

**Brief to the Standing Committee on Finance**  
**(Ref.: Priorities for the 2015 Federal Budget)**

Longueuil, August 1, 2014

Parliament of Canada  
Standing Committee on Finance  
Ottawa, Ontario

Sent via email to: [finapbc-cpb@parl.gc.ca](mailto:finapbc-cpb@parl.gc.ca)

Dear Sir/Madam:

In the news release issued on June 6, 2014, Canadians were invited to share their priorities for the 2015 federal budget. Six “key themes” were identified, one of which was “Improving Canada’s taxation and regulatory regimes.”

You will find in this submission various points for discussion on this theme, specifically relating to international taxation in Canada.

We are available to appear before the Standing Committee if you would like further information.

We give our authorization for this submission to be posted on the Committee’s website, with credit to Robert Robillard, CPA, CGA, MBA, M.Sc. Economics, Chief Economist, RBRT Transfer Pricing (RBRT Inc.) and professor at the Université du Québec à Montréal.

## **Summary**

The member nations of the OECD are in the process of making numerous changes in international taxation. Among those changes, the rules for documenting transfer prices for cross-border controlled transactions are currently being examined around the world. Because Canada cannot escape this significant trend, we propose specific legislative amendments to sections 233.1 and 247 of the *Income Tax Act* in order to bring Canada in line with these changes, without unnecessarily increasing the obligations of Canadian taxpayers.

### **1. Transfer pricing in Canada: background**

1.1 In July 2013, the OECD member nations criticized the presumed phenomenon of tax base erosion. <sup>1</sup> This led to the “BEPS initiative” now under way.

1.2 Among the alleged problems needing to be addressed is a desire to “assure that transfer pricing outcomes are in line with value creation”<sup>2</sup> and to “develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for businesses.”<sup>3</sup>

1.3 This led to an initial publication,<sup>4</sup> later revised in January 2014,<sup>5</sup> which will eventually become the new Chapter V of the OECD Guidelines<sup>6</sup> coming out this fall.<sup>7</sup>

1.4 In the annex to the revised January 2014 publication are the three templates that comprise the “triple documentary approach” proposed by the OECD. We agree with most of the comments<sup>8</sup> that the approach will not resolve the problems identified by the BEPS initiative regarding transfer pricing documentation.

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<sup>1</sup> OECD, *Action Plan on Base Erosion and Profit Shifting*, July 2013, online: <http://www.oecd.org/ctp/BEPSActionPlan.pdf>.

<sup>2</sup> *Ibid.*, p. 20.

<sup>3</sup> *Ibid.*, p. 25.

<sup>4</sup> OECD, *White Paper on Transfer Pricing Documentation*, July 30, 2014, online: <http://www.oecd.org/ctp/transfer-pricing/white-paper-transfer-pricing-documentation.pdf>.

<sup>5</sup> OECD, *Discussion Draft on Transfer Pricing Documentation and CbC Reporting*, January 30, 2014, online: <http://www.oecd.org/ctp/transfer-pricing/discussion-draft-transfer-pricing-documentation.pdf>.

<sup>6</sup> OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, July 2010.

<sup>7</sup> OECD, *Live Webcast. Update on BEPS Project*, May 26, 2014, p. 23, online: <http://www.oecd.org/ctp/OECD-BEPS-Webcast-26-May.pdf>.

<sup>8</sup> OECD, *Comments received on Discussion Draft on transfer pricing documentations and country-by-country reporting published today*, March 3, 2014, online: <http://www.oecd.org/ctp/transfer-pricing/comments-discussion-draft-transfer-pricing-documentation.htm>.

1.5 As practitioners, we are of the opinion that the triple documentary approach will be a new source of double taxation situations around the world over the course of the next few years.

1.6 Alongside the work conducted by the OECD, the Canadian government announced that it would hold consultations on international tax planning in the budget speech on February 11, 2014.<sup>9</sup>

1.7 It now appears clear to us that the international initiatives led by the OECD, in which Canada is a stakeholder, combined with the consultations held across the country, will soon result in amendments to the *Income Tax Act* (the Act).

1.8 The obligations regarding transfer pricing documentation are mainly set out in sections 233.1 and 247 of the Act. We propose a few changes to these legislative provisions in order to respond to the concerns of OECD member nations, without burying Canadian taxpayers under a mountain of compliance requirements.

## 2. Information return

2.1 Section 233.1 stipulates that the controlled transactions of a Canadian taxpayer and a non-resident must be declared when the conditions set out in that section are met.

2.2 Subsection 233.1(4) provides a *de minimis* exception that, where applicable, allows the taxpayer to avoid the obligation to file an information return. The amount identified in the exception has not been indexed for many years.

2.3 We propose that the amount of \$1,000,000 identified in subsection 233.1(4) be increased to \$5,000,000 to take into account the economic growth and increase in international trade over the past 15 years or so.<sup>10</sup>

2.4 We further propose that taxpayers be allowed to file the T106 Summary and Slips with their tax returns, contrary to the current instructions.

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<sup>9</sup> Canada, *The Road to Balance: Creating Jobs and Opportunities, Budget Plan*, February 11, 2014, pp. 397-400. We had the opportunity to provide some general observations on this topic.

<sup>10</sup> Along with the appropriate amendments to Form T106, *Information Return of Non-Arm's Length Transactions with Non-Residents*, online: <http://www.cra-arc.gc.ca/E/pbg/tf/t106>.

### 3. Transfer pricing documentation

3.1 Section 247 of the Act sets out Canadian tax liabilities with respect to transfer pricing.

3.2 More specifically, subsection 247(2) provides for a “transfer pricing adjustment” when “the terms or conditions made or imposed, in respect of the transaction or series, between any of the participants in the transaction or series differ from those that would have been made between persons dealing at arm’s length;” i.e., where there is infringement of the “arm’s length principle.”

3.3 Under subsection 247(3), the adjustment may give rise to a “transfer pricing penalty” when the taxpayer has not made “reasonable efforts” regarding determination of the transfer prices.

3.4 The concept of “reasonable efforts” is not defined in the Act.

3.5 In practice, taxpayers are likely to be deemed to have made reasonable efforts if they meet all of the legislative provisions set out in paragraphs 247(4)(a), (b) and (c) of the Act, according to the administrative position taken by the Canada Revenue Agency (CRA), as set out in Information Circular IC 87-2R.<sup>11</sup>

3.6 However, this administrative position considerably increases the scope of potential application of subsection 247(4), because the “list of documents in subsection 247(4) of the Act is not intended to be an exhaustive list.”<sup>12</sup>

3.7 The CRA’s administrative position is reformulated in TPM-09,<sup>13</sup> which goes into greater detail regarding the related concept of “demonstrated efforts” and gives a few examples “where taxpayers are at risk for a transfer pricing penalty.”

3.8 It should therefore be noted that these CRA administrative positions unduly and unnecessarily broaden the application of subsection 247(4) of the Act, which clearly identifies the situations in which the taxpayer would be deemed “not to have made reasonable efforts to determine and use arm’s length transfer prices or arm’s length allocations in respect of a transaction” under paragraphs 247(4)(a), (b) and (c).

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<sup>11</sup> Canada, *IC 87-2R, International Transfer Pricing*, Canada Revenue Agency, September 27, 1999, Part 7.

<sup>12</sup> *Ibid.*, par. 183.

<sup>13</sup> Canada, *TPM-09, Reasonable efforts under section 247 of the Income Tax Act*, Canada Revenue Agency, September 18, 2006.

3.9 The CRA's administrative positions illegitimately increase the taxpayer's compliance burden.

3.10 In a recent decision, the Tax Court of Canada implicitly recognized the lack of foundation for the administrative positions for the purpose of establishing the existence of "reasonable efforts." In ruling on what constitutes "reasonable efforts," the Court in fact restricted itself specifically to the wording of subsections 247(3) and 247(4) of the Act.<sup>14</sup>

3.11 We therefore propose that the CRA administrative positions set out in IC 87-2R and TPM-09 be revised with respect to "reasonable efforts" to bring them in line with the wording of subsection 247(4) of the Act.

3.12 Furthermore, as regards the current international context described in section 1 above, it is clearly unlikely that Canada will not align itself with the proposals coming out of the OECD.

3.13 In light of this, we propose that the legislator add a new paragraph to section 247 that requires the use of a new "prescribed form" in line with the information in Annex III of the new Chapter V of the OECD Guidelines.<sup>15</sup>

3.14 The current paragraph 247(4)(c) of the Act would become paragraph 247(4)(d), with the relevant changes, while the new paragraph 247(4)(c) could be worded as follows:

247(4)(c) makes or obtains, at the latest one year following the taxpayer's or partnership's documentation due date for the taxation year or fiscal period, as the case may be, in which the transaction is entered into, the prescribed information to be submitted upon request using the prescribed form.<sup>16</sup>

3.15 In our view, however, the anticipated provisions of the new paragraph 247(4)(c) should not apply to small and medium-sized businesses with gross revenue not exceeding \$30,000,000 for the year. We thus propose that a "safe harbour provision" be established.<sup>17</sup> Continuing with the paragraph numbering, this would form paragraph 247(4)(e) of the Act.

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<sup>14</sup> See paragraphs 222 to 231 inclusive of *Marzen Artistic Aluminum Ltd. v. The Queen*, 2014 TCC 194 (CanLII), judgment released on June 10, 2014.

<sup>15</sup> *Op. cit.*, note 5.

<sup>16</sup> We suggest the wording "one year following" to respect the intent expressed in paragraph 28 of the new Chapter V of the OECD Guidelines (*op. cit.*, note 5). As part of a request for documentation, the CRA would therefore require the prescribed information for the year prior to the taxation year covered by the request.

<sup>17</sup> See more specifically paragraphs 4.95, 4.98 and 4.99 of the OECD Guidelines, (*op. cit.*, note 6). This proposal is also in line with paragraph 30 of the new Chapter V of the OECD Guidelines (*op. cit.*, note 5).

3.16 Again with a view to harmonization, we further propose that the legislator review the current wording of paragraphs 247(4)(a) and 247(4)(b) to bring them in line with Annexes I and II of the new Chapter V of the OECD Guidelines.<sup>18</sup>

3.17 We propose that the legislative changes to section 247 of the Act be applicable only to the taxation years starting after December 31, 2016 in order to allow businesses to prepare adequately for the changes.

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August 1, 2014

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<sup>18</sup> *Op. cit.*, note 5. It goes without saying that the changes should also include a revision of the CRA administrative positions.