



[rbrt.ca](http://rbrt.ca)

**Contact:**

**Robert Robillard**  
**514-742-8086**  
[robertrobillard@rbrt.ca](mailto:robertrobillard@rbrt.ca)

## Transfer Pricing in Canada: Reasonable efforts to Determine an Arm's Length Price

### 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(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.

The preamble to subsection 247(4) ITA indicates that "a taxpayer or a partnership is deemed not to have made reasonable efforts to determine and use arm's length transfer prices" unless it provides the "documents and records" prescribed in paragraph 247(4)(a) and (b) ITA before the time limit prescribed under paragraph 247(4)(c) ITA.

### Administrative position

However, the transfer pricing rules included in the Canadian *Income Tax act* are fairly broad by design. As such, the notion of "reasonable efforts" is not clearly defined.

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.

Paragraph 179 of the Information Circular *IC 87-2R* indicates that the "general determination of whether a taxpayer has made reasonable efforts to determine and use arm's length transfer prices or allocations is a question of fact. The Department [CRA] will consider that taxpayers have made reasonable efforts if they have taken all reasonable steps to ensure that their transfer prices or allocations conform with the arm's length principle."

Paragraph 183 of the Information Circular *IC 87-2R* makes clear that the documents enumerated in subsection 247(4) ITA are not “intended to be an exhaustive list of the documents” that may be necessary to determine an arm's length price or to consider that a taxpayer has made reasonable efforts in that determination.

In Canada, the International Tax Auditor must assess if the taxpayer has made reasonable efforts. However, to ensure a consistent application of the transfer pricing penalty prescribed under subsection 247(3) ITA, Transfer Pricing Memorandum *TPM-05R – Contemporaneous Documentation* reaffirms that the “Transfer Pricing Review Committee (TPRC) has the (ultimate) mandate of determining whether reasonable efforts have been made. The TPRC bases the determination of reasonable efforts on the facts and circumstances of the taxpayer's situation.”

More on the administrative position of the CRA on what constitute reasonable efforts can be found in *TPM-09 Reasonable efforts under section 247 of the Income Tax Act* released on September 18, 2006. In Transfer Pricing Memorandum *TPM-09*, the CRA indicates that:

“The reasonable efforts test is contained in both subsections 247(3) and 247(4) [ITA] and contains two elements:

1. the general determination of reasonable efforts, and
2. the deeming provision of not having made reasonable efforts.

The general determination of whether a taxpayer has made reasonable efforts to determine and use arm's length transfer prices or allocations is a question of fact. The CRA will consider taxpayers to have made reasonable efforts if they have taken all reasonable steps to ensure that their transfer prices or allocations conform with the arm's length principle.

The reasonable efforts test in both subsections 247(3) and 247(4) also refers to a dual obligation in that taxpayers must make reasonable efforts:

1. to determine arm's length transfer prices or arm's length allocations, and
2. to use those prices or allocations.

Therefore, in determining whether the transfer pricing penalty is applicable, it will be necessary to show that reasonable efforts were made both in establishing and using arm's length pricing.”

The CRA specifies that “reasonable efforts” means the “degree of effort that an independent and competent person engaged in the same line of business or endeavour would exercise under similar circumstances. What is reasonable is based on what a reasonable business person in the taxpayer's circumstances would do, having regard to the complexity and importance of the transfer pricing issues that arise in the taxpayer's case.”

In more tangible terms, reasonable efforts are demonstrated where:

1. the determination of an arm's length price is fairly accurate as to not trigger the liability to a transfer penalty as per paragraph 247(3)(b) ITA;
2. the taxpayer has documented its transfer pricing in such a way as to demonstrate reasonable efforts in the determination of an arm's length price and the systematic use of that price;
3. the taxpayer properly weighted the materiality of the controlled transactions with the additional administrative costs required to prepare or obtain transfer pricing documentation.

### **Canadian tax courts**

The clear demonstration of reasonable efforts is highly subjective in nature. What an independent and competent person engaged in the same line of business would do under similar circumstances is of paramount importance for that determination.

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.

In *McKesson Canada Corporation v. The Queen*, 2013 TCC 404, the Honourable Justice Patrick Boyle remarked that the CRA may need to review its threshold criteria with respect to subsection 247(4) ITA and the liability to transfer penalties as per subsection 247(3) ITA.

In *Marzen Artistic Aluminum Ltd. v. The Queen*, 2014 TCC 194, the Honourable Justice G. A. Sheridan simply ignored the administrative position of the CRA to determine if the taxpayer had made reasonable efforts in its determination of arm's length price. The analysis of the Tax Court of Canada was limited to the content of subparagraphs 247(4)(a)(i)-(vi) ITA.

### **Reasonable efforts 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). In Canada, the notion of reasonable efforts is closely linked to the timely production of the contemporaneous documentation provided to the CRA under subsection 247(4) ITA.

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.



**RBRT Inc.**

Robert Robillard, Ph.D., CPA, CGA, Adm.A., MBA, M.Sc. Econ., M.A.P.

Senior Partner

514-742-8086

[robertrobillard@rbrt.ca](mailto:robertrobillard@rbrt.ca)

---

*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.*

*The information in this technical note is current to January 2019. It is general information only. Data and information come from sources believed to be reliable but complete accuracy cannot be guaranteed. RBRT Inc. and the author are not responsible or liable for any error, omission or inaccuracy in such information. Readers should seek independent tax advice and tax counsel from RBRT Inc. as required.*