Introduction

Canadian transfer pricing legislation and administrative guidelines are generally consistent with the Organisation for Economic Co-operation and Development (OECD) Guidelines. Statutory rules require that transactions between related parties occur under arm’s-length terms and conditions. Penalties may be imposed where contemporaneous documentation requirements are not met. There have been three major transfer pricing cases litigated in Canada, and the number of cases is expected to increase as the transfer pricing-related audit activity of the Canada Revenue Agency (CRA) continues to intensify under ongoing mandates from the federal government.

Canada has adopted International Financial Reporting Standards (IFRS), which became effective for public companies in their first tax year beginning on or after 1 January 2011 (or earlier with approval of the Canadian Securities Administrators). IFRS is optional for private companies. A Canadian company’s transfer pricing policies may need to be reassessed in light of IFRS, as accounting practices transition to comply with the new standards. For example, Canadian companies will need to assess how the adoption of IFRS affects comparability to US companies used in a transactional net margin method (TNMM) analysis, and how to address multiple-year analysis that includes periods of different accounting practices.

Statutory rules

General anti-avoidance rule

A general anti-avoidance rule (GAAR) (ITA section 245) can apply to any transaction considered to be an avoidance transaction. The CRA may apply this section in transfer pricing situations, if section 247(2), (see below), does not apply.

Statutory rules specific to transfer pricing

The Canadian statutory rules on transfer pricing included in section 247 of Canada’s Income Tax Act (ITA) are effective for taxation periods beginning after 1997. These rules embody the arm’s-length principle.

‘Transfer price’ is broadly defined to cover the consideration paid in all related party transactions. ‘Qualifying cost contribution arrangements’ are also specifically addressed in the Canadian rules (see Qualifying cost-contribution arrangements section, below).

Transactions between related parties will be adjusted where the terms and conditions differ from those that would have been established between arm’s-length parties. That is, the nature of the transaction can be adjusted (or recharacterised) in circumstances where it is reasonable to consider that the primary purpose of the transaction is to
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obtain a tax benefit. A reduction, avoidance or deferral of tax (or increase in a refund of tax) will be viewed to be a ‘tax benefit’.

The legislation does not include specific guidelines or safe harbours to measure arm’s length; rather, it leaves scope for the application of judgment. The best protection against a tax authority adjustment, and penalties, is the maintenance of contemporaneous documentation. The nature of the documentation required to avoid penalties is described in the legislation.

The legislation is supported by administrative guidelines in the CRA’s Information Circular 87-2R (IC 87-2R) and the CRA’s Transfer Pricing Memoranda (TPM-02 through TPM-12). IC 87-2R is cross-referenced to the OECD Guidelines.

To summarise the highlights of the Canadian legislation and administrative guidance:

**ITA**
- Related party transactions may be adjusted if the CRA determines that they are not on arm’s-length terms (section 247(2)).
- Transfer pricing adjustments that result in a net increase in income or a net decrease in a loss may be subject to a non-deductible 10% penalty (section 247(3)) for taxation years beginning after 1998 (see Additional tax and penalties section, below).
- Set-offs may reduce the amount of the adjustment subject to penalty where supporting documentation for the transaction that relates to the favourable adjustment is available (section 247(3)) and is approved by the Minister of National Revenue (the Minister) (section 247(10)).
- Penalties may not apply to a transaction where reasonable efforts were made to determine and use arm’s-length transfer prices. Contemporaneous documentation standards are legislated for that purpose (section 247(4)).

**IC 87-2R**
- Describes the following five arm’s-length pricing methods recognised by the CRA: comparable uncontrolled price (CUP), cost plus, resale price, profit split and TNMM. The CRA examines the application of the method selected by a taxpayer to ensure that it produces the most reliable measure of an arm’s-length result (paragraphs 47 to 63).
- Provides administrative guidelines on cost-contribution arrangements, intangible property and intragroup services.

**Secondary adjustments**
Where property or services have been obtained by a resident taxpayer from a related non-resident at an overvalued amount or transferred from a resident taxpayer to a non-resident at an undervalued amount, a benefit will have been conferred on the non-resident unless the parties complete a corrective transaction. The benefit amount will be deemed to be a dividend and will be subject to non-resident withholding tax of 25%. The withholding tax may be reduced depending on the provisions of a relevant tax treaty. These provisions may apply to transactions with any related party, not just the parent or a shareholder. This result is accomplished through the combination of provisions in ITA sections 15(1), 56(2), 214(3)(a) and 212(2).

The federal budget tabled on 29 March 2012 consolidated the desired effect of these provisions into section 247. Under the new provisions, secondary adjustments are
deemed to be a dividend paid to the related non-resident regardless of whether the non-resident has an ownership interest in the Canadian company. As a deemed dividend, the amount is subject to withholding tax as high as 25%, which could be reduced under the relevant treaty. The amount of the deemed dividend and associated withholding tax can be reduced, at the Minister’s discretion, if the amount of the primary adjustment is repatriated to the Canadian taxpayer.

**Legislation relating to inter-company debt**
The following legislation applies to inter-company debt and interest charges:

**Section 15(2) – Loan treated as a dividend**
This provision applies where a loan or any other indebtedness owing to a corporation resident in Canada by a non-resident shareholder or a non-resident person not acting at arm’s length with a non-resident shareholder has not been repaid within one year (i.e. 365 days) from the end of the corporation’s tax year in which the indebtedness arose. Where this provision applies, the amount is deemed to have been paid as a dividend and is subject to non-resident withholding tax of 25%. The withholding tax may be reduced depending on the provisions of a relevant tax treaty. Anti-avoidance rules prevent a long-term loan from being disguised by a series of short-term loans and repayments. There are exceptions to these rules, such as loans to a foreign corporation that is a foreign affiliate (defined as a foreign corporation in which the Canadian corporation has an equity interest of at least 1% and together with related parties has an equity interest of at least 10%).

The ITA provides a mechanism for the non-resident to apply for a refund of withholding tax paid, within a certain period of time, upon the repayment of the loan or indebtedness when the repayment is not part of a series of loans and repayments.

**Section 17 – Deemed interest income**
Where a loan or other indebtedness owing from a non-resident to a corporation resident in Canada is outstanding for one year (i.e. 365 days) or longer without a reasonable rate of interest being charged, the corporation is deemed to earn income from the loan or other indebtedness computed at a prescribed rate of interest and this amount, net of any interest actually received, is included in the corporation’s income for tax purposes. Section 17 does not apply, however, if section 15(2) as described above applies to the loan or indebtedness and a refund of the withholding tax has not been received by the non-resident. Loans to controlled foreign affiliates are excluded from the deemed interest rule provided that the funds loaned are used by the controlled foreign affiliate to earn income from an active business. Accordingly, loans made downstream to these affiliates can be non-interest-bearing. However, the deductibility of any interest expense incurred in Canada relating to making such a loan must be considered under the general interest deductibility guidelines.

Avoidance of these rules through the use of a trust or partnership is not possible where a corporation resident in Canada is a beneficiary or partner of the trust or partnership. A further anti-avoidance provision imputes interest to the Canadian resident corporation on an amount owing between two non-residents when it is reasonable to conclude that such indebtedness arose because of a loan or transfer of property by the corporation to a person or partnership.
Section 80.4(2) – Deemed benefit treated as a dividend
Where a related non-resident has received a loan from or become indebted to a
corporation resident in Canada at a rate of interest less than the prescribed rate or at a
rate otherwise considered favourable to the non-resident, then the non-resident will be
debemed to have received a shareholder benefit under section 15(1). Loans to foreign
affiliates are excluded from the deemed benefit rule. The amount of the benefit is
calculated by comparing the interest rate charged with the prescribed rate of interest.
This benefit is deemed to be a dividend and is subject to non-resident withholding tax
of 25%. The withholding tax may be reduced by the provisions of a relevant tax treaty.
This section does not apply, however, where section 15(2) as described above applies
or where the non-resident is a foreign affiliate of the Canadian taxpayer.

Section 18(4) – Thin capitalisation
The thin capitalisation rules can result in the permanent denial of an interest expense
deduction to a corporation resident in Canada (see Thin capitalisation section, below).

Section 78(1) – Unpaid expenses included in income
This provision applies where a corporation resident in Canada has previously deducted
an amount owing to a related non-resident and has not paid or settled the liability
within two tax years following the year in which the liability was incurred. In these
circumstances, the unpaid amount is included in the income of the corporation in the
third tax year following the year in which the liability was incurred. Alternatively,
an election may be filed to have the liability deemed as paid and loaned back to
the corporation on the first day of the third tax year, although this may result in a
withholding tax liability on the amount deemed as paid. If such an election is filed late
(i.e. more than six months after the end of the third year), 25% of the unpaid amount
will still be included in income in the third year.

Reporting requirements relating to transfer pricing
Section 231.6 – Foreign-based information or documentation
The CRA may formally serve notice requiring a person resident or carrying on business
in Canada to provide foreign-based information or documentation where this is
relevant to the administration or enforcement of the ITA. Such notices must set out the
time frame for production, a reasonable period of not less than 90 days. Supporting
documents for inter-company charges and transfer pricing are prime examples of the
types of information likely to be formally required. Information or documentation not
produced following the delivery of the notice may not be used as a defence against a
later reassessment. Taxpayers can bring an application to have the requirement varied
by a judge. Failure to provide the information or documentation may lead to possible
fines or possible imprisonment as discussed in section 238(1). In a 2003 decision, the
Tax Court of Canada (TCC) prohibited GlaxoSmithKline Inc. from submitting foreign-
based documents as evidence at trial because the documents had not been provided to
the CRA when it served notice. In a 2005 decision, the TCC upheld the CRA’s right to
request such documentation from Saipem Luxembourg, S.A.

Section 233.1 – Annual information return: non-arm’s-length transactions with
non-resident persons
Persons carrying on business in Canada are required to file an annual information
return reporting transactions with related non-residents. For every type of transaction
(e.g. tangible property, services, royalty arrangements, factoring, securitisations and
securities, lease payments, securities lending, derivative contracts, etc.) it is necessary to identify the transfer pricing methodology used.

The prescribed form, Form T106, Information Return of Non-Arm’s-length Transactions with Non-Residents (see also Tax audit procedures section, below), also asks for the North American Industrial Classification System (NAICS) codes for the transactions reported, whether any income or deductions are affected by requests for competent authority assistance or by assessment by foreign tax administrations, and whether an advance pricing arrangement in either country governs the transfer pricing methodology.

A separate T106 form is required for each related non-resident that has reportable transactions with the Canadian taxpayer. Each form asks if contemporaneous documentation has been prepared for transactions with that related non-resident. The CRA imposes late-filing penalties with respect to these forms.

A de minimis exception removes the filing requirement where the total market value of reportable transactions with all related non-residents does not exceed Canadian dollars (CAD) 1 million.

**Foreign reporting requirements**

Canadian residents are required to report their holdings in foreign properties and certain transactions with foreign trusts and non-resident corporations. Significant penalties are assessed for failure to comply with these rules.

**Section 233.2 – Information returns relating to transfers or loans to a non-resident trust**

Generally, amounts transferred or loaned by a Canadian resident to a non-resident trust, or to a company controlled by such a trust, must be reported annually on Form T1141. The filing deadlines generally depend on whether the Canadian resident is an individual, corporation, trust or partnership. The rules are complex and should be reviewed in detail for possible application.

**Section 233.6 – Information return relating to distributions from and indebtedness to a non-resident trust**

A Canadian resident that is a beneficiary of a non-resident trust and is either indebted to or receives a distribution from such trust must report such transactions on Form T1142.

**Section 233.3 – Information return relating to foreign property**

Form T1135 should be filed where the cost of the Canadian resident taxpayer’s total specified foreign property exceeds CAD 100,000 at any time in the year. The foreign property definition is comprehensive. Specific exclusions from the definition include personal assets (e.g. condominiums), property used exclusively in an active business and assets in a pension fund trust.

**Section 233.4 – Information return relating to foreign affiliates**

Where a person (including a corporation) or a partnership resident in Canada has an interest in a corporation or trust that is a foreign affiliate or a controlled foreign affiliate, the person or partnership is required to file an information return (Form T1134A or T1134B) for each such corporation or trust. Financial statements of the
corporation or trust must also be submitted. The filing deadline for these information returns is 15 months after the tax year-end of the person or partnership.

**Treaty-based disclosure**
Any non-resident corporation carrying on business in Canada that claims a treaty-based exemption from Canadian tax must file a Canadian income tax return, together with Schedules 91 and 97. This filing will identify those non-resident companies that are carrying on business in Canada without a permanent establishment (PE) or are eligible for any other type of treaty exemption from Canadian income tax.

**Other regulations**
The CRA releases information explaining its interpretation of various taxation matters through a series of publications, as follows:

- Information circulars, which deal with administrative and procedural matters.
- Interpretation bulletins, which outline the CRA’s interpretation of specific law.
- Advance tax rulings, which summarise certain advance tax rulings given by the CRA.
- Other documents.

These publications describe departmental practice only and do not have the authority of legislation. However, courts have found that these publications can be persuasive where there is doubt about the meaning of the legislation. News releases are another source of information, which communicate changes in and confirm the position of the CRA on income tax issues.

The CRA has published relatively few guidelines on transfer pricing. Those available are summarised below.

**Information Circular (IC) 87-2R: International Transfer Pricing**
IC 87-2R provides guidance with respect to the application of the transfer pricing rules as amended in 1998 to conform to the 1995 OECD Guidelines.

The CRA has published other documents on various transfer pricing matters to complement IC 87-2R. As of 30 August 2012, the following documents were available on the CRA website:

- 16 March 2001, IC 94-4R regarding advance pricing arrangements (see Advance pricing arrangements section, below).
- 27 March 2003, TPM 02 – Repatriation of Funds by Non-Residents – Part XIII Assessments: This document explains the CRA’s policy on the repatriation of funds following a transfer pricing adjustment under section 247(2) of the ITA; as this memo has not been updated to reflect subsequent legislative changes since the date of issue (see Secondary adjustments, above), some information may no longer be valid.
- 20 October 2003, TPM 03 – Downward Transfer Pricing Adjustments under Subsection 247(2) [of the ITA]: This document provides guidance on dealing with downward transfer pricing adjustments that may result from an audit or a taxpayer-requested adjustment.
• 27 October 2003, TPM 04 – Third-Party Information: This document provides guidelines on the use of confidential third party information in the context of transfer pricing audits by CRA auditors.
• 13 October 2004, TPM 05 – Contemporaneous Documentation: This document provides directives to CRA auditors concerning requests for contemporaneous documentation pursuant to section 247(4) of the ITA.
• 1 January 2005, IC 71-17R5 regarding competent authority assistance under Canada's tax conventions (see Limitation of double taxation and competent authority proceeding section, below).
• 18 March 2005, IC 94-4RSR (Special Release) regarding advance pricing arrangements for small businesses (see Advance pricing agreements section, below).
• 16 May 2005, TPM 06 – Bundled Transactions: This document explains the circumstances in which the CRA will accept bundled transactions.
• 2 August 2005, TPM 07 – Referrals to the Transfer Pricing Review Committee: This document replaces TPM 01 (a 26 March 2003 document with the same title), which remains available on the CRA website. TPM 07 provides guidelines for referrals by CRA auditors to the International Tax Directorate and the Transfer Pricing Review Committee (TPRC) regarding the possible application of the penalty under section 247(3) of the ITA or the possible recharacterisation of a transaction pursuant to section 247(2)(b). The revised TPM seeks to ensure a more open dialogue with taxpayers for consistent and fair application of the transfer pricing penalties.
• 5 December 2005, TPM 08 – The Dudney Decision – Effects on Fixed Base or Permanent Establishment Audits and Regulation 105 Treaty-Based Waiver Guidelines: This document provides guidelines and a general framework for permanent establishment determinations.
• 18 September 2006, TPM 09 – Reasonable Efforts under Section 247 of the Income Tax Act: This document provides guidance as to what constitutes reasonable efforts to determine and use arm’s-length transfer prices or arm’s-length allocations; it also provides examples of situations where taxpayers are at greater risk for a transfer pricing penalty.
• 28 October 2008, TPM 11 – Advance Pricing Arrangement (APA) Rollback: This document cancels and replaces TPM 10 with respect to APA rollbacks and clarifies CRA policy regarding an APA request to cover prior tax years, sometimes referred to as an APA ‘rollback’.
• 12 December 2008, TPM 12 – Accelerated Competent Authority Procedure (ACAP): This document provides guidance on ACAP, which provides for the resolution of a mutual agreement procedure (MAP) case to be applied to subsequent years.

The CRA’s guidance on ‘range issues’ as they arise in testing a taxpayer’s (or its affiliate’s) profitability was published in an article presented at the Canadian Tax Foundation 2002 Tax Conference by Ronald I. Simkover, Chief Economist, International Tax Directorate, CRA.

**Legal cases**

**GlaxoSmithKline v. The Queen 2008 TCC 324 (FCA decision at 2010 FCA 201)**

This case was heard by the Supreme Court of Canada (SCC) on January 13, 2012 and was the first transfer pricing case to be heard by the SCC. A decision is expected in late 2012.
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Facts
The facts that gave rise to the initial dispute occurred during the period from 1990 to 1993. Pharmaceutical company GlaxoSmithKline Inc. (GSK Canada), which had been distributing the ulcer drug Zantac since 1982, was purchasing ranitidine, the active ingredient in Zantac, from Adechsa, a Switzerland-based related party. The ranitidine was manufactured in Singapore. The CRA concluded that the price GSK Canada paid for the ranitidine over the period was too high, based on comparable prices paid by generic drug producers.

The TCC decided in favour of the CRA. GSK Canada appealed to the FCA, which set aside the decision and returned the case to the TCC for reconsideration. The Crown appealed to the SCC, and GSK Canada cross-appealed.

TCC decision
The Crown framed the case as one of tax avoidance by GSK Canada due to the low tax rate in Singapore, where the bulk of the profit was earned. The TCC followed the hierarchy of methods using the 1995 OECD Guidelines and accepted the Crown’s CUP analysis, focusing only on the supply agreement. Under this agreement the ranitidine was supplied without associated intangibles such as brand name (which came from the licence agreement for 6%); this was deemed comparable to the generics’ supply agreements. The TCC rejected GSK Canada’s resale price comparables, where brand and the ranitidine were obtained in one, or linked agreements, as well as its TNMM analysis, holding that the sole issue was the price of ranitidine, not the price to sell Zantac, and therefore the business circumstances that allowed Zantac to sell at a premium to generics were not relevant.

FCA decision
The FCA found that the TCC ignored the fact that GSK’s transaction took place in the branded pharmaceutical market, and that business realities such as the use of the brand name and resulting higher prices should be taken into account, thus bringing into question the comparability of the generic CUPs. The FCA recognised that the high profitability associated with selling Zantac did not belong to GSK Canada and that only in a fictitious world could one buy ranitidine at low generic prices and sell at high Zantac prices. In doing so, the FCA also recognised the importance of the factors that a reasonable business person dealing at arm’s length would consider in a similar situation. It also found that the TCC should not have separated the licence and supply agreements in considering the reasonableness of the price.

Crown’s appeal to the SCC
In its appeal, the Crown argued that the OECD Guidelines require respect for the legal structure adopted by the taxpayer and that bundling the licence and supply agreements (as suggested by the FCA) violated this principle. It also submitted that transfer prices should be assessed on a ‘transaction by transaction’ basis, not lumped together to test the bottom-line result. Essentially it suggested that the arm’s-length standard has been displaced by a ‘reasonable business person’ test, thus moving Canada away from the OECD Guidelines. As such, it argued, the question is no longer how the price compares to arm’s-length prices but whether the taxpayer acted ‘reasonably’ in paying the amount that it did.

GSK’s response (cross-appeal)
GSK Canada responded that it did not recharacterise or bundle the transactions, but rather considered both agreements because both were relevant to determining the
appropriate transfer price, that is, analysing the circumstances of the supply agreement included consideration of the licence agreement. This principle (i.e. consideration of relevant circumstances) is endorsed by the OECD Guidelines. GSK Canada also challenged the FCA order to return the matter to the TCC as this effectively extended the statutory limitation period by giving the Minister another kick at the can. GSK Canada argued that it had successfully ‘demolished’ the assessment at the FCA and was entitled to have the matter set aside.

**General Electric Capital Canada Inc. v. The Queen 2009 TCC 563 (FCA decision at 2010 FCA 344)**

On 15 December 2010 the Federal Court of Appeal (FCA) dismissed the Crown’s appeal of the 2009 TCC decision in the General Electric Capital Canada case, which favoured the taxpayer.

**Facts**

This transfer pricing case involves the deductibility of guarantee fees paid by a subsidiary to its parent.

During its 1996 to 2000 taxation years, General Electric Capital Canada Inc. (GECC) deducted CAD 136 million in guarantee fees paid to General Electric Capital Corporation (GECUS), its US-based parent company, for explicitly provided financial guarantees. The Minister disallowed the deductions on the basis that the fees provided no value to the taxpayer. The TCC allowed GECC’s appeals and ordered that the Minister’s reassessments be vacated, finding that the 1% guarantee fee paid was equal to or below an arm’s-length price. The Crown appealed, contending first that the TCC judge made a number of legal and factual errors and second that his behaviour during the trial gave rise to a reasonable apprehension of bias against the Crown’s position. The Crown asked that the matter be remitted for a new trial before a different judge. The FCA dismissed the Crown’s appeal, finding no errors of fact or law and no procedural bias.

**TCC decision**

The TCC decision was in many ways a compromise between the position of the Crown and that of the taxpayer. The Crown argued that GECC did not benefit from the explicit guarantee because of the ‘implicit’ guarantee that existed by virtue of the parent-subsidiary relationship and therefore, no payment was required for the explicit guarantee. GECC argued that although such implicit support is recognised in the market, it is a factor inherent in a non-arm’s-length relationship and as such cannot be considered under the arm’s-length principle. The TCC rejected both positions, finding that the implicit support derived from GECC being a member of the GE family was a relevant factor that should be considered as part of the circumstances surrounding the transaction. However, even after considering the implicit support, the TCC found, using the 'yield' approach, that there was significant benefit from the explicit guarantee. Because the benefit exceeded the price charged for the guarantee, the TCC found in favour of the taxpayer.

**Crown’s appeal**

The Crown identified the following four errors of law:

- The judge failed to identify the relevant transaction because he took into account a fact that did not exist, namely the removal of the explicit guarantee and its impact on GECC’s cost of borrowing.
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- The judge erred in preferring the evidence of GECC’s expert to that of the Crown’s insofar as the GECC expert failed to address certain significant characteristics relevant to assessing the value of the guarantee.
- The judge failed to conduct a reasonableness check.
- The judge should not have relied on the business judgment of a former GECC executive because it was subjective.

The Crown also contended that the judge’s behaviour during the trial gave rise to a reasonable apprehension of bias against it.

All of these arguments were discussed and dismissed by the FCA. The bias argument was rejected on the grounds that the behaviour in question (i.e. the TCC judge engaging in ‘excessive pursuit’ of the possible impact of a removal of the guarantee) related to an issue that had ‘no substantial connection with the outcome’ of the trial.

**GECC’s appeal**

GECC argued that the judge misapplied the relevant transfer pricing law when he reduced the arm’s-length price of the guarantee on account of implicit support. Specifically, implicit support cannot arise if the parties are assumed to be truly arm’s length. It arises only as a result of the non-arm’s-length relationship that must be ignored under the arm’s-length principle.

GECC also argued that the TCC judge erred by adopting the yield or ‘benefit to the borrower’ approach instead of focusing on a market price for the guarantee. Because market participants would have charged up to 300 basis points to guarantee the debt, the yield approach undervalued the guarantee.

The FCA rejected both arguments, stating that the concept underlying subsections 69(2) and 247(2)(a) and (c) is simply ‘to ascertain the price that would have been paid in the same circumstances if the parties had been dealing at arm’s length’. This determination involves ‘taking into account all the circumstances which bear on the price, whether they arise from the relationship or otherwise’.

The FCA discussed the statutory objective, ‘which is to prevent the avoidance of tax resulting from price distortions which arise in the context of non-arm’s-length relationships’. Further, ‘the elimination of these distortions by reference to objective benchmarks is all that is required to achieve the statutory objective’. In this case, because implicit support is a factor that an arm’s-length person would find relevant in pricing a guarantee, the FCA’s view was that it had to be considered, and ignoring it would be turning ‘a blind eye on a relevant fact and deprive the transfer pricing provisions of their intended effect’.

The FCA judge also cited the GlaxoSmithKline Inc. decision (see above), which found that all relevant circumstances must be taken into account when determining an arm’s-length price, holding that ‘there is no doubt that the existence of the implicit guarantee is relevant to the inquiry and must be considered in identifying the arm’s-length price’.

On the matter of which approach is appropriate, the FCA took the view that if the explicit guarantee provided no benefit, ‘an arm’s-length party standing in the shoes of [GECC] would not have paid anything towards it.’ It further found that ‘the assessment of the benefit is but a means to ascertain whether a guarantee fee would have been paid by an arm’s-length party’.

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This responded to only one question – whether an amount should be paid at all – but did not address whether the yield approach should on its own be used to establish the arm's-length price.

In conclusion, the FCA rejected all appeal issues raised by both the Crown and GECC and dismissed the appeal.

**Alberta Printed Circuits Ltd. v. The Queen (2011 TCC 232)**

In this case, the TCC found in favour of the taxpayer, Alberta Printed Circuits, Ltd. (APCI Canada), in respect of the application of the comparable uncontrolled price (CUP) method to determine arm’s length set up service fees paid to a related company in Barbados (APCI Barbados). However, despite the TCC’s rejection of the CRA’s analysis supporting its reassessments, it substantially disallowed the fees paid by APCI Canada to APCI Barbados for other services. While the TCC found that there was an absence of any compelling evidence to show the arm’s-length nature of the charge for these other services, it nonetheless computed a charge for the services that left a significant portion of the CRA’s reassessments in place.

**Other relevant cases**

The CRA continues to focus on financial transactions in its transfer pricing audits, as evidenced by two cases heard by Canadian courts in 2011/2012.

- At issue in *McKesson Canada Corporation v. The Queen* was whether the discount rate for factoring accounts receivable agreed to by related parties differed from the rate that would have been agreed to had the parties been dealing at arm’s length. A decision is pending.

- In *The Queen v. GE Canada Company*, the Crown is seeking to disallow guarantee fees paid by the taxpayer’s predecessors to their US parent, arguing that the guarantees serve no commercial purpose and as such would not have been entered into by arm’s-length parties. (*See GECC case, above; GE Company is the successor to GECC by amalgamation and inherited its debts*).

**Burden of proof**

Under the Canadian taxation system, the taxpayer makes a self-assessment of tax that is then assessed by the CRA (either with or without an audit). In the event of an audit, the burden of proof to satisfy the tax authorities that transfer prices are arm’s length lies with the taxpayer.

The transfer pricing legislation also requires that the taxpayer show that it has made reasonable efforts to determine and use arm’s-length transfer prices in order to exclude any related adjustments from penalty. The maintenance of complete and accurate contemporaneous documentation, as provided in the legislation, will constitute reasonable efforts for these purposes (*see Tax audit procedures section, below*).

**Tax audit procedures**

**Selection of companies for audit**

The CRA is changing the way it selects files for audit with the introduction of a risk-assessment approach that targets taxpayers considered to have the highest risk of non-compliance. This model will focus not only on corporations but on partnerships and trusts as well.
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There will be three categories: ‘High’ (will be audited), ‘Medium’ (may dictate a restricted audit related to specific concerns) and ‘Low’ (unlikely to be audited pending future evaluations). Sources of information that will be used to determine which category a taxpayer falls into include (but are not limited to) the following:

- The taxpayer’s history of compliance.
- Data gathered from internal databases created from information required to be filed by law.
- Information received from tax treaties and tax information exchange agreements signed with other countries and provinces.

**Provision of information and duty of the taxpayer to cooperate with tax authorities**

Sections 231.1 to 231.5 of the ITA provide guidance on the authority of a person authorised by the Minister in regard to an audit. Basically, the rights of an auditor are far-reaching and taxpayers are expected to cooperate. As discussed earlier, section 231.2 authorises an auditor to issue a requirement for information that the taxpayer has not readily provided.

As discussed earlier, section 231.6 of the ITA requires that foreign information or documents that are available or located outside Canada be provided to the CRA if relevant to the administration or enforcement of the ITA. Failure to comply may result in the inadmissibility of foreign-based information or documents if defending a later reassessment in court.

**The transfer pricing audit procedure**

The risk-assessment approach (see also Tax audit procedures section, above) applies to transfer pricing audits as well. These audits can be initiated in two ways: as part of a regular corporate audit (where transfer pricing may be included in the audit at the discretion of the audit case manager), or when a local international tax auditor screens a file solely for a transfer pricing audit, primarily using Form T106 (see also Statutory rules section, above), which taxpayers must file annually.

CRA auditors are required to provide a taxpayer with a written request for contemporaneous documentation at the initial contact stage of a transfer pricing audit. The documentation must be provided within three months of the date of service of the request. Canada’s transfer pricing legislation offers no opportunity to negotiate an extension of the three-month deadline; the time frame is specified in the ITA and is not discretionary. If the deadline is not met, the taxpayer will be deemed not to have made reasonable efforts to determine and use arm’s-length transfer prices and may be subject to penalty if any resulting adjustment exceeds the legislated penalty threshold.

After the CRA has received the contemporaneous documentation, the auditor usually visits the taxpayer’s premises (and in some cases the premises of the non-resident related party) to confirm the information provided. In some circumstances, the auditor may determine that the taxpayer is low risk and not proceed further.

Throughout the audit process, the auditor can refer the case to the CRA’s head office to obtain technical assistance from economists.
Contemporaneous documentation
The CRA continues to pursue a relatively aggressive programme of transfer pricing enforcement. Any transfer pricing adjustment may be subjected to a 10% penalty, with some de minimis exceptions (see Additional tax and penalties section, below), unless the taxpayer has made reasonable efforts to determine and use arm’s-length prices. This requires contemporaneous documentation to be on hand when the tax returns for the year are due (i.e. six months after the end of the taxation year for corporations).

As a minimum, the taxpayer should have a complete and accurate description of the following:

- The property or services to which the transaction relates.
- The terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction.
- An organisation chart – the identity of the participants in the transaction and their relationship to each other at the time the transaction was entered into.
- A functional analysis – the functions performed, property used or contributed and the risks assumed in respect of the transaction by the participants in the transaction.
- The data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the transaction.
- The assumptions, strategies and policies, if any, that influenced the determination of the transfer prices or the allocation of profits or losses or contributions to costs, as the case may be, in respect of the transaction.

Where contemporaneous documentation has been prepared for a prior year, the ITA provides that only those items that pertain to a material change in respect of a transfer pricing transaction must be addressed.

Statute of limitations
The statute of limitations for most taxpayers is four years. However, transactions with related non-resident persons can be subject to audit for up to seven years after the tax year is initially assessed. In the rare situation where an audit may take longer, the CRA can ask the taxpayer to sign a waiver to extend beyond the seven years, which must be signed within the seven-year period. The CRA has stated that it is committed to timely review and audit.

The appropriate tax treaty should be consulted, as treaties often include a provision whereby a taxpayer must be reassessed within a specified period in order to preserve its right to request competent authority assistance in the event of double taxation. Such a reassessment can be raised regardless of whether the audit is completed.

Reassessments and the appeals procedure
Many transfer pricing issues can be resolved with the field auditor or the auditor’s supervisor based on information provided and discussions held during the audit. If an issue cannot be resolved, the CRA issues a Notice of Reassessment for tax owing based on its audit findings. At this stage, a taxpayer may have two options. The first is to pursue the issue through the CRA’s appeals division and possibly the Canadian tax courts. The second is to request relief from double taxation through the competent...
authority process (available only if the transfer pricing reassessment involves a related entity in a country that has a tax treaty with Canada).

In either case, the taxpayer should file a Notice of Objection. This Notice must be filed within 90 days of the date of mailing of the Notice of Reassessment and can either initiate the appeal process (if that is the desired option), or be held in abeyance (at the taxpayer’s request) while the taxpayer pursues relief through the competent authority process. If the taxpayer pursues the appeal process and is not satisfied with the result, it may seek a resolution in the Canadian tax courts. If the taxpayer pursues relief through the competent authority process, the Notice of Objection will protect the taxpayer’s rights of appeal in the event that the issue is not resolved through this process.

A taxpayer can request competent authority assistance after it has proceeded through the appeal process and/or obtained a decision from a Canadian tax court. However, in its dealings with the foreign competent authority the Canadian competent authority is bound by any settlement with the CRA’s appeals division or a Canadian court decision. Whether relief from double taxation is provided is at the sole discretion of the foreign competent authority.

A large corporation (as defined under the ITA) may be required to remit 50% of any amounts owing to the federal government as a result of the reassessment (tax, interest and penalties) while appealing the Notice of Reassessment. This relief is not available in the case of withholding taxes and provincial taxes.

**Additional tax and penalties**

Transfer pricing penalty provisions apply for tax years commencing after 1998. Transfer pricing adjustments can result from the following circumstances:

- A net increase in income or a net decrease in loss.
- A reduction in the taxpayer’s tax cost of non-depreciable and depreciable capital property and eligible capital property.

These transfer pricing adjustments are liable for a 10% penalty, subject to the following exceptions:

- Penalties will not be applied where the net transfer pricing adjustment does not exceed the lesser of 10% of the taxpayer’s gross revenue and CAD 5 million.
- No penalties will be applied where the taxpayer has made reasonable efforts to determine that its prices are arm’s length and to document such on or before the date its tax return is due for the taxation year (see Transfer pricing audit procedure section, above). Taxpayers must be able to provide this documentation to the Minister within three months of a request.

The legislation allows favourable adjustments to reduce unfavourable adjustments when determining the amount subject to penalty. However, to obtain a set-off, taxpayers must have documentation supporting the transaction to which the favourable adjustment relates and the Minister’s approval of the favourable adjustment; taxpayers without contemporaneous documentation cannot benefit from set-offs.
The CRA’s TPM-09 provides additional guidance on what constitutes reasonable efforts to determine and use arm’s-length transfer prices. According to TPM-09, a reasonable effort is defined as ‘the degree of effort that an independent and competent person engaged in the same line of business or endeavour would exercise under similar circumstances’. Further, the CRA considers a taxpayer to have made reasonable efforts when it has ‘taken all reasonable steps to ensure that [its] transfer prices or allocations conform to the arm’s-length principle’.

Canada’s penalties are based on the amount of the transfer pricing adjustment and can apply when the taxpayer is in a loss position, such that no increased taxes are payable as a result of the adjustment. In the event of capital transactions, the penalty applies to the taxable portion of any gain. Each case where a penalty may apply is referred to the TPRC, which makes a determination as to whether reasonable efforts were made.

Interest (at rates prescribed by the CRA) is charged on the underpayment of income-tax liabilities and withholding tax. This interest is not deductible for income-tax purposes. Interest is not charged on transfer pricing penalties unless the penalty is not paid within the required time frame.

**Risk transactions or industries**

Although the CRA may not be targeting any particular industry for transfer pricing audits, it has begun to adopt an industry-based audit approach by developing tax service offices (TSOs) that have expertise in specific industries, including pharmaceutical (TSO in Laval, Quebec), automotive (Windsor, Ontario), banking (Toronto, Ontario) and oil and gas (Calgary, Alberta). It is not yet known whether this approach will be extended to other industries. Over time, the CRA is expected to become more consistent in its approach to transfer pricing audits in these industries and to develop national industry-specific audit procedures.

Specific transactions scrutinised by the CRA include intragroup services, inter-company debt, interest charges, guarantee fees, royalty payments, intellectual property (IP) migration, contract manufacturing arrangements and restructuring and plant closures. Again, the CRA may not focus on a particular type of transaction but is paying more attention to transactions involving IP, which are routinely referred to the CRA’s specialist teams in Ottawa for review.

The CRA has an Aggressive International Tax Planning (AITP) division, which is part of the International and Large Business Directorate. The AITP initiative is aimed at identifying and responding to international transactions that may be designed to avoid paying income tax in Canada.

**Limitation of double taxation and competent authority proceedings**

Two articles in Canada’s income-tax treaties are relevant to transfer pricing.

- The Associated Enterprises article (Article 9) provides a definition of related parties for the purpose of the treaty and provides that each State can make adjustments to related party transactions based on the arm’s-length principle. Certain treaties may stipulate a time limit to make application for assistance under this article. In the absence of a time line, the time provided under domestic legislation prevails.
Canada

- The MAP article (Article 25) states that the competent authorities shall endeavour to resolve any taxation (e.g. double taxation) that is not in accordance with the treaty.

A taxpayer does not need to wait for the issuance of a Notice of Reassessment before filing a request for competent authority assistance. However, the competent authority will not act on the request until a reassessment has been issued.

The competent authority process for a Canadian taxpayer that has been reassessed can be summarised as follows. The non-resident related party must file a request for competent authority assistance (complete submission) in its country of residence within the time frame provided in the treaty. A similar request is normally filed simultaneously with the Canadian competent authority by the Canadian resident. The foreign competent authority informs the Canadian competent authority that it has received the request and requests a position paper outlining the details of the reassessment. The Canadian competent authority obtains the auditor's working papers (including additional information provided by the Canadian taxpayer), reviews the case and, if unable to unilaterally resolve the double taxation, provides the position paper to the foreign tax administration, after which negotiations between the competent authorities take place to resolve the double taxation. Once the competent authorities reach agreement, they advise the taxpayers in their respective countries of the proposed settlement. Once the taxpayers have accepted the proposed settlement, the necessary adjustments are processed in each country.

As the timing for filing a competent authority request varies from treaty to treaty, it is important to consult the MAP article of the relevant treaty. Generally, the competent authority submission must be filed within two years of the date of the Notice of Reassessment.

Canada currently has two treaties where the Associated Enterprises article requires that the other competent authority be notified of potential double taxation within six years of the end of the taxation year under audit. Once notification is provided, the MAP articles in those treaties do not impose a time frame within which the competent authority submission must be filed.

If a request for competent authority assistance with a submission or notification is not filed on time, a taxpayer may be denied relief by the competent authority of the non-resident related party.

The CRA’s Competent Authority Services Division is responsible for the competent authority function as it pertains to the MAP and Exchange of Information articles in the treaties. Case officers in this division meet quarterly with their US counterparts and occasionally with governments of other foreign jurisdictions to discuss specific cases.

An amendment to the Canada-US treaty providing for binding arbitration in MAP cases was ratified on 15 December 2008, and a Memorandum of Understanding (MOU) regarding the conduct of these arbitration proceedings was released on 26 November 2010. The MOU establishes the procedures for arbitration cases and indicates that the two countries have resolved their differences regarding the scope of the treaty’s arbitration provision, the types of cases eligible for arbitration and the manner in which issues will be resolved in arbitration proceedings. The process is described as
'baseball' arbitration, i.e. the arbitration board (comprising three members) selects one of the proposed resolutions provided by the competent authorities as its determination.

Arbitration may only be invoked by the taxpayers with the filing of the required non-disclosure agreements. Generally, such agreements can be filed two years after the competent authorities have agreed they have received a complete submission to resolve the case.

TPM 12 – Accelerated Competent Authority Procedure was released on 12 December 2008. This document provides guidance on the process where, at the taxpayer’s request, the issues that gave rise to a MAP case can be addressed in subsequent years by the competent authorities (see Statutory rules section, above).

The CRA’s MAP programme report for 2011 includes the following highlights:

• A total of 743 new cases were accepted during the year, with 740 completed.
• Of new cases accepted, 94 were categorised as ‘negotiable’ (i.e. involving another tax administration).
• Of the 740 cases in inventory that were completed, 95 were negotiable.
• The average time to complete the 84 Canadian-initiated cases was 32 months, while the 11 foreign-initiated completed cases took an average of 20 months.
• Full relief was granted in 85% of the negotiable cases, no relief was granted in 13 cases and partial relief was granted in one case.

**Advance pricing arrangements (APAs)**

Canada was one of the first countries to implement an APA programme. The service is intended to assist Canadian taxpayers in determining acceptable transfer pricing methodology and, where negotiated with tax authorities of other jurisdictions, provide certainty on covered transactions. An APA is intended to consider proposed pricing arrangements or methodologies that have prospective application and is designed to seek agreement on an appropriate transfer pricing methodology for a specified cross-border transaction between related parties. The service is offered in addition to competent authority assistance on the appropriateness of historic transactions that have been challenged by one or both of the jurisdictions involved.

APAs can be unilateral, bilateral or multilateral. At the conclusion of the procedure, there is a binding agreement between the taxpayer and the CRA and, in the case of bilateral or multilateral APAs, between the CRA and the other tax authorities involved.

IC 94-4R, dated 16 March 2001, outlines the procedures and guidelines for obtaining APAs in Canada.

The CRA has established the following policies regarding the rollback of transfer pricing methodologies agreed upon through the APA process:

• A rollback will be considered if a request for contemporaneous documentation has not been issued by the CRA, the facts and circumstances are the same, and the foreign tax administration and the CRA both agreed to accept the APA rollback request.
• A waiver must be filed for each year in question in accordance with the ITA.
Canada

- Once an APA is in force, transactions occurring in tax years covered by the APA and the rollback period are not subject to a transfer pricing penalty.
- The CRA will not issue a request for contemporaneous documentation for transactions in a year that a taxpayer has requested to be covered by an APA rollback at a pre-filing meeting.
- An APA rollback will not be permitted when a taxpayer requests a unilateral APA.

The first year of a unilateral APA will be the first taxation year for which a tax return has not been filed in which the transfer pricing methodology has been agreed to.

IC 94-4RSR (Special Release) addresses APAs for small businesses. The following are highlights of this release:

- The programme will have a fixed non-refundable administration fee of CAD 5,000.
- Taxpayers must have gross revenues of less than CAD 50 million or a proposed transaction to be covered by the APA of less than CAD 10 million.
- The programme will cover only transactions of tangible property and routine services.
- Site visits will not be performed.
- The minimum information required from a taxpayer is a functional analysis. The CRA will perform the economic analysis if requested to do so.
- The programme applies only to a unilateral APA without a rollback.
- Taxpayers' annual reporting under the programme will be limited to stating in writing whether the critical assumptions have or have not been breached.

Due to a staffing shortage in the competent authority division in 2011, the CRA has implemented the following changes to the APA programme:

- CRA case officers must present a business case to the competent authority with respect to the necessity of site visits.
- There is reluctance to accept requests for a unilateral APA.
- The CRA is relying increasingly on the taxpayer to provide analyses the CRA would normally undertake.
- At the pre-filing meeting, there is increased scrutiny concerning the viability of a taxpayer to enter the APA programme.

The 2011 annual report on the APA programme published by the CRA reports the following:

- Twenty cases were accepted into the programme.
- The active case inventory was 95 cases.
- Sixteen cases were completed, of which 14 were bilateral and two were unilateral.
- Of the completed cases, bilateral APAs took an average of 50.3 months to complete, while unilateral APAs took an average of 28.4 months to complete.
- The TNMM continues to be the predominant methodology used in APAs (43% of completed and in-progress cases), followed by the profit split (21% of completed and in-progress cases) and the cost plus method, at 15%.
- When the TNMM is used, the most common profit level indicator used is the operating margin (used 61% of the time), followed by total cost plus (25% of the time) and the Berry ratio and return on assets (combined, 14% of the time).
**Liaison with customs authorities**

Customs programmes are administered by the Canada Border Services Agency (CBSA).

Canada has implemented the World Trade Organisation’s Valuation Agreement, under which the primary basis of the value for customs' purposes is the ‘price actually paid or payable’ in a sale for export. As a matter of policy, the CBSA will generally accept that the transfer price was not influenced by the relationship between a buyer and seller if the transfer price was determined in accordance with the OECD Guidelines. However, the CBSA closely scrutinises other payments flowing from the buyer to the related seller (e.g. ‘management fees’) to determine whether these should be part of the ‘price paid or payable’ for the goods. In a 2009 policy statement (Memorandum D13-4-13), the CBSA clearly states that it considers any payment beyond the actual selling price to be part of the dutiable value of the goods, unless the importer can demonstrate that it should not be.

In the course of a ‘valuation verification’ (i.e. an audit of the values declared on customs entries), an importer that purchases goods from a related party can expect to be asked to provide a copy of the documentation (such as a transfer pricing study) that demonstrates that the transfer price was determined in accordance with the OECD Guidelines.

There is no routine exchange of information between the CBSA and the CRA. However, the two agencies have been encouraged to have greater cooperation as anticipated by the OECD Guidelines. The two agencies have tended to stress the difference between a value calculated for income-tax purposes and a value calculated for customs purposes, given the different legislative bases.

It should also be noted that income-tax decisions that are adverse to the taxpayer may not result in the recovery of duty or tax that may have been payable on the import of goods. Importers are not required to report to the CBSA downward adjustments to transfer prices that are affected after importation, but neither can a duty refund be claimed based on the reduced customs price. However, post-importation increases in the transfer price must be reported to the CBSA, and additional duty (if any) must be paid. Failure to do so may result in penalties being assessed against the importer.

**OECD issues**

Canada is a member of the OECD. The Canadian transfer pricing legislation was redrafted in 1997 to conform with the OECD Guidelines.

On 22 July 2010 the OECD issued revised guidelines that address a number of issues concerning comparability, including factors to consider when assessing comparability of transactions as well as the selection of an appropriate transfer pricing method. The revised OECD Guidelines also address business restructuring issues.

On 26 June 2012, the governments of US and Canada entered into an agreement to follow the Authorized OECD Approach for determining the amount of profit to attribute to a permanent establishment (PE), which allows profits to be established for a PE regardless of whether the enterprise as a whole shows a profit or loss.
Canada

**Joint audits**
Most tax treaties have exchange-of-information provisions, including a provision for joint audits. Canada and the US have an agreement in place for joint audits. Both groups of auditors on complex audits initiate these reviews to minimise the time and effort.

**Thin capitalisation**
Rules regarding thin capitalisation and restrictions on the amount of deductible interest since 1972 are well-entrenched in Canada and usually enforced through the general audit procedures of CRA assessors and auditors. However, there are proposed changes to these rules as a result of the 2012 federal budget.

Where a corporation resident in Canada has average ‘outstanding debts to specified non-residents’ that exceed two times the corporation’s ‘equity’ (as defined for the purposes of the thin capitalisation rules), a portion of the related interest expense is not deductible in computing the corporation’s income for tax purposes. Proposed legislation would (i) reduce the permissible ratio of debt to equity to 1.5:1 (effective for taxation years starting after 2012) and (ii) treat the denied interest as a dividend subject to non-resident withholding tax (effective for taxation years ending after 2012).

‘Outstanding debts to specified non-residents’ is a defined term and generally refers to interest-bearing debts or other obligations owed either to non-resident shareholders who own (together with related persons) 25% or more of the voting shares of the corporation or to persons related to such shareholders. The average of such debts is determined using the greatest amount of such debt outstanding at any time during each calendar month that ends in the year. Proposed legislation would require the corporation to include certain debts of partnerships of which the corporation is a member, either directly or through multiple tiers of partnerships (effective for taxation years starting after 2012).

‘Equity’ is defined to include:

- The retained earnings of the corporation as at the beginning of the year, except to the extent that those earnings include retained earnings of any other corporation.
- The average of all amounts, each of which is the corporation’s contributed surplus (determined, in the CRA’s view, in accordance with Canadian generally accepted accounting principles) at the beginning of each calendar month that ends in the year, to the extent that it was contributed by a specified non-resident shareholder of the corporation.
- The average of all amounts each of which is the corporation’s paid-up capital at the beginning of each calendar month that ends in the year, excluding the paid-up capital in respect of shares of any class of the capital stock of the corporation owned by a person other than a specified non-resident shareholder of the corporation.

International groups that have a Canadian holding company for their Canadian operating company or companies should be cautious when a related non-resident makes a loan directly to the Canadian operating company. The Canadian operating company may not have any direct non-resident shareholders and, accordingly, a portion or the entire amount of the interest could potentially become non-deductible under the thin capitalisation rules. Where possible, loans from related non-residents
should be made to the Canadian holding company that has the direct non-resident ownership, keeping in mind the lack of consolidated tax filing in Canada and the ‘back-to-back’ anti-avoidance provisions included in the thin capitalisation rules.

It should also be noted that because of the difference in timing with respect to including debt and equity in the statutory averaging formula, interest may become non-deductible even where equity and debt are contributed concurrently, because the thin capitalisation calculation does not recognise increases in equity amounts until the beginning of the next calendar month.

**Intragroup services (management fees)**

For intragroup service fees to be tax-deductible in Canada, a specific expense must be incurred and the expense must be reasonable in the circumstances. There should also be documentary evidence to support the amount of the charge, such as a written agreement to provide the services and working papers evidencing the expense charged.

Intragroup service charges are governed by section 247 of the ITA; there is no specific transfer pricing legislation for intragroup service fees, though the CRA's position on this issue is included in IC 87-2R. The withholding tax legislation in section 212 of the ITA provides insight into what constitutes intragroup services.

**Qualifying cost-contribution arrangements**

Qualifying cost-contribution arrangements provide a vehicle to share the costs and risks of producing, developing or acquiring any property, or acquiring or performing any services. The costs and risks should be shared in proportion to the benefits that each participant is reasonably expected to derive from the property or services as a result of the arrangement. Where a participant's contribution is not consistent with its share of expected benefits, a balancing payment may be appropriate.