

# Tax memo

Canadian tax updates



## TCDR alert: CRA endorses update of the OECD transfer pricing guidelines

*Outlines the CRA's acceptance of the OECD's recent updates to transfer pricing guidelines.*

*December 20, 2012*

The Canada Revenue Agency (CRA) recently published TPM-14 (one in a series of Transfer Pricing Memoranda) on the 2010 update of the OECD Transfer Pricing Guidelines (the "Guidelines"). TPM-14 explains the CRA's position on the OECD's revisions to Chapters I to III of the Guidelines, as well as its guidance on business restructurings (included in a new Chapter IX of the Guidelines), both issued by the OECD on July 22, 2010.

For more information on the OECD's revised guidance please see two PKNs issued July 22, 2010: "OECD publishes revised guidelines on transfer pricing" and "OECD publishes final guidance on the transfer pricing aspects of business restructurings."

### Overview

TPM-14 confirms that the CRA endorses, without reservation, the application of the revised Guidelines for the administration of the *Income Tax Act* (the "Act") regarding transfer pricing matters. TPM-14 also clarifies that the CRA will apply the 2010 version of the Guidelines to all years open for audit, including transactions that predate their publication, and provides that the new version should apply to all treaties (including those that predate the revisions).

### Significant changes

In summary, the 2010 revisions to the Guidelines clarify and provide expanded guidance in respect of the application of the arm's length principle. TPM-14 endorses all revisions to the Guidelines and highlights the following as significant changes:

- selection of the transfer pricing method;
- application of the transactional profit methods;
- performing a comparability analysis; and
- transfer pricing aspects of business restructurings.

### Transfer pricing method

The revised Guidelines introduce the concept of "the most appropriate transfer pricing method" for a particular case – a move away from the selection of a transfer pricing method based on the hierarchy of methods. The CRA notes that the revised OECD guidance should focus on the degree of comparability and the availability of reliable data under each transfer pricing method.

## Transactional profit methods

In respect of the application of transactional profit methods, TPM-14 confirms the CRA's endorsement of the expanded guidance in the revised Guidelines for the application of the arm's length principle using one of the transactional profit methods. This includes:

- more detailed criteria to be considered for the selection of a profit level indicator;
- more extensive guidance for the calculation of net profit;
- discussion regarding the use of the Berry ratio; and
- more detail on the application of the profit split method.

## Comparability analysis

While the CRA has not previously prescribed a process for undertaking a comparability analysis, TPM-14 endorses the "typical process" outlined in the revised Guidelines. Under this process, also referred to as the "nine-step process," the OECD provides an example of how to apply the recommendations in the new guidance in practice to perform a comparability analysis that is both reliable and transparent.

## Business restructurings

Chapter IX of the revised Guidelines addresses business restructurings, and specifically the following issues:

- allocation and transfer of risk among related parties;
- whether and when internal business restructuring transactions require arm's length compensation and/or indemnification;
- remuneration to the parties to be considered following the restructuring.

It also confirms that if an appropriate transfer price can be determined, the transactions or arrangements should not be disregarded.

## Update to Canadian transfer pricing administrative policies

TPM-14 also specifies that certain paragraph references in Information Circular (IC) 87-2R, International Transfer Pricing (the CRA's principal transfer pricing guidance), are no longer valid and provides new references that allow IC87-2R to be read harmoniously with the revised Guidelines.

## PwC observations

This is a positive development. The CRA's full endorsement of the revised Guidelines gives taxpayers greater certainty as to the acceptable methods and guidance on how those methods should be applied. Both the CRA and taxpayers may use this guidance to hold each other accountable to the Guideline's higher standards of comparability. However, it remains to be seen to what extent the CRA's endorsement will influence the standard of transfer pricing documentation required by the CRA to meet its "reasonable efforts" test and whether a higher standard will be applied to pre-2010 years under audit.

With respect to business restructurings, we welcome CRA's endorsement of the principles set out in the new Chapter IX as they provide an objective framework within which to analyze the complex issue of when compensation may or may not be appropriate. This has been a common audit issue in the past that has caused many prolonged disputes on audit and at competent authority.

## Need more help?

For more information, please contact any of the following individuals.

Andrew F. McCrodan	416 869 8726 <a href="mailto:andrew.f.mccrodan@ca.pwc.com">andrew.f.mccrodan@ca.pwc.com</a>
Rémi Gray <sup>1</sup>	613 755 5910 <a href="mailto:remi.gray@ca.pwc.com">remi.gray@ca.pwc.com</a>
Joanne Hawley	514 205 5234 <a href="mailto:joanne.c.hawley@ca.pwc.com">joanne.c.hawley@ca.pwc.com</a>

1. Member of PwC's Tax Controversy and Dispute Resolution (TCDR) network, see: [www.pwc.com/ca/tcdr](http://www.pwc.com/ca/tcdr)