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Transfer Pricing in Canada: Reporting of Non-Arm's Length Transactions with Non-Residents

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.

Subsection 233.1(4) 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 exceeds \$1,000,000.

Subsection 233.8(3) ITA prescribes the filing of the country-by-country report containing the prescribed information (form *RC4649*) where the total amount of the consolidated group revenues is equal or above 750 million Euros.

Administrative position

Regarding T106 filing, the *De minimis Administrative Policy* of the Canada Revenue Agency (CRA) explains:

“Before the 1998 amendments to section 233.1 of the Income Tax Act, the Canada Revenue Agency (CRA) required taxpayers to report detailed information on a T106 return only when their transactions with particular non-residents amounted to \$25,000 or more. The 1998 amendments [paragraph 233.1(4) ITA] introduced a de minimis rule that eliminated reporting unless the total amount of non-arm's length transactions with all non-residents exceeded \$1,000,000 in a reporting period. Since this overall de minimis threshold exempted a significant number of smaller taxpayers from the reporting requirement, the CRA removed the \$25,000 individual threshold.

Even though the \$1,000,000 threshold eliminates reporting for many taxpayers, it creates an administrative burden for others. Once taxpayers exceed the threshold, they must report all their non-arm's length transactions with non-residents. As a result, some taxpayers must prepare detailed information returns even when their total transactions with particular non-residents fall well below the previous \$25,000 threshold.

To reduce this administrative burden, the \$25,000 threshold for non-arm's length transactions with each non-resident person is once again applicable. Taxpayers must still file Form T106 to report other information, but they do not need to report detailed information where their total transactions with a particular non-resident are below the \$25,000 threshold. In other words, taxpayers are no longer required to report these transactions in Part III of the form.”

T106 reporting rules

The instructions in form *T106 Information Return of Non-Arm's Length Transactions with Non-Residents* include detail on how to report these transactions. In accordance with section 233.1 ITA:

“A reporting person (or partnership) has to file T106 documentation for a tax year in respect of reportable transactions in which the reporting person and the non-arm's length non-resident person (or partnership of which that non-resident person is a member) participated in the period.”

A T106 form must be filed for each non-resident with which the reporting person (or partnership) has had non-arm's length transactions. One *T106 Summary* must also be filed to provide an overview of the nature and materiality of the reported non-arm's length transactions.

In the case of a corporation, the *T106* documentation must be filed six months after the end of the taxation year at the latest. For partnerships, the due date is the same as the due date for filing a partnership information return.

The instructions in form *T106 Information Return of Non-Arm's Length Transactions with Non-Residents* also indicate that “T106 documentation has to be mailed to the Ottawa Technology Centre, Validation and Verification Division, Other Programs Unit, 875 Heron Road, Ottawa ON K1A 1A2. T106 documentation has to be filed separately from the income tax return. Do not attach T106 documentation to your income tax return.”

T106 reporting penalties

The Canadian *Income Tax Act* prescribes numerous penalties for failure to comply with the reporting obligations of non-arm's length transactions with non-residents as highlighted in the T106 form's instructions:

- “Late Filing – A late filing penalty, or multiple late filing penalties for more than one T106 Slip may be assessed under subsection 162(7) of the Income Tax Act where T106 documentation is filed after the due date. The penalty is equal to the greater of \$100 and \$25 per day, as long as the failure to file continues, to a maximum of 100 days.
- Failure to file – A failure to file penalty may be assessed under subsection 162(10) of the Income Tax Act where reporting persons or partnerships knowingly, or under circumstances amounting to gross negligence, fail to file or fail to comply with a request by the Canada Revenue Agency (CRA) for T106 documentation. The minimum penalty is \$500 per month, to a maximum of \$12,000 for each failure to comply. Where the CRA has served a demand to file T106 documentation, the minimum penalty is \$1,000 per month, to a maximum of \$24,000 for each failure to comply.
- False statement or omission – A false statement or omissions penalty may be assessed under subsection 163(2.4) of the Income Tax Act where information provided on the T106 Summary or Slip is incomplete or incorrect. The penalty is \$24,000.”

RC4649 country-by-country reporting 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, form *RC4649, Country-by-Country Report* requires numerous information, including:

- Revenues;
- Earnings before income tax;
- Income tax paid;
- Total withholding tax paid;
- Stated capital and accumulated earnings;
- Number of employees;
- Total employee expense;
- Tangible assets other than cash and cash equivalents;
- Royalties paid and received;
- Interest paid and received;
- Service fees paid and received.

RC4649 reporting rules

The instructions in guidance *RC4651 Guidance on Country-by-Country Reporting in Canada* indicates that an “MNE group that has total consolidated group revenue of 750 million euros or more in the fiscal year immediately preceding a particular fiscal year, as reflected in its consolidated financial statements for the preceding fiscal year, is required to file a CbCR [country-by-country report] for fiscal years that begin after 2015. If the consolidated financial statements are reported in a currency other than the euro, a conversion to euros will have to be made to determine whether the threshold is met. For this calculation use the average exchange rate for the fiscal period as published by the Bank of Canada to convert the consolidated group revenue amount of the MNE group. Annual and monthly average exchange rates can be found at the Bank of Canada website. The selection of a particular exchange rate must be supported with appropriate documentation”

As indicated in *RC4651 Guidance on Country-by-Country Reporting in Canada*, country-by-country reporting in Canada commences on fiscal years starting on January 1st, 2018 for any subjected MNE group to account for the transition period.

RC4649 reporting penalties

The instructions in guidance *RC4651* also indicates that the country-by-country report “is due no later than 12 months after the last day of the "Reporting Fiscal Year" of the MNE group. If notification of systemic failure has been received by a constituent entity, this deadline can be extended by 30 days after receipt of the notification.”

Filing must be done separately from other filings and sent directly to the International Policy Section of the International Tax Division.

The Canadian *Income Tax Act* prescribes numerous penalties for failure to comply with the reporting obligations of non-arm's length transactions with non-residents as highlighted in the *RC4651*:

- “Subsection 162(5) of the Act provides a penalty for the failure of any person to provide any information required on a prescribed form made pursuant to the Act or the Regulations. The penalty for the failure to provide the information is \$100 and is applicable to each such failure. [...]
- Subsection 162(7) of the Act provides a penalty for the failure to file an information return as and when required by the Act and for the failure to comply with a duty or obligation imposed under the Act or the Regulations. The penalty is equal to \$25 per day of default, subject to a \$100 minimum and a \$2,500 maximum.”

Additional penalties may be levied in situation of gross negligence and failure to file in a timely fashion or following a request from the CRA to file. With respect to subsection 162(10) ITA, the minimum penalty is \$1,000 per month, to a maximum of \$24,000 for each failure to comply.

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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