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Transfer Pricing in Canada: Contemporaneous Documentation

Legislation

Since 1997, Canada's transfer pricing rules have been included in section 247 of the Canadian *Income Tax Act* (ITA).

The Canadian transfer pricing rules are managed by the Canada Revenue Agency (CRA). In the province of Quebec, the *Agence du revenu du Quebec* also does transfer pricing compliance audit.

Subsection 247(4) ITA describes the "documents and records" required in answer to a request for contemporaneous documentation issued by the CRA. Paragraph 247(4)(a) ITA indicates that records or documents must "provide a description that is complete and accurate in all material respects of

- (i) the property or services to which the transaction relates,
- (ii) the terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction,
- (iii) the identity of the participants in the transaction and their relationship to each other at the time the transaction was entered into,
- (iv) the functions performed, the property used or contributed and the risks assumed, in respect of the transaction, by the participants in the transaction,
- (v) the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the transaction, and
- (vi) the assumptions, strategies and policies, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the transaction."

Paragraph 247(4)(b) ITA indicates that material changes to the non-arm's length transactions documented as per paragraph 247(4)(a) ITA must also be documented in the contemporaneous documentation.

Paragraph 247(4)(c) ITA states that the taxpayer must "provide the records and documents described in paragraphs 247(4)(a) and 247(4)(b) to the Minister within 3 months after service, made personally or by registered or certified mail, of a written request."

The preamble of subsection 247(4) ITA clearly specifies that without full compliance to these rules the taxpayer is deemed not to have made reasonable efforts in response to the request for contemporaneous documentation. Subsection 247(3) ITA prescribes the liability to a transfer pricing penalty when there is a lack of reasonable efforts in the determination of any arm's length price.

Administrative position

The transfer pricing documentation rules included in the Canadian *Income Tax act* are fairly 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.

In Quebec, the *Agence du revenu du Quebec* has indicated its intent to cooperate with the CRA where a transfer pricing audit is performed.

More information on the administrative position of the CRA is available in the *Transfer Pricing Memoranda (TPM)* series.

Paragraph 187 of the Information Circular *IC 87-2R* indicates that the "Department [CRA] expects the taxpayer's documentation to include:

- the general organization and description of the business;
- the selection of a particular transfer pricing methodology, including an explanation of why the selected method is more appropriate than any higher-ranking methods;
- the projection of the expected benefits as they relate to the valuation of an intangible;
- the scope of the search and criteria used to select comparables;
- an analysis of the factors determining comparability, including a review of the differences and attempts made to make adjustments; and
- the assumptions, strategies, and policies as they relate to the tangible property, intangible property, and services being transferred."

Paragraph 188 clarifies that the taxpayer may nonetheless weight the "significance of the transactions in terms of their business with the additional administrative costs required to prepare or obtain such documentation."

The Canadian transfer pricing documentation requirements are similar to those listed in Chapter V of the *OECD Transfer Pricing Guidelines* issued in July 2017.

In Canada, the Transfer Pricing Memorandum *TPM-05R Requests for Contemporaneous Documentation*, released on March 28, 2014, explains at paragraph 9 that a “requests for contemporaneous documentation must be issued at the stage of initial contact with the taxpayer” in all transfer pricing audits carry out by the CRA.

The request for contemporaneous documentation (C-doc) must be issued for each taxation year when more than one year is subjected to a transfer pricing compliance audit.

TPM-05R Requests for Contemporaneous Documentation indicates that the 3-month delay prescribed under paragraph 247(4)(c) ITA is computed on a monthly basis only:

“17. The three-month deadline cannot be altered or interpreted as meaning a number of days (such as 90 days or 92 days). Section 28 of the Interpretation Act explains how to calculate the three-month period. Under paragraph 28(c) of the Interpretation Act, the day on which the three-month period expires will bear the same calendar day number as the specified day [Specified day is the day on which the request for contemporaneous documentation is served (received)]. If the calendar day does not exist in the month in which the period of time expires, the period will expire on the last day of that month. This addresses the months of the calendar year that do not have days 29, 30, and 31.

18. For example, when a request for contemporaneous documentation is served on April 15, the taxpayer has until July 15 of the same year to provide the documentation. Similarly, when a request is served on April 30, the taxpayer has until July 30 to provide the documentation, not July 31. However, if a request is served on January 31, the taxpayer has until April 30 to provide the documentation because April does not have a 31st day. If a request is served on March 31, the taxpayer has to provide the documentation by June 30. If the request is served on November 30, the taxpayer has to provide the documentation by February 28 of the following calendar year (or February 29 in the case of a leap year).

19. When the last day to comply falls on a holiday, the taxpayer has until the next day that is not a holiday to comply, according to section 26 of the Interpretation Act. A holiday includes statutory and provincial holidays, Saturdays, and Sundays [Refer to section 26 and subsection 35(1) (including the notes) of the Interpretation Act.]”

TPM-05R Requests for Contemporaneous Documentation also indicates that “provide” as it is written in paragraph 247(4)(c) ITA means “to supply such information to an individual. For clarity, “provide” means the documents have to be delivered to and received by a CRA office and does not mean “made available.””

Transfer pricing documentation 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.

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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