since the seller may not know the ultimate destination of the goods.

Sales Generated From Assets in Canada

Section 2.3 proposes that revenues be considered generated from assets in Canada if “any of the revenue-generating assets of the target business are located in Canada.” Read literally, this does not require any relationship between the product sold to the Canadian purchaser and the revenue generating assets in Canada to count the sales as “in Canada”. For instance, a company could sell Product A manufactured from its U.S. facilities to a Canadian purchaser. If the company had a warehouse for Product B located in Canada, then any and all of the company's sales of any product into Canada (Product A, Product B or another product) would be considered sales generated from assets in Canada. If the company sold Product B to a Canadian purchaser, but only 10% of the products passed through its Canadian warehouse, all of the sales of Product B would be considered to be sales “generated from assets in” Canada. Conversely, if the company sold Product B to a U.S. customer and 10% of the order was filled from its Canadian warehouse, Draft IG #15 would treat all the sales to the U.S. customer as being sales from Canada generated from assets in Canada. The Act's language is clear that sales of Product A should not count for the purposes of Part IX because the Canadian assets were not responsible for generating the revenue from the sales. Neither the Act nor the Regulation provide any basis for counting all the sales of Product B for the purposes of Part IX. If read literally, Draft IG #15 is inconsistent with the Act in this instance and should be clarified to avoid such an interpretation.

Examples

The examples in Draft IG #15 adopt interpretations inconsistent with the Act, the Regulations and the policies in the IGs.

Example One does not include any facts to suggest that any of the goods valued at $200 million were sold by the Canadian sales office. Only to the extent that the sales were negotiated, contracted for, and organized through the Canadian sales office to a substantial degree might it be appropriate to treat the sales as being generated from assets in Canada. Absent a nexus between the supply of the goods and the Canadian sales office, it would be inappropriate to treat these sales as "generated from assets in" Canada. Rather, these would be sales "into" Canada, which are not counted under s. 110 of the Act.

Example Two appears to treat the cruise ships as assets "in Canada" simply because of the existence of a Canadian administrative office. Even if the approach proposed in Draft IG #15 were adopted, other factors that might demonstrate a sufficient nexus between the ships and Canada for the ships to be considered assets "in Canada" could include a high percentage of Canadian customers on the cruise ships relative to the nationalities of other passengers, the revenues attributable to those Canadian customers, or information about the degree of control exercised by the Canadian administrative office over each of the vessels.[6] Whether or not the administrative office is a "Canadian entity" is not relevant to the inquiry.

In addition, the guidance proposed in section 2.1.1 for moveable tangible assets of a foreign entity, such as Party C, would require allocation of only a proportion of the value of the ships to Canada, and not the entire book value. The discussion of the example appears to assume that the entire book value of the ships is allocated to Canada. Otherwise, it is not clear that the relevant portion of the value of the ships attributable to Canada would exceed $50 million, or on what basis the value would be apportioned.

Alternatively, if the Bureau is suggesting in this example that it would consider an administrative office in Canada of a foreign corporation to be a "Canadian entity", that would also be inconsistent with the Act and the Regulations. An office of foreign corporation is not in itself a person for the

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6 See Informal Staff Opinion 0703003 - 802.50, 802.4 of the U.S. Federal Trade Commission, available online at: http://ftcsearch.ftc.gov/search?q=cruise+ship&site=InformalOpinions&client=default_frontend&output=xml_no_dtd&proxystylesheet=ftc_advanced&filter=0. See also *Fundy Settlement v. Canada*, 2012 SCC 14 at para. 15, in which the Court held that jurisdiction is established where "its real business is carried on."

purposes of the Act or the Regulations, and the example gives no indication of any ownership of any relevant assets (i.e., the two ships or the lease or other assets related to the administrative office) by any person other than C, which is a U.S. corporation.

V. CONCLUSION

We trust that our comments will be of value to the Bureau in finalizing the Interpretation Guidelines.