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Transfer Pricing in Canada: An Overview

Legislation

Since 1997, Canada's transfer pricing rules have been included in section 247 of the Canadian *Income Tax Act* (ITA). They are complemented by sections 233.1 ITA, 233.3 ITA, 233.4 ITA, and 233.8 ITA, as applicable.

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The Canadian transfer pricing rules are administered by the Canada Revenue Agency (CRA). In the province of Quebec, the Agence du revenu du Québec (ARQ) also conduct transfer pricing compliance audit, although it has indicated in the past that it shall abide by CRA's tax judgement regarding controlled transactions.

Section 233.1 ITA prescribes the filing of an information return containing the prescribed information (Form T106) for non-arm's length transactions with non-residents when the total amount of these controlled transactions exceed \$1,000,000. Specific penalties apply for failure to comply.

Subsection 247(1) ITA provides various definitions such as "arm's length allocation", "arm's length transfer price" and "transfer price".

Subsection 247(2) ITA authorizes the adjustment by the CRA of the terms and conditions made or imposed between the participants in a controlled transaction when they differ from those that would have been made between persons dealing at arm's length.

In essence, subsection 247(2) ITA allows the CRA to adjust the terms and conditions of a specific controlled transaction to ensure respect of article 9 of the *OECD Model Tax Convention on Income and on Capital*. Canada has concluded 92 bilateral tax treaties. These tax treaties take precedence on the Canadian *Income Tax Act*.

In specific cases, paragraph 247(2)(b) ITA enables the CRA to recharacterize a controlled transaction when it can be reasonably considered that such transaction has no other purpose than to obtain a tax benefit.

Subsection 247(3) ITA prescribes the liability to a transfer pricing penalty when there is a lack of reasonable efforts in the determination of an arm's length price.

Other penalties may also apply when there is failure to comply with either section 247 ITA or sections 233.1 ITA, 233.3 ITA, 233.4 ITA and 233.8 ITA.

Subsection 247(4) ITA describes the documents and records required in answer to a request for contemporaneous documentation issued by the CRA at the commencement of a transfer pricing compliance audit.

Administrative position

The transfer pricing rules included in the Canadian *Income Tax act* are broad by design. As such, Information Circular *IC 87-2R International Transfer Pricing* contains the administrative position of the CRA on the Canadian transfer pricing rules.

More information on the administrative position of the CRA is available in the *Transfer Pricing Memoranda* (TPM) series. The TPM series deals with the request for contemporaneous documentation, the definition of reasonable efforts for the determination of an arm's length transfer price, the tax consequences of combined and bundled transactions, the recharacterization process of a controlled transaction, and the use of third party information by the CRA, among other subjects.

The *OECD Transfer Pricing Guidelines* are officially recognized in Canada. The *CRA Audit Manual* and *Information Circular IC 87-2R* explicitly refer to the *OECD Transfer Pricing Guidelines*.

The CRA administrative position also includes guidance on the mutual agreement procedure (MAP) and the Canadian advance pricing arrangement (APA) program.

Transfer pricing compliance audit

The transfer pricing compliance audit is the responsibility of the CRA. It is legally enforced as per section 231.1 ITA. Often times, the compliance tax audit starts with an audit protocol which defines the scope and the issues under audit. In the case of a transfer pricing compliance audit, the process always commence with the request for contemporaneous documentation.

Canadian tax courts

The Canadian tax courts have acknowledged the relevance of the CRA administrative position and of the *OECD Transfer Pricing Guidelines* in their decisions related to transfer pricing.

However, the Canadian tax courts have given explicit precedence to the notion of "reasonable business person" in the determination of an arm's length price, which may on occasion create subtleties in the interpretation of the proper application of the arm's length principle in Canada.

Canada and the Base Erosion and Profit Shifting initiative (BEPS)

On October 15, 2015, the OECD released an updated series of reports including the updated *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting* (BEPS Action 13). As an OECD member country, Canada has been deeply involved in the Base Erosion and Profit Shifting initiative (BEPS).

This was followed by the *Country-by-Country Reporting XML Schema: User Guide for Tax Administrations and Taxpayers* in March 2016 and numerous updated versions of *Guidance on the Implementation of Country-by-Country Reporting*.

In Canada, section 233.8 ITA prescribes country-by-country reporting in Canada. The CRA has also published *RC4651 Guidance on Country-by-Country Reporting in Canada*. Country-by-country reporting is applicable to fiscal years starting on or after January 1st, 2016.

However, country-by-country reporting varies around the world. To deal with these discrepancies, the CRA has indicated that a constituent entity will not be required to file a country-by-country report in Canada during the transition period. Filing in Canada commences on fiscal years starting on January 1st, 2018 for subjected MNE group.

Conclusion

To ensure that you are fully compliant with the Canadian transfer pricing rules, it may be time to review the transfer pricing policies and procedures of your company. Other business processes may also need to be reconsidered, revised or modified to produce strong operational transfer pricing processes in the MNE group.



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The accounting firm RBRT Inc. is governed by the Ordre des CPA du Québec, Canada. RBRT Inc. specializes in transfer pricing, tax treaties and other international tax matters. Our services include transfer pricing documentation (BEPS, transfer pricing policies and procedures, and contemporaneous documentation), transfer pricing dispute resolution, tax treaty matters including double tax relief, tax treaty-based returns and waivers, advanced pricing agreement (APA), value chain management and TP planning and transfer pricing training.

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