Tax memo

Canadian tax updates

pwc

Will your foreign-based transfer pricing documentation withstand CRA scrutiny?

How to ensure your Canadian transfer pricing documentation meets CRA standards.

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If your foreign or U.S.-based parent prepares your Canadian transfer pricing (TP) documentation, how can you be sure it will meet Canada Revenue Agency (CRA) standards? A Canadian review will ensure that your documentation complies with Canadian guidelines and could even reduce issues arising on audit.

Global documentation

While preparing documentation from a global perspective is an effective process that allows for a consistent framework/message for all entities, foreign parents may focus their efforts on high-risk countries and transactions. This could leave Canadian-specific documentation at a level that might not meet the CRA's "reasonable efforts" exception that allows you to avoid penalties in the event of a TP adjustment.

What your Canadian documentation could be missing

The CRA's approach to TP documentation is different from that of many other tax authorities, including the Internal Revenue Service (IRS):

- An unbundled approach is preferred; analysis is performed transaction-by-transaction.
- The functional analysis is detailed, including a comprehensive description of the Canadian business; sometimes global documentation oversimplifies the functions performed by the Canadian entity, assuming that its operations are the same as in other countries.
- A financial analysis is expected, with segmented results of the intercompany transactions that tie to the entity financial statements filed with the tax return; financial information used in foreign-based documentation may come from a centralized system and not reflect local entries (goodwill, amortization, purchase price accounting differences, etc.).
- The CRA uses the full range of results rather than statistical measures like the interquartile range; results are reviewed on a year-by-year rather than weighted average basis.
- A more precise selection of comparables is required, with the selection of the most comparable; these must be relevant to the North American market (i.e., not global).

- The CRA endorses the Organisation for Economic Development and Co-operation (OECD) Guidelines, including the “nine-step process” and the comparability analysis in the revised 2010 Guidelines; these will be applied to all years open for audit including transactions that predate their publication (see the CRA’s recently issued TPM-14).
- All amounts must agree to Form T106, which reports the intercompany transactions, and all significant intercompany transactions must be documented and supported, i.e., some significant Canadian transactions may not be covered in the foreign-based documentation.

Summary

If you plan to use foreign-based TP documentation for Canadian purposes, consider a review from a Canadian perspective before submission to the CRA. This review will help ensure that you have all the information the CRA needs to fully understand the Canadian operations and its relationships with foreign affiliates. It should also help reduce CRA audit time, meet applicable deadlines (often earlier than in the United States or other countries) and reduce the possibility of significant TP penalties based on any adjustments.

We can help

For more information on the preparation of Canadian TP documentation, contact your PwC adviser or any of the individuals listed below.

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