

Table of Contents

I. Introduction	1
II. Law and Administration	7
A. The Legislation	7
1. ITA: Past Provisions	7
(a) The Income Tax Act	7
2. ITA: Current Provisions	7
(a) The September 1997 Proposal	8
(i) The New Legislation	8
a) The Arm's Length Principle	9
b) Penalty	9
c) Contemporaneous Documentation	10
(ii) General Analysis	12
a) Transactional vs. Year-End Analysis	12
b) Approved Transactional Transfer Pricing Methods	13
c) Application of September 1997 Proposals to Partnerships	13
d) Recharacterization of Transactions	14
e) Contemporaneous Documentation and Information Gathering	14
f) Scope of Contemporaneous Documentation	15
g) Rate of Penalty	15
h) Downward Adjustment	16
i) Separation of Transactions	16
j) Part XIII Withholding Tax	17
k) Cost Contribution Arrangements	17
l) Intragroup Services	18
m) Employees and Insurance of Risks	18
n) Confidentiality of Third Party Information	18
o) Date of Application	18
p) Summary	19
(b) The December 8, 1997 Notice of Ways and Means Motion	19
(i) Recharacterizing the Nature of Transactions	20
(ii) Set-Offs	21
(iii) Contemporaneous Documentation	23
(iv) Interest Calculation	24
(c) Analysis: The Arm's Length Principle	26
(i) The New Rules: Adherence to and Rationale for the Arm's Length Principle	26
(ii) What is the Arm's Length Principle?	28
(iii) Do the New Rules Respect the Arm's Length Principle?	28
a) Triggering the Application of the Arm's Length Principle	29
b) Adjusting the Quantum or Recharacterizing	31

c)	Partners and Partnerships	32
(d)	Subsection 247(2) vs. 69(1)	35
(i)	The Act Proper	36
a)	The Scheme of the Act Since 1939	36
b)	Statutory Interpretation	41
(i)	The Specific Prevails Over the More General	41
(ii)	The Narrow Scope of Subsection 69(1)	42
(iii)	A Result Contrary to Basic Logic and Tax Policy	42
c)	The Purposes of Subsection 247(8)	42
(ii)	Treaty Override	45
(e)	Analysis	48
(i)	The New Rules: Legislation by Information Circular	48
(ii)	Role of the Information Circular and the Interpretation Bulletin	49
(iii)	The Legal Enforceability of Interpretation Bulletins and Other Administrative Pronouncements	50
(iv)	The Circular: Ranking Transfer Pricing Methods	55
(v)	“Reasonable Efforts”	57
(vi)	Recharacterizing the Transaction	66
a)	Pursuant to Paragraphs 247(2)(b) and (d)	66
b)	Pursuant to Paragraphs 247(2)(a) and (c)	84
(vii)	Other Developments	126
a)	Report of the Technical Committee on Business Taxation	126
b)	Electronic Commerce and Canada’s Tax Administration	127
c)	Transfer of Property between Bank and Affiliate	128
d)	Patronage Dividends	128
e)	Advisory Panel on Canada’s System of International Taxation	129
f)	Exclusion for Certain Guarantees	132
g)	Part XIII Deemed Dividends	132
h)	Country-by-Country Reporting	133
(i)	Background	133
(ii)	Recommendations	134
(iii)	Canadian Legislative Response to the Report	135
(iv)	Canadian Reporting Obligations	136
(v)	Application of the CbC Reporting Requirements	138
(vi)	Reporting Entities	139
(vii)	Voluntary CbC Reporting	141
(viii)	Penalties	142
(ix)	Automatic Exchanges	142
3.	Provincial Legislation	143
(a)	Alberta	143

(b)	Ontario	144
(c)	Québec	145
4.	Article IX of Canada's Tax Treaties	145
B.	The Case Law	148
1.	Transfer Pricing Settlements and Decisions	153
(a)	<i>Squibb</i> : 1987 Settlement, Pharmaceutical, Active Ingredient	153
(b)	<i>Indalex</i> : 1986 FCTD, 1988 FCA, Aluminum, Discounts, Pooling of Purchasing Power, Hard Bargaining Between Affiliates	154
(c)	<i>Crestbrook</i> : 1996 Settlement, Forestry, Discounts, <i>De Facto</i> Non-Arm's Length, Third-Party Information	157
(d)	<i>Mattel</i> : 1998 Settlement, Toys, Marketing Expenses, Competent Authority	158
(e)	<i>Safety Boss</i> : 2000 TCC, Oil and Gas, Personal Services, Management Fees, Bonus, Multiple-Year Data	160
(f)	<i>Denim Pipeline</i> : 2002 Settlement, Oil and Gas, Pipeline Construction, Shareholder Appropriation	161
(g)	<i>FPI Fireplace</i> : 2003 Settlement, Fireplaces, Commission, Transfer of International Business	162
(h)	<i>SmithKline</i> : 2003 Settlement, Pharmaceutical, Active Ingredient	163
(i)	<i>Pacific Ammonia</i> , 2004 Settlement, Ammonia, Commission	167
(j)	<i>Attila Dogan</i> , 2004 Settlement, Pipeline Construction, Royalties, Guarantee Fees, Quality Control Fees	168
(k)	<i>BMO Nesbitt Burns</i> , 2005 Settlement, Financial Transactions	170
(l)	<i>Canada Safeway</i> , 2006 Settlement, Groceries, Procurement	171
(m)	<i>Bridges Brothers</i> : 2007 Settlement, Blueberries, Broker Fees	172
(n)	<i>Wyeth Canada Inc.</i> : 2008 Settlement, Pharmaceutical, R&D Services	173
(o)	<i>Glaxo</i> : 2008 TCC, 2010 FCA, 2012 SCC, Pharmaceutical, Active Ingredient, Foreign-Based Information	175
(p)	<i>H&R Block Canada Inc.</i> : 2008 Settlement, Services and Interest	200
(q)	<i>Hoffmann-La Roche</i> : 2008 Settlement, Pharmaceutical, Active Ingredient	202
(r)	<i>Norand Data</i> : 2008 Withdrawal, Computer Products, Attribution of Profits to a Permanent Establishment, Downward Adjustment	203
(s)	<i>Tregaskiss Limited</i> : 2010 Settlement, Transfer of International Business, Recharacterization	204
(t)	<i>GE Capital</i> : 2009 TCC, 2010 FCA, Financial Services, Guarantee Fees, Recharacterization, Implicit Support	206
(u)	<i>Bornstein Seafoods</i> : 2010 Withdrawal, Seafood, Management Fees, Penalties	223
(v)	<i>Sherwood Industries</i> : 2009 Withdrawal, Heating Appliances, Tangible Goods, Recharacterization, Penalties	224
(w)	<i>Alberta Printed Circuits</i> : 2011 TCC, Computer Software, CUP ...	226

x TABLE OF CONTENTS

(x)	<i>Canadian Autoparts Toyota</i> : 2009 Settlement, Automotive Services	246
(y)	<i>Star Shipping (Canada)</i> : 2009 Withdrawal, Shipping Services	248
(z)	<i>Northern Pacific Appliance Distribution</i> : 2009 Settlement, Appliances, Allocation of Purchase Price	250
(aa)	<i>Four Star Distribution (Canada)</i> : 2011 Settlement, Snowboard Equipment, Shared Costs	252
(bb)	<i>Philips Electronics</i> : 2011 Settlement, Electronics, Purchase Price Allocation	253
(cc)	<i>NCO Customer Management</i> : 2010 Withdrawal, Customer Relationship Management Services	255
(dd)	<i>HSBC</i> : 2012 Withdrawal, Financial Services, Guarantee Fees, Penalties	258
(ee)	<i>Schering-Plough Canada</i> : 2012 Withdrawal, Pharmaceutical, Tangible Goods	261
(ff)	<i>Smith International Canada</i> : 2012 Withdrawal, Tangible Goods, Services, Penalties	262
(gg)	<i>Commonwealth Plywood</i> : 2012 Withdrawal, Wood Products, Commissions	263
(hh)	<i>McKesson</i> : 2013 TCC, 2014 FCA and 2015 Settlement(?), Pharmaceutical, Factoring	263
(i)	Facts	264
(ii)	CRA Reassessment	265
(iii)	The Tax Court of Canada Decision	265
(iv)	Analysis	273
(v)	Conclusion re: Part XIII and the Treaty	277
(vi)	Precedent	279
(ii)	<i>Marzen Artistic Aluminum</i> : 2014 TCC, 2016 FCA, Building Products, Substance	280
(i)	Facts	280
(ii)	The Decision	281
(jj)	<i>Sifto Canada Corp.</i> : 2017 TCC 37, Rock Salt, 2008 Voluntary Disclosure, Reassessment, Settlements Under Mutual Agreement Procedure	283
(i)	Facts	284
(ii)	Issue	285
(iii)	Position of the Parties	285
(iv)	The Tax Court of Canada Decision	286
(v)	Comments	287
2.	Other Tax Cases	290
(a)	<i>Central Canada Forest Products</i> : 1952 TAB, Forestry, Fair Market Value, Secret Comparables	290
(b)	<i>Hofert</i> : 1962 TAB, Christmas Trees, Fair Market Value	291
(c)	<i>Dominion Bridge</i> : 1977 FCA, Steel, Sham	291
(d)	<i>Spur Oil</i> : 1981 FCA, Oil, Artificial Reduction of Income, Fair Market Value	292

(e) <i>Redpath</i> : 1984 Que. S.C., Sugar, Sham, Tax Evasion	292
(f) <i>Irving Oil</i> : 1991 FCA, Oil, Sham, Tax Avoidance, Artificial Reduction of Income, Fair Market Value	292
(g) <i>Kleysen</i> : 1996 Man. Q.B., Heavy Equipment, Tax Evasion	293
(h) <i>World Corp.</i> : 2003 TCC, Commission, Business Valuation	293
(i) <i>1143132 Ontario</i> , 2010 TCC, Residency	294
(j) <i>Nielsen Development</i> , 2009 TCC, Management Fees	295
(k) <i>Cudd Pressure Control</i> : 1995 TCC, 1998 FCA, Oil and Gas, Attribution of Profits to a Permanent Establishment, Notional Rent	296
(i) Facts	296
(ii) TCC Decision	297
(iii) FCA Decision	299
(iv) FCA Minority Judgment	300
(v) Analysis	302
(l) <i>Specialty Manufacturing</i> : 1997 TCC, Thin Cap Rules vs. Arm's Length Principle	306
3. Other Cases	307
(a) <i>Ford Canada</i> : 2004 Ont. S.C., Automobiles, Royalties, Minority Shareholders	307
(b) <i>Nortel</i> : 2014 Ont. S.C., Hi-Tech, CCAA	311
C. Administrative Positions	312
1. OECD Guidelines	313
2. Permanent Establishments (PEs)	314
3. Financial Transactions	315
4. Taxpayer-Initiated Adjustments/Downward Adjustments	318
(a) Background	320
(i) Legislative Provisions	320
(ii) Guidelines for the Exercise of the Ministerial Discretion	321
(b) Issues	323
(i) Discretion not Exercised where Case Results from the Action of Another Tax Authority	323
(ii) Discretion not Exercised at all	324
5. Transaction-by-Transaction Approach (vs. Bundling)	326
6. Transfer Pricing Review Committee	328
7. Hierarchy of Methods	330
8. Multiple-Year Data (Averaging) and Interquartile Range	331
(a) IC 87-2R	331
(b) The Simkover Paper	331
(c) TPM-16	333
(d) Discussion	335
(i) The Arm's Length Principle is not an Exact Science	335
(ii) "Not an Exact Science" Implies the Application of a Reasonableness Criterion	337
(iii) Reasonableness Implies a Range of Acceptable Results	339
(iv) Multiple-Year Data and the Range of Acceptable Results ...	342

xii TABLE OF CONTENTS

(v) Summary	347
9. Cost Plus Method	348
10. Transactional Profit Methods	348
11. CPM/TNMM	348
12. Government Assistance	349
13. Qualifying Cost Contribution Arrangements (“QCCA”)	351
(a) SR&ED Costs	351
(b) Costs vs. Profits	351
14. Market Penetration	355
15. Secondary Adjustments/Part XIII Withholding Tax	355
16. Hard Bargaining	369
17. Competent Authority Notification	370
18. Incidental Sales	370
19. Exclusive Right	370
20. Advantage Created by an Activity	370
21. Total Return on Unique Intangible (Marketing Intangibles)	371
(a) Origin of the Concept	372
(i) 1968 Treasury Regulations	372
(ii) 1994 Fromage Frere Examples	373
(iii) The DHL Decisions	375
(iv) Glaxo	376
(b) OECD	377
(c) Application in Canada	379
(d) Issues	380
(i) Lack of Legal Framework	380
(ii) Value	383
(iii) Incompatibility with the Arm’s Length Principle	386
(e) Solution	388
22. Genuine Offer	389
23. Guarantee Fees	389
24. Comparable Profits Margin	390
25. Intra-Group Services	391
26. Cancellation of a Canadian Project at Non-Resident’s Request and 69(3) ITA (Business Restructuring)	396
27. Customs Valuations vs. Transfer Pricing	396
28. Immigrant Investor Trusts	397
29. Consignment Restructurings/Commissionaires	397
30. Compensating Adjustments	399
31. Rules of Thumb (Safe Harbours)	400
D. OECD Transfer Pricing Guidelines	402
E. The OECD’s Base Erosion and Profit Shifting (BEPS) Project	403
1. Historical Background	403
2. The BEPS Project	405
3. BEPS Measures Addressing Transfer Pricing	405
(a) Overview	405
(b) Action 8: Transfer Pricing - Intangibles	408

- (i) The Definition of “Intangibles” 408
 - (ii) Hard-To-Value Intangibles & Uncertain Value 410
 - (iii) Allocation of Profits 412
 - (c) Action 9: Transfer Pricing - Risk and Capital 413
 - (i) The Determination of Risks 414
 - (ii) Control of Risk 415
 - (iii) Overcapitalization 416
 - (d) Action 10: Transfer Pricing - Other High-Risk Transactions 418
 - (i) Re-characterization of Transactions 418
 - (ii) Low-value Intra-Group Services 419
 - (iii) Commodity Transactions 421
 - (e) The Transactional Profit Split Method 421
 - (f) Action 13: Documentation and Reporting 423
 - (g) The Multilateral Instrument 424
- III. Related Topics** 427
- A. Penalties 427
 - 1. Penalties Related to an Adjustment 427
 - (a) Transfer Pricing Penalties 247(3) 427
 - (b) Penalties for Failure to Withhold 227(8) 427
 - (c) Penalties for Underestimation of Installment Base 163.1 428
 - 2. Penalties Related to the T106 429
 - (a) Failure to File 429
 - (b) False Statement or Omission 430
 - 3. Requests/Requirements to Provide Information/Documentation 431
 - (a) 231.1 Requests 431
 - (b) 231.2 Requirements 432
 - (c) 231.6 Requirements 432
 - (d) 247(4)(c) Requests 433
 - 4. Civil Penalties for Tax Preparers 436
- B. Information Gathering 438
 - 1. Form T106 439
 - (a) Changes 440
 - (b) Summary Form 440
 - (c) T106 Slip 441
 - (d) Transfer Pricing Methods 442
 - (e) *De Minimis* Exception 443
 - 2. Audit: 231.1 and 231.2 ITA 443
 - 3. Section 231.6 Requirements 450
 - 4. Exchange of Information 459
 - 5. Taxpayers’ Access to Third Party Comparables (Secret Comparables) 460
- C. Competent Authority 478
 - 1. General 478
 - 2. IC 71-17R5 479
 - (a) Unilateral Resolution 479
 - (b) CA Proceedings without Taxpayer’s Consent 480

(c)	Complete Requests	481
(d)	ACAP	483
(e)	Acceptability of CA Requests	486
(f)	Tax Avoidance	486
(g)	Responsibilities of the Taxpayer	487
(i)	Cooperation by providing information	487
(ii)	No self adjustments	488
(iii)	Keep both competent authorities informed	488
(iv)	Ensure that taxation years do not become statute-barred	489
(h)	Appeals	489
(i)	Collections	490
(j)	Not Precedent Setting	491
(k)	Provincial Income Tax Considerations	491
(l)	Specific Issues Under the US Convention	491
3.	Notifications	492
(a)	Notification to be Eligible for MAP	492
(b)	First Notification of Action Resulting in Double Taxation	496
4.	PATA Guidelines	500
5.	Canada-US MOUs	500
(a)	Resolving All Cases	501
(b)	Consistency	501
(c)	Reciprocity	502
(d)	OECD Guidelines	502
6.	Arbitration	502
7.	MEMAP	514
D.	Advance Pricing Arrangements	515
1.	Eligibility for an APA	517
2.	Roll-Back	517
3.	Use and Confidentiality of Information	520
4.	Length of Time of the APA Process	521
5.	Taxation Years to be Covered by the APA	523
6.	Term of the APA	523
7.	Compensating Adjustments	524
8.	Inconsistent Domestic APAs	524
9.	Binding Agreements	525
10.	Confidentiality of Information	529
11.	Critical Assumptions	532
(a)	The Tax Authority's Approach	533
(b)	Critical Assumptions and Special Adjustments	533
(c)	The Case for Critical Assumptions	535
(d)	Triggering a Critical Assumption	537
(e)	The Economic Events of 2008 and 2009 Testing the APA Process	537
12.	APA First Step Initiative	538
13.	Small Business Taxpayer APA	538
E.	Voluntary Disclosure	539

TABLE OF CONTENTS xv

F. Customs Valuations	544
G. Time Limitations	548
1. Domestic	548
2. Under Tax Treaties	551
Appendix	553
1. Income Tax Act Excerpts	557
2. Interpretation Bulletins and Folios	571
3. Information Circulars	609
4. T106 Summary Form	787
5. Transfer Pricing Memoranda	795
6. Other CRA Documents	927
7. PATA Documents	999
8. Canada-US MOUs	1041
9. Canada-US Protocol	1055
10. The Administration of Canada's Transfer Pricing Rules	1061
Index	1093