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Sent by E-Mail prixdetransfert-transferpricing@fin.gc.ca

Transfer Pricing Consultation
c/o Tax Treaties Section
Tax Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa ON, K1A 0G5

Dear Sirs/Mdms:

Re: Transfer Pricing Consultation

1. Introduction

These submissions are in response to the draft amendments (the "**Draft Amendments**") to Canada's transfer pricing rules included in the Consultation on Reforming and Modernizing Canada's Transfer Pricing Rules released on June 6, 2023 (the "**Consultation Paper**").

While we acknowledge the intention to provide greater clarity on the application of the arm's length principle to align with international views that motivates the proposals in the Consultation Paper, the Draft Amendments to section 247 in the *Income Tax Act* (the "**Act**") would compound uncertainties associated with the interpretation and application of Canada's transfer pricing rules, invite overreach on the part of the Canada Revenue Agency ("**CRA**") in its application of transfer pricing rules, and may result in further burdening of the administrative and judicial systems with additional tax disputes. In addition, the rationales and examples advanced in the Consultation Paper to support the need for Draft Amendments (such as looking at the conduct of the parties and considering relevant economic circumstances) appear not to account for the fact that Canadian courts already do so under the existing transfer pricing legislation.

Our submissions are not limited to the specific questions posed in the Consultation Paper. We have provided comments on those questions in the Consultation Paper in an Appendix.

We consent to the public disclosure of these submissions by the Department of Finance.

2. The Consultation Paper's Description of the Current State of Canada's Transfer Pricing Tax Law is Flawed

We disagree with the Consultation Paper's suggestion that the decision in *Her Majesty The Queen v. Cameco Corporation*[1] highlights issues with the existing transfer pricing legislation and, in particular, we disagree with the assertion that such an approach has led to outcomes in which the profit allocations between Canadian and non-resident taxpayers were at odds with the economic contributions of the parties.

As you are aware, we are counsel for Cameco. We do not believe this letter is the appropriate forum for dealing with our concerns with the references to *Cameco* and the prior litigation. We will restrict our comments in this letter as it relates to *Cameco* to the limited references below and the overall observation that while the Government has every right to make policy choices surrounding how inter-affiliate transactions are taxed, the Consultation Paper's description of the facts is inaccurate and its description of the analysis from the *Cameco* case is flawed.

3. Draft Amendments Should be Clearly Prospective

The Draft Amendments do not include a proposed coming into force date; however, the Consultation Paper states that they are expected to apply on a prospective basis. There is a pressing need for clarification of the coming into force date for the Draft Amendments, particularly with respect to existing arrangements between non-arm's length parties.

If enacted, the Draft Amendments should only be effective on Royal Assent. It would be inappropriate to enact an earlier effective date based on the initiation of a public consultation, much less on statements made years prior in budget documents that the Government intended to launch such a consultation.

The Department of Finance should also clarify the implications of the proposals for ongoing audits in respect of existing arrangements between non-arm's length parties. The Draft Amendments are influenced by the Base Erosion and Profit Shifting ("**BEPS**") project, and in particular the BEPS concept of disregarding a contractual assumption of risk (and associated returns) if the risk-assuming party does not also perform significant functions in respect of the control of that risk and have the financial capacity to bear it. In our experience, the CRA has already, and increasingly, been relying on BEPS concepts in transfer pricing audits. This includes audits of taxation years that pre-date the relevant BEPS revisions, which were initially published as proposals in 2015, incorporated in the

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[1] *The Queen v. Cameco Corporation*, 2018 TCC 195 ("*Cameco* TCC"), aff'd 2020 FCA 112 ("*Cameco* FCA"), leave to appeal to Supreme Court of Canada denied.

OECD Transfer Pricing Guidelines (the "**OECD Guidelines**," including subsequent amendments) in 2017, and are only now proposed to be introduced into Canadian law.

It is inappropriate—and, indeed, inconsistent with the rule of law—to apply BEPS concepts retroactively, especially where those concepts depart from the established Canadian principle that tax laws apply based on parties' substantive legal rights and obligations, and not based on the "economic substance" of parties' arrangements, unless there is a finding of sham or the conditions of a specific provision in the legislation that calls for recharacterization have been met.[2] This tension is compounded by the proposed consistency rule in subsection (2.03) to align amounts determined under Canada's domestic legislation with the OECD Guidelines, unless the context otherwise requires. The coming into force provision must clearly state that aspects of the Draft Amendments or any future OECD guidance incorporated by the consistency rule that represent a departure from the pre-existing principles are effective only on Royal Assent or, where relevant, the subsequent date when a text other than the 2022 version of the OECD Guidelines is prescribed by regulations (except to the extent the new text is relieving or consistent with prior guidance).

The coming into force provision should also include a transitional period for arrangements that were in place prior to the release of the Draft Amendments. This would allow taxpayers sufficient time to revisit their arrangements and intelligently restructure them, if necessary, without the need for immediate action. It should not be the case that taxpayers must revisit each of their existing non-arm's length transactions on an urgent basis.

In giving effect to the prospective application of the rules, it is important that rules do not directly or indirectly, impact transactions that were entered into prior to their implementation in Canada. In this regard, the "delineated transaction" or application of the proposed non-recognition and replacement rule should not apply effectively so as to alter a transaction that took place before the effective date (e.g., by recasting the consequences of such a transaction in a later period), even if the reassessment is only for post-amendment years.

In addition, if taxpayers restructure to align with BEPS concepts incorporated in the OECD Guidelines, this should not in any way influence the CRA's views on how returns should be assessed for taxation years prior to the effective date. It is essential that the CRA evaluates each taxation year independently, under the rules in place for the applicable year, without allowing knowledge of subsequent restructuring decisions to impact their assessment of prior years.

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[2] See e.g. *The Queen v. Lagueux & Frères Inc.*, 74 DTC 6569 (FCTD) and *Shell Canada Ltd. v. Canada*, [1999] 3 SCR 622 at para 39, per McLachlin J.

4. Starting Point in the Comparability Analysis

The Draft Amendments should be clarified so that there are specific conditions that must be met before legal and contractual relationships can be ignored, if that is the desire of the Government, in determining the "delineated transaction". This clarification is needed because, unlike jurisdictions such as the United States, Canada does not follow the "economic substance" doctrine. This difference is acknowledged in footnote 51 in the Consultation Paper, which states: "Generally speaking, some jurisdictions apply a substance over form approach while others, like Canada, absent direction to the contrary, favour a form over substance approach."[3]

The starting point in the Canadian context should be an assessment of the transactions undertaken, followed by determining whether a provision allows for the disregard or recharacterization of that specific conduct. It is not clear that the concept of "actual conduct" referenced in the proposed legislation has any relevant meaning. The absence of clear markers for departing from legal form or substance leads to intolerable uncertainty and potentially absurd outcomes. There is a concern that different parts of the Act may not work harmoniously if technical rules with specific requirements regarding legal form or substance are subjugated to by the application of transfer pricing rules that redefine the "facts" into a vague alternative interpretation, leaving taxpayers uncertain about the proper course of action. It cannot be the case that there is one "delineated" transaction for transfer pricing purposes and another for all other purposes in the Act.

To the extent the Government views the "accurate delineation" concept as allowing the CRA the ability to disregard the legal form and substance of a transaction or series of transactions to effectively create a transfer pricing fiction that attributes the bearing of risks to entities that provide "people" functions (rather than the entities that legally and economically bear the risks), it should say so directly. In our view, this would be a fundamental change to our transfer pricing rules that is inappropriate. Rather, the crux of accurate delineation should lie in examining the transactions actually undertaken by the parties, rather than attempting to recharacterize those actions as something different. The OECD Guidelines provide guidance on this approach, emphasizing the importance of understanding what the parties did, pricing the transaction accordingly, and only resorting to non-recognition in exceptional circumstances when pricing is not feasible.

The discussion of "control over risk" in the Consultation Paper is vague and inconsistent with the core tenets of the arm's length principle. When arm's length parties invest capital, they typically receive residual returns regardless of whether they exercise control over risk or other functions. This raises the question of why non-arm's length transactions are required to be structured fundamentally differently from how arm's length transactions are

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[3] Consultation Paper, footnote 51.

conducted. The OECD Guidelines themselves are inconsistent on this point, as exemplified by the investment advisor example, where the person who puts capital at risk is allocated a residual return.

It is possible, and commonly observed in transactions between arm's length parties, for risks to be contractually assigned without any change in the party who ultimately controls the risk. This can be exemplified by the insurance industry, where risks are often transferred through contractual arrangements while the ultimate control over those risks remains with the insured party. Another example is credit default swaps, where one party transfers the risk of default on a loan or bond to another party.

As discussed below, Example 1 in the consultation paper which involves determining the delineated transaction does not appear to add anything to the existing approach mandated by the courts to transfer pricing. That approach also starts the analysis by determining what transaction was undertaken by the parties (by looking at the terms and conditions and the conduct of the parties).

5. Role of Economically Relevant Characteristics in Prior Jurisprudence

Proposed subsection (1.1) in the Draft Amendments requires analysis of the transaction or series based on its "economically relevant characteristics", including the contractual terms and the "actual conduct" of the parties. The related definition of "economically relevant characteristics" to be added to the definitions section in subsection 247(1) is based on the definition of "economically relevant characteristics" in the OECD Guidelines, but there are notable differences.

The list of economically relevant characteristics in the Draft Amendments refers to the "actual conduct" of the parties, which may supersede contractual terms.

This is a departure from the approach in the OECD Guidelines, where the first item in the description of "economically relevant characteristics" is "the contractual terms of the transaction", without mention of any override. The Consultation Paper explains that the proposed reference to "actual conduct" in paragraph (a) of the definition of "economically relevant characteristics" aims to prevent what is described in the Consultation Paper as an overly narrow interpretation of the OECD Guidelines that could limit the relevant information in delineating a transaction to intra-group contracts. The accompanying footnote explains this departure with reference to the OECD Guidelines being a consensus document, and there being different approaches in jurisdictions regarding economic substance.

This appears to be a misinterpretation of the *Cameco* decision in light of statements in the Consultation Paper to the effect that shortcomings and the lack of clarity in the existing legislation have led to an overreliance on intra-group contracts in that decision. The

Consultation Paper provides no support to suggest that Canadian courts would restrict themselves to an evaluation of just the terms and conditions in a contract if the actual conduct of the parties was such that the transaction was something different than that specified in the contract.

Example 1 in the Consultation Paper is intended to show the application of "economically relevant characteristics" in determining delineated transactions. In this example, Canco provides services to Forco in support of Forco's manufacturing operations. The services agreement between Canco and Forco specifies that Canco will provide services related to Forco's quality control function, with remuneration based on cost plus. Canco has been providing a broader range of services to Forco beyond quality control, although the contract has not been updated. The Consultation Paper states that the "delineated transaction" is determined to be the full range of services actually provided, resolving the discrepancy between the contract and the actual conduct of the parties, and that the application of the test in paragraph (2)(b) will be based on all the services actually provided.

We see nothing controversial in Example 1, and indeed would expect that a court would reach the same conclusion under the existing rules in, and judicial interpretation of, section 247. In particular, it would be appropriate to consider all the services actually provided, and not only those described in intra-group contracts, when determining whether the price charged for those services differs from comparable transactions between arm's length parties pursuant to existing subsection 247(2).

The fact that Canadian courts, including the Tax Court and Federal Court of Appeal in *Cameco*, have previously referred to the guidance in the OECD Guidelines on economically relevant characteristics is not expressly acknowledged in the Consultation Paper. Both *Glaxo*[4] and *GE*[5] are examples of cases in which Canadian courts confirmed that transactions are to be priced having regard to all of their economically relevant characteristics, and not based on a narrow view of the transactions at issue.

The Tax Court in *Cameco* similarly addressed the role of economically relevant characteristics, stating "the identification of a particular transaction or a particular series does not preclude consideration of the broader circumstances in applying the analysis required by paragraphs 247(2)(a) through (d) to that transaction or series. The jurisprudence of the Supreme Court of Canada and the Federal Court of Appeal makes clear the fact that all relevant circumstances must be considered in the application of the current and past versions of the transfer pricing rules in the [Act]."[6] The Tax Court, citing

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4 *The Queen v. GlaxoSmithKline Inc.*, 2012 SCC 52, aff'g 2010 FCA 201, rev'g, 2008 TCC 324 ("*Glaxo*").

5 *General Electric Capital Canada Inc. v. The Queen*, 2009 TCC 563, aff'd 2010 FCA 344 ("*GE*").

6 *Cameco* at para 698.

GE, noted that all the circumstances must be considered, whether they arise from the non-arm's length relationship or from other factors.[7]

Example 2 in the Consultation Paper appears as similarly non-controversial as Example 1. Given the guidance by the courts in *GE, Glaxo*, and *Cameco*, it seems obvious to us under the existing legislation that the courts would take into account whether arm's length parties would have agreed to a concession on price.

Subject to the ambiguous reference to "actual conduct" overriding contractual terms, adding a definition of "economically relevant characteristics" to the legislation does not effect a material change in the law. The Draft Amendments largely codify the approach currently mandated by Canadian courts in the jurisprudence. The addition of "actual conduct" is unnecessary. If the intention is to align with the OECD Guidelines, why not be consistent with the OECD Guidelines and use the same definition?

6. The Definition of "Conditions" is Overly Broad

The Draft Amendments provide that the "conditions" of a transaction or series of transactions are to be "analyzed and determined with reference to [their] economically relevant characteristics." The proposed interpretive rule in subsection (1.4) of the Draft Amendments, and in particular the sweeping reference to *all information*, is overly broad (and arguably goes beyond the OECD Guidelines).

As noted in the Consultation Paper, the OECD Guidelines do not define the term "conditions". Rather, the OECD Guidelines state that conditions include, but are not limited to, prices. This contrasts with proposed subsection (1.4) of the Draft Amendments, which states that the term conditions "is to be interpreted broadly to include *all information* in respect of the delineated transaction or series relevant to the determination of the quantum or nature of initial amounts" (emphasis added). The reference to *all information* is overly broad to the point of being meaningless. Moreover, this could lead to unintended consequences in the context of a transfer pricing audit. If *all information* is relevant to the determination of an appropriate transfer price, taxpayers can have no confidence that the scope of the CRA's audit activity will be appropriately constrained or that they will not be required to exhaust their compliance resources in responding to information requests of marginal relevance to the administration of the Act.

7. Role of the OECD Transfer Pricing Guidelines

The Consultation Paper indicates that the proposals seek "to bring the application of the arm's length principle in Canada's transfer pricing rules in line with the international consensus" reflected in the OECD Guidelines. The Draft Amendments include a proposed

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[7] *Cameco* at FN 783 citing *GE* at para 54.

consistency rule in subsection (2.03) to align amounts determined under subsection (2.02) and the OECD Guidelines, unless the context otherwise requires.

The approach set out in in the Draft Amendments and the Consultation Paper differs from the current approach taken by Canadian courts, which have considered the OECD Guidelines when pricing-controlled transactions, but have not viewed them as legally binding or "controlling as if they were a Canadian statute."[8]

The Draft Amendments contemplate a static reference to the 2022 version of the OECD Guidelines, or any other text prescribed by regulation.[9] If a consistency rule is enacted to align with amounts determined under the OECD Guidelines, we agree that it should be static (and not ambulatory) to promote certainty and predictability for taxpayers in structuring their affairs, and to ensure that Canada does not delegate its legislative authority to the OECD. Subsequent versions of the OECD Guidelines should not automatically be incorporated unless appropriate steps are taken to amend the definition of "Transfer Pricing Guidelines" or to prescribe the text by regulation. This is particularly important because, as noted in the Consultation Paper, the "guidelines are a consensus document used by decision makers in different jurisdictions with varying legal traditions."[10]

Subsequent versions of the OECD Guidelines or any other text prescribed by regulation should generally only be incorporated prospectively unless such guidance is relieving or consistent with prior guidance. Revenue authorities should not be able to apply a publication retroactively to prior taxation years.[11]

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[8] *Glaxo* at para 20. The frequently cited statement from the Supreme Court of Canada in this context that the OECD Guidelines are "not controlling as if they were a Canadian statute" arose in response to a misquotation in the courts below. In particular, the Tax Court of Canada quoted a related Federal Court of Appeal procedural decision that said: "It appears to be common ground that the OECD Guidelines inform or should inform the interpretation and application of subsection 69(2)" in *SmithKline Beecham Animal Health Inc v. R.*, 2002 FCA 299 at para 8. However, the quotation from *SmithKline* was based on the parties in that case agreeing to consider OECD Guidelines (it was common ground between the parties in the context of the dispute, not general common ground).

[9] We note that reference to "or any other text prescribed by regulation" in the proposed definition provides flexibility for the Government to incorporate documents beyond the OECD Guidelines, which could allow the Government to adopt OECD guidance before it is formally included in the OECD Guidelines. The OECD's guidance on transfer pricing aspects of financial transactions published in 2020 was not included in the Guidelines until 2022, highlighting how the proposed approach would allow for earlier adoption of guidance if the legislation were amended or the text is added by regulation.

[10] Consultation Paper, footnote 51.

[11] In *Alberta Printed Circuits Ltd. v. The Queen*, 2011 TCC 232, the Tax Court considered only the applicable guidelines in force during the relevant taxation years, stating at para 149: "Paragraphs 247(2)(a) and (c), like former subsection 69(2), is analogous to Article 9(1) of the OECD Model Double Taxation Convention on Income and Capital. The OECD issued a Commentary on transfer pricing in

If introducing a consistency rule to align with the OECD Guidelines, the Government should clarify that the BEPS concepts initially introduced in the 2017 version of the OECD Guidelines are inapplicable to prior periods. In our experience, these concepts are being applied retroactively. Australia has codified the principle that revenue authorities cannot retroactively apply a publication to previous taxation years. Specifically, Australia introduced a consistency rule to the *Income Tax Assessment Act 1997* (Cth), initially referring to the 2010 Guidelines. This provision was subsequently amended to add the 2015 BEPS revisions and then the 2017 Guidelines.[12] There is a parallel provision in *Income Tax (Transitional Provisions) Act 1997* (Cth) that applies to prior taxation years and restricts reference to the version of the OECD Guidelines in place before the start of the taxation year.[13]

8. Other Provisions

The Draft Amendments are limited to the provisions that make transfer pricing adjustments in subsection 247(2) and related definitions. In addition to the proposals described in the Consultation Paper relating to the transfer pricing penalty and documentation provisions in subsection 247(3) and (4) of the Act, the Department of Finance should consider amendments to:

(a) As currently drafted, subsection 247(10) requires additional Ministerial discretion for any adjustment that might be favourable to a taxpayer. It is not clear from a tax policy perspective why a taxpayer's income and tax liability computation should be subject to Ministerial discretion solely because it may benefit the taxpayer. Transfer pricing adjustments that reflect arm's length conditions should operate the same whether the adjustment favours the taxpayer or the Minister. The distinction between upwards and downwards transfer pricing adjustments (which is inherent in subsection 247(10)) should be removed by eliminating subsection 247(10) or restricting its application to the determination of the base to which transfer pricing penalties may apply.

(b) Subsection 227(6.1) to provide relief for the Part XIII withholding tax in circumstances where the refund under subsection 227(6.1) would have been available but is now out of time when the application is made.

(c) Align Part I and Part XIII objections to treat a Part I objection as also constituting an objection to a secondary Part XIII reassessment. In the transfer pricing context,

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1979, which was updated in 1995. There was a further update in 2010, but, since this update is well beyond the taxation years in issue, I will refer only to the applicable 1995 Commentary."

12 *Income Tax Assessment Act 1997* (Cth), s. 815-135.

13 *Income Tax (Transitional Provisions) Act 1997* (Cth), s. 815-5.

the Part XIII reassessment is a direct result of a Part I reassessment. By aligning the objections, the administrative burden would be reduced, particularly since taxpayers may be unaware of the need to file a separate objection to the Part XIII assessment, and in many cases have not received Part XIII assessments that the CRA believes it has issued, resulting in taxpayers having to request copies from auditors after having been alerted to the purported existence of an assessment by a CRA collections officer.

(d) Eliminate the requirement for large corporations that object to an assessment to pay (or post security for) 50% of the disputed amount. This requirement creates perverse incentives with respect to the issuance and dispute of reassessments and is out of step with the regimes of Canada's peer jurisdictions.

9. Concluding Remarks

The Draft Amendments, if enacted as proposed, would introduce uncertainty and potentially harm Canadian competitiveness. Canada has actively participated in the BEPS project and has already implemented several international standards derived from its recommendations. However, this implementation has occurred without a comprehensive review of domestic measures, leading to a complex and overlapping patchwork of regimes. For instance, an intercompany loan between Canadian taxpayers and non-arm's length non-resident parties would now be subject to various overlapping limitations in the Act, potentially including the transfer pricing rules, thin capitalization rules, proposed anti-hybrid rules, proposed EIFEL rules, sections 15 and/or 17, the FAD rules, and the general limits on interest deductibility in paragraph 20(1)(c). The Department of Finance should consider harmonization and simplification of these measures to ensure clarity and coherence in the tax system.

We strongly urge the Department of Finance to consider making necessary revisions, taking into account the concerns outlined in this submission, and would be pleased to discuss this submission further or to comment on any further revisions to the Draft Amendments.

We have provided comments on the specific questions asked in the Consultation Paper in an Appendix.

Yours very truly,

Osler, Hoskin & Harcourt LLP.

Osler, Hoskin & Harcourt LLP

APPENDIX

COMMENTS ON QUESTIONS IN CONSULTATION PAPER

With Respect to The Current State of Canada's Transfer Pricing Law

Question 1

- **As it relates to the application of the arm's length principle, the consultation paper identifies two main areas where Canada's current transfer pricing legislation does not provide explicit guidance, together with proposed amendments to provide greater certainty in these areas. Are there other areas that would benefit from additional guidance in order to ensure that the arm's length principle, as articulated in the Transfer Pricing Guidelines, is applied in Canada?**

- **If so, please indicate the area and provide input as to the form(s) you consider such guidance should take (legislation, technical notes or administrative guidance).**

As we noted in our submission, the Draft Amendments, if enacted as proposed, would increase uncertainties in the interpretation and application of Canada's transfer pricing rules. Moreover, the Draft Amendments could potentially lead to overreach by the CRA as the language in the amendments introduce a highly speculative analysis that invites the use of hindsight when administering the rules. It is important to carefully consider the potential consequences of these amendments and find a balanced approach that addresses the concerns without creating further complications and burdens.

With Respect to Proposed Solutions

Question 2

- **The requirement proposed by the rule at (1.1) to establish the starting point of the comparison respects the transaction or series as structured by the taxpayer. There are, however, limits placed on this. The rule at (1.1) requires that a transaction or series meeting the conditions of paragraph (2)(a) must be augmented by relevant facts deriving from the elements of the definition of "economically relevant characteristics". In some cases the Transfer Pricing Guidelines provide that the risks are to be reallocated based on the level of control over the risk and financial capacity to assume the risk.**

- **Does the proposed legislation provide sufficient direction or guidance for this delineation exercise consistent with the Transfer Pricing Guidelines? If not, what additional legislative direction or guidance would be required?**

See our comments above regarding the starting point in the comparability analysis and the role of "economically relevant characteristics".

Question 3

- **The transfer pricing application rule at paragraph (2)(b) would scrutinize the delineated transaction or series to determine whether it includes conditions that differ from those that would have been included had the parties been dealing with each other at arm's length in comparable circumstances.**

- **A proposed interpretive rule at subsection (1.4) would provide that conditions is to be interpreted broadly to include all information relevant to the determination of "initial amounts" as this term is used in subsection (2.1).**

- **Do you agree that the "conditions" of the delineated transaction or series would capture all relevant conditions that operate in respect of the delineated transaction or series?**

See our comments above regarding the proposed interpretive rule in subsection (1.4), which is broad to the point that it lacks clarity.

Question 4

- **The arm's length principle applies taking into account the commercial interest of the parties to the controlled transaction posited as separate entities and should not include assessments taken from the commercial interests of the MNE group as a whole. This approach is relevant whether the principle is applied directly through the transfer pricing application rule at proposed paragraph (2)(b) or the non-recognition and replacement rule at proposed subsections (1.2) and (1.3) (discussed next).**

- **The language proposed to adopt the non-recognition and replacement rule includes some guidance regarding the consideration of the separate perspectives of the parties to the transaction at the preamble to subsection (1.2). No similar language is proposed at paragraph (2)(b), because a consideration of the interests of the parties as separate entities underlies the statement of the arm's length principle in that paragraph.**

- **Do you agree that the language at paragraph (2)(b) is sufficient to ensure that assessments of the commercial interests of the MNE group as a whole are not**

included in the test at proposed paragraph (2)(b) or do you consider that additional language is required to establish this approach?

The arm's length principle does not necessitate constructing the hypothetical based on the assumption that the tested party operates independently on a standalone basis. Instead, the principle simply requires the elimination of the common interest among the participants, while maintaining other relevant circumstances that impact the pricing of the hypothetical transaction.

Question 5

- **In addition to the application of the general anti-avoidance rule, a specific rule is required to protect the integrity of the rules that incorporate the arm's length principle for Canadian tax purposes.**

- **It is proposed that paragraphs 247(2)(b) and (d) be repealed and replaced with the non- recognition and replacement rule outlined above, which is designed to protect domestic tax bases from profit allocations resulting from controlled transactions meeting the criteria of the rule at proposed subsection (1.2) by replacing them with controlled transactions that have a commercially rational expected result and that can be priced from the point of view of arm's length parties taking their individual interests into account.**

- **In your view, will the proposed rule be effective in protecting the integrity of the Canadian transfer pricing rules and the Canadian tax base? Taking into account the international consensus on transfer pricing, is there a different approach that you would propose?**

We observe that the proposed non-recognition and replacement rule in subsections (1.2) and (1.3) includes subjective and speculative language, with reference to "would have been acceptable to the participants" and "expected result that…would have been commercially rational."

Question 6

- **Do you agree that the inclusion in the proposed legislation of a consistency rule with respect to the Transfer Pricing Guidelines is a practical way of helping to align Canada's transfer pricing legislation with the international consensus? If not, what alternative approach would you recommend and why?**

- **The proposed consistency rule would adopt a static approach to the Transfer Pricing Guidelines. Do you agree with this approach? Or do you consider that an ambulatory approach would be preferable as it would ensure that Canada's**

transfer pricing legislation is contemporaneous with the guidelines as they evolve?

- **Assuming a static approach is adopted, what should be the considerations in the future when updating a reference to the Transfer Pricing Guidelines? Should they apply only prospectively? Would it matter if the updated version of the guidelines were beneficial to the taxpayer or the tax administration?**

See our comments above regarding the role of the OECD Guidelines. The proposed consistency rule in subsection (2.02), if enacted as proposed, should be static.

Question 7

- **With reference to Appendix A, please comment on any other aspects of the proposed legislative changes to section 247.**

See our comments above regarding other aspects of the transfer pricing rules.

With Respect to Transfer Pricing Documentation and Penalty Provisions

Question 8

- **What changes do you think need to be made to the transfer pricing documentation provision?**

Industry stakeholders that prepare transfer pricing documentation for Canada as well as other jurisdictions are better placed than we are as tax advisors to comment on specific measures to reform these requirements. In concept, simplification and alignment of transfer pricing documentation requirements are laudable goals, provided that these changes do not result in increased compliance burden for taxpayers. Transitional rules are also important to allow for a period of time during which either the former or any new format of documentation would satisfy the requirements of the Act. This approach would help mitigate any potential disruptions caused by the transition to new documentation requirements.

Question 9

- **What changes do you think need to be made to the transfer pricing penalty provision?**

See response to Question 8.

Question 10

- **Do you agree with the proposal to align the documentation requirements of subsection 247 with those of the Local file detailed in Appendix E?**

See response to Question 8.

Question 11

- **Do you agree with this proposal to introduce Master file reporting requirements (on request) for taxpayers that are members of MNE groups that are also subject to CbC reporting requirements?**

See response to Question 8.

Question 12

- **What information, if any, should be required to be completed for the Local file and Master file other than or instead of that described in Appendices D and E?**

See response to Question 8.

With Respect to Simplified Documentation Requirements for Lower Value Transactions and Smaller Taxpayers

Question 13

- **Do you agree with the proposal to provide simplified documentation requirements for low-risk taxpayers and transactions?**

Yes. This would reduce the administrative burden and compliance costs for low-risk taxpayers and transactions.

Question 14

- **What criteria could be used to identify taxpayers and transactions to whom reduced documentation requirements would apply?**

In addition to considering relative and absolute quantitative materiality thresholds, reduced documentation requirements should be in place for low value-adding intra-group services on a qualitative basis.

Question 15

- **What content would be required to demonstrate compliance with the arm's length principle under such reduced documentation requirements?**

The following content would identify and describe the transactions while minimizing the administrative burden and cost of extensive documentation under such reduced documentation requirements:

(a) identification of relevant transactions;

(b) copies or summaries of intra-group agreements; and

(c) invoiced amounts.

With Respect to Transfer Pricing Penalty Thresholds

Question 16

- **Should the $5 million threshold be changed? If so, would an increase to [$10] million be appropriate?**

Yes, the $5 million threshold should be increased.

Question 17

- **Does the penalty provision operate as intended to encourage the preparation of contemporaneous documentation? If no, how could it be changed to encourage compliance?**

Yes.

With Respect to Streamlined Pricing Approaches

Question 18

- **Do you think that the low value-adding intra-group services approach should be adopted by Canada?**

Yes. However, to avoid unnecessary disputes, it is essential to define and provide specific lists or guidelines that clearly outline what constitutes low value-adding intra-group services.

Question 19

- **If this approach were to be adopted, should it be made mandatory, adopted as a default position or established as a safe harbour?**

If this approach is adopted, it should be implemented as a safe harbour with simplified documentation requirements. Taxpayers should have the option to choose between utilizing the simplified method or conducting a full analysis of the application of the arm's length principle.

Question 20

- **Should there be a cap on the amount of costs that could qualify for treatment under such an approach, either as a dollar amount or a percentage of total costs? If so, what should that cap be?**

No.

Question 21

- **Do you agree that Canada should introduce limits on the features that may be taken into account for pricing intra-group financial transactions in line with those described above?**

No. Please see our comments above in concluding remarks about the various overlapping limitations in the Act for financing transactions.

Question 22

- **If so, should there be additional features?**

N/A.

Question 23

- **Should these rules be applied on a universal basis or only in certain circumstances?**

N/A.