



Transfer pricing alert

Cancellation of IC87-2R

April 7, 2020

Effective December 30, 2019, the Canada Revenue Agency (CRA) has cancelled its information circular IC87-2R, *International Transfer Pricing*.

IC87-2R was issued on September 27, 1999 with the purpose of providing guidance with respect to the application of Canadian transfer pricing rules that are contained in section 247 of the Canadian Income Tax Act (the Act).

A comprehensive document at the time of its issuance, IC87-2R set out the CRA's views on transfer pricing and its position with respect to the application of the Organisation for Economic Co-operation and Development (OECD) report, *Transfer Pricing for Multinational Enterprises and Tax Administrations* (the OECD TPG) that was issued in 1995.

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Rationale for cancellation

The CRA notified Canadian taxpayers of the cancellation of IC87-2R on its webpage used by the public to access the publication and on its transfer pricing webpage.

On its transfer pricing webpage, the CRA states that the circular, which reflects the policies in place on the date it was published, has been archived. The CRA directs Canadian taxpayers to its transfer pricing memoranda that it issues periodically to supplement and update its transfer pricing policy and to provide guidance on specific aspects of the transfer pricing legislation.

It is noteworthy that on its transfer pricing webpage, the CRA directs Canadian taxpayers to the 2017 OECD TPG and continues to state that the Canadian transfer pricing legislation and administrative guidelines are generally consistent with the 2017 OECD TPG.

More recently, on February 26, 2020, the CRA issued a draft notice to tax professionals on this matter that provides some insight into CRA's rationale for cancelling IC87-2R. According to the notice, IC87-2R was cancelled due to its inconsistency with the CRA's current interpretation and application of Canadian transfer pricing legislation, and also due to the fact that it does not reflect updates to the OECD TPG.

In the notice, the CRA cites two key examples illustrating its views and factors contributing to the cancellation of IC87-2R – the ordering rule and the broader application of the Canadian transfer pricing recharacterization provisions.

Ordering rule

In the draft notice to tax professionals, the CRA highlights that IC87-2R stated that as a general rule, the specific provisions of the Act relating to cross-border debt would be applied before considering the more general provisions of section 247 of the Act. According to CRA, this is inconsistent with its interpretation of the Act's transfer pricing legislation. Except as otherwise specified in the tax rules, the CRA considers that section 247 applies to all cross-border transactions with non-arm's length entities.

Although not explicitly expressed by CRA, it is apparent that a factor triggering the cancellation of IC87-2R was the ordering rule. The ordering rule is intended to provide Canadian transfer pricing rules in section 247 of the Act priority over any other provision in the Act. The ordering rule was first introduced as part of the federal budget for 2019-2020 and applies to taxation periods that began on or after March 19, 2019.

The CRA is generally of the view that subsection 247(2) of the Act, which empowers the CRA to adjust amounts associated with a transaction (or series of transactions) to align with prices that would prevail under arm's length terms and conditions, can apply in conjunction with other provisions of the Act. These other provisions include, for example, section 17 of the Act which generally imputes interest income for a Canadian taxpayer at the prescribed rate on an amount that has been outstanding for an extended period of time and is owed to it by a non-resident person. Given this, there may be instances where both sections 17 and 247 of the Act apply to an intercompany loan extended by a

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Canadian taxpayer to a foreign related party. According to both the CRA's draft notice to tax professionals and the introduction of the ordering rule, section 247 would take priority over the applicability of section 17, but both sections would apply.

Broader application of the recharacterization provisions

The CRA also highlights in the draft notice to tax professionals that the indication in IC87-2R that only in limited instances would it be necessary to recharacterize a transaction under paragraphs 247(2)(b) and (d) of the Act, is out of date. This is due to the fact that IC-87-2R refers to the 1995 OECD TPG. This is inconsistent with the CRA's current interpretation of the Act's transfer pricing legislation. The CRA is of the view that the updates to the OECD TPG in 2010 and 2017, and the relevant provisions in the Act, provide support for a broader application of the recharacterization provisions.

Implications for Canadian taxpayers

The views expressed by the CRA in its cancellation of IC87-2R are far-reaching and may have meaningful implications for Canadian taxpayers with cross-border intercompany transactions.

As an example, the introduction of the ordering rule may lead Canadian taxpayers to revisit the arm's length nature of interest income that they report on amounts owed to them by non-Canadian related parties. When reevaluating such arrangements and preparing contemporaneous documentation, due consideration should also be given to the newly introduced Chapter X of the OECD TPG (transfer pricing guidance on financial transactions), in February 2020.

As another example, the CRA's new interpretation regarding the broader application of the recharacterization provisions may impose an additional burden on Canadian taxpayers in respect of determining and documenting their intercompany arrangements. This additional burden may be in the form of more extensive documentation of a Canadian taxpayer's reasons for entering into the intercompany arrangements. As well, a taxpayer may be required to prepare more thorough analyses that conclude that persons dealing at arm's length would have entered arrangements akin to the intercompany arrangements of the Canadian taxpayer.

We encourage Canadian taxpayers to carefully consider what these views might mean for them in the context of their intercompany arrangements and from the perspective of the transfer pricing rules in their various counterparty jurisdictions.

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