

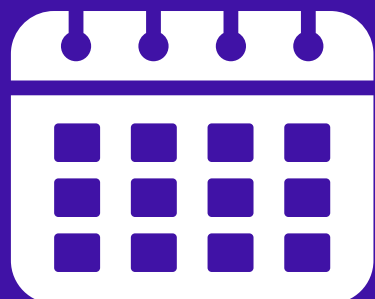
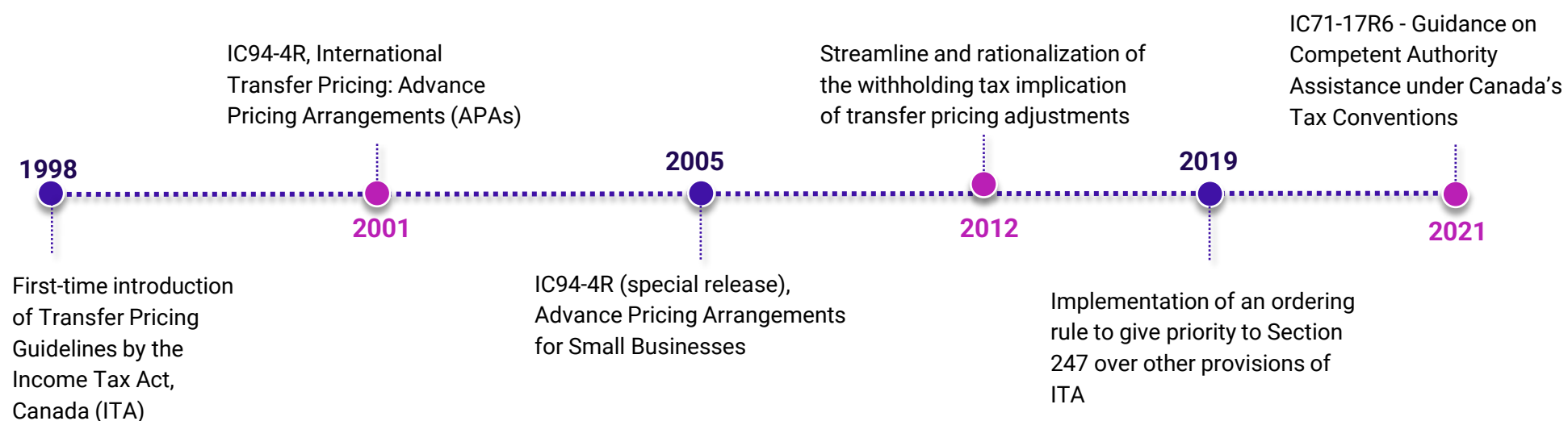
Global Transfer Pricing Landscape

Canada

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Highlights



Introduction

Canada is a member of the OECD. Section 247 of the Income Tax Act, Canada (ITA) received Royal Assent on 18 June 1998 and generally applies to the tax years after 1997. There is no mention in the OECD Guidelines in Section 247 of the ITA. However, the legislative provision in the OECD Guidelines is intended to reflect the arm's-length principle.

Currently, the relevant Canadian statutory provisions are being relied upon for domestic transfer pricing issues. The proposal for revision of Canadian transfer pricing legislation is currently under consideration, including harmonization of domestic documentation requirements with the OECD documentation framework.

Implementation of BEPS Action 13

Canada has not adopted or implemented BEPS Action 13 for transfer pricing documentation in its local regulations. It relies on the jurisdiction outlined in Section 247(4)(a)(i) to (vi) of the ITA for transfer pricing documentation framework.

Transfer Pricing Documentation

There is no specific threshold for Transfer Pricing documentation. However, if the total reportable transactions **exceed CAD 1 million**, then they are required to be reported in **Form T106**.

As per the local jurisdiction regulations, transfer pricing documentation should be annually maintained. The documentation needs to be prepared contemporaneously and is required to be submitted upon request by the Canada Revenue Agency (CRA). For domestic transactions, maintenance of documentation is not required.

Transfer Pricing Returns

The taxpayers are required to file Form T106 return annually. All transactions undertaken with non-arm's-length non-residents during the taxation year need to be reported in the said form. The above applies only in the cases where the value of transactions with non-arm's-length non-residents on an aggregate basis exceeds CAD1 million in the taxation year.

The T106 is a separate information return, but it is usually filed together with the corporate tax return. T106 information return and Transfer Pricing documentation should be filed within six months after the year-end for corporations and within five months after year-end for partnerships

Penalties for late filing/non-filing

- Late-filed T106 form is subject to a penalty of CAD 25/ day (CAD 2,500 maximum)
- Failure to file is penalized at CAD 500 (CAD 12,000 maximum), which is doubled (CAD 1,000/ month, CAD 24,000 maximum) when the CRA has served a demand to file.

Master file and Local file

There are no requirements laid down by CRA for Master file and Local file compliances.

Country by Country report

The limit for Country-by-Country Reporting (CbCR) is EUR 750 million, similar to the BEPS Action 13. The report should be submitted no later than 12 months after the last day of the Fiscal Year to which the CbCR relates.

Transfer Pricing methods

For international and domestic transactions, the CRA accepts the transfer pricing methods as recommended in the OECD Guidelines.

Domestic transactions may be conceptually subject to transfer pricing approaches. However, they are not addressed in the transfer pricing rules under Section 247 of the ITA. Following the 2010 revisions to the OECD Guidelines, the CRA published TPM-14 in 2012.

Benchmarking

CRA prefers local benchmarking following the jurisdiction of the tested party. Canadian benchmarks are preferred for Canada, but generally, North American companies are acceptable as comparable.

Single-year data are generally considered; however, multiple-year data can be considered for the Advance Pricing Arrangements (APA).

A Fresh benchmarking is not required every year, provided no material change in transactions. However, a fresh benchmarking would be required every 3 years in line with OECD guidelines.

Transfer Pricing Penalties

Compliance penalties

Subsection 247(3) of the ITA imposes a penalty of 10% of the net upward transfer pricing adjustments. These penalties are applicable if:

- Adjustments exceed the lesser of 10% of the taxpayer's gross revenue for the year or CAD 5 million
- The taxpayer has not made reasonable efforts to determine and use arm's-length transfer prices

A taxpayer will be deemed not to have made reasonable efforts to determine and use arm's-length transfer prices or allocations if the records or documents are not provided to the CRA within three months of the issuance of a written request to do so.

As set out in TPM-13, all proposed reassessments involving potential transfer pricing penalties must be referred to the Transfer Pricing Review Committee (TPRC) for review and recommendation for final action.

Penalty Relief

Taxpayers will be relieved from the transfer pricing penalties under Subsection 247(3) of the ITA with respect to transactions covered by an APA, as long as the APA remains in effect and the taxpayer complies with its terms and conditions.

Transfer Pricing Assessments

Under Subsection 152(4) of the ITA, the Minister of National Revenue ordinarily cannot reassess a taxpayer after the “normal reassessment period” as defined in Subsection 152(3.1) of the ITA.

For most multinational taxpayers, the assessment period is four years, beginning after the day of mailing a notice of an original assessment for the year or the day of mailing an original notification that no tax is payable for the year.

In respect of non-arm’s-length transactions with non-residents, the reassessment period is extended by an additional three years, i.e., to seven years. This time period may be further extended if the taxpayer provides the CRA with a waiver (authorization from the taxpayer to the CRA to waive the time limit for reassessment).

CRA guidance in TPM-16 indicates that “the CRA will not make a transfer pricing adjustment if the price or margin of the transaction is within the arm’s length range.

If the price or margin falls outside the established range, the CRA will determine the most appropriate point within the range using the most suitable measure. CRA can resort to determining the arm’s length using the “average.”

Specific transactions

The below transactions are most likely to undergo an audit:

- Corporate restructuring,
- Royalties,
- Hybrid debt transactions,
- Financial products and
- Corporate services charges

Having said that, CRA does not limit itself to these categories, and all types of transactions are susceptible to being selected for audit.

APA and MAP Procedures

Advance Pricing Agreement (APA)

The CRA launched its APA program in July 1993. As set out in IC94-4R, it allows taxpayers to pursue unilateral, bilateral, and multilateral APAs.

In addition, the CRA has made a small business APA program available to Canadian taxpayers under certain conditions. The CRA no longer charges taxpayers to complete an APA.

An APA request can cover a taxation year if the request is made before the filing due date for that year.

Typically, the tenure of APA is five years, but terms can vary. Additional years may be added at the end of an APA negotiation.

In line with TPM-11, APAs cannot be rolled back to the tax years under assessment.

Mutual Agreement Procedure (MAP)

The taxpayer may request MAP consideration under an applicable treaty.

Thin Capitalization

Canada operates a “thin capitalization” regime that caps the proportion of related party cross-border interest that may be deducted by reference to a debt-equity ratio of 1.5:1.

Proposal

The proposals below are set out in the Transfer Pricing Consultation paper:

- The threshold for transfer pricing adjustments to potentially trigger penalties should be increased to CAD 10 million;
- Aligning existing contemporaneous documentation standards with those used by the OECD and
- Adopting streamlined approaches for certain situations (e.g., intra-group loans, routine distribution activities, etc.)
- A rule limiting deductions of interest consistent with the recommendations of the BEPS Action 4 Report
- Introduce anti-hybrid rules consistent with the BEPS Action 2 recommendations.

Summary of Transfer Pricing Requirements

Effective from

- Original transfer pricing guidelines were effective from 18 June 1998 and applicable to tax years that began after 1997.
- For transactions after 28 March 2012, Sections 247(12) to 247(15) were added in 2012 to streamline and rationalize the withholding tax implications of transfer pricing adjustments.
- Section 247(2.1) was added in 2021, applicable to taxation years that begin after 18 March 2019, to implement an ordering rule to give priority to Section 247 over other provisions of the ITA

Compliance Requirements

- No specific threshold for Transfer Pricing documentation. However, if the total reportable transactions exceed CAD 1 million, then they are required to be reported in Form T106.

Penalties

- Late-filed T106 form is subject to a penalty of CAD 25/ day (CAD 2,500 maximum)
- Failure to file is penalized at CAD 500 (CAD 12,000 maximum), which is doubled (CAD 1,000/ month, CAD 24,000 maximum) where the CRA has served a demand to file.

Method and Preference for Comparable

- CRA accepts the Transfer Pricing methods as defined in the OECD guidelines.

- Canadian benchmarks are preferred, but North American are generally companies are acceptable as comparable.

Peculiar Features

- The taxpayers are required to file Form T106 return annually. All transactions undertaken with non-arm's-length nonresidents during the taxation year need to be reported in the said form.
- Canada has not adopted or implemented BEPS Action 13 for transfer pricing documentation in its local regulations. It relies on the jurisdiction outlined in Section 247(4)(a)(i) to (vi) of the ITA for transfer pricing documentation framework

Safe Harbour and APA

- No specific provisions for safe harbor.
- The tenure of APA is five years, but terms can vary. Additional years may be added at the end of an APA negotiation.
- In line with TPM-11, APAs cannot be rolled back to the tax years under assessment.

CbCR applicability

The limit for CbCr is EUR 750 million similar to the BEPS Action 13. The report should be submitted no later than 12 months after the last day of the Fiscal Year to which the CbCR relates.



About Nexdigm

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