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Transfer pricing alert

Canada releases draft legislation for country-by-country reporting

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On July 29, 2016 Canada's Department of Finance released draft legislation to implement certain measures previously announced in the 2016 federal budget, including draft legislation implementing country-by-country (CbC) reporting requirements for large multinational entities (MNEs). As anticipated based on the budget announcement, Canada's CbC rules are consistent with the Organisation for Economic Co-operation and Development (OECD) recommendations outlined in the October 5, 2015 final report *Transfer Pricing Documentation and Country-by-Country Reporting – Action 13* (OECD Guidance).

Draft legislation

The following are the key aspects of the draft legislation for Canadian CbC reporting:

1. CbC reporting threshold

The CbC draft legislation provides that taxpayers with total annual consolidated group revenues of more than EUR750 million for the preceding year have a CbC filing obligation. As noted, this is consistent with the OECD Guidance.

While the OECD's June 29, 2016 *Guidance on the Implementation of Country-by-Country Reporting* recommends that an MNE group that complies with the parent country threshold (such as the USD850 million threshold in the United States) should not be exposed to a local filing obligation in any other jurisdiction that is using a threshold denominated in a different currency, the draft legislation does not exempt a Canadian entity from the reporting obligation that would arise based on the Canadian threshold of EUR750 million. As such, it is possible that Canadian corporations that are owned by a foreign parent could have a CbC reporting obligation in Canada, even though the parent company falls below the reporting threshold established in its home jurisdiction.

2. First year of CbC reporting

The draft legislation provides that the CbC reporting rules will apply to fiscal years of MNE groups that begin after 2015.

As some countries have a later implementation date for CbC reporting, the Canadian CbC filing requirement could result in a Canadian subsidiary having a reporting obligation for a taxation year where the ultimate parent company does not have a similar reporting obligation in its home country. MNEs are cautioned to consider the filing requirements of their Canadian subsidiaries as well as ultimate parent entities, since the draft legislation indicates that Canada will require CbC reporting for subsidiaries (with the potential for penalties in the event of non-compliance) even if the ultimate parent entity is in a jurisdiction that does not require a CbC report.

3. Deadlines to file CbC reports

The draft legislation provides that entities required to file a CbC report in Canada will be required to do so within 12 months after the end of the fiscal year. Thus, the first possible reporting deadline is December 31, 2017. For this purpose, the fiscal year refers to the financial reporting year of the ultimate parent, which may differ from the taxation year of the Canadian entity that is obligated to file the CbC report.

4. Parent and subsidiary filing requirement

A Canadian entity that is the MNE group's parent is obligated to file a CbC report on behalf of the MNE group.

If the ultimate parent of the MNE group is not a resident of Canada, Canadian subsidiaries are relieved of the filing obligation provided that the ultimate parent (or an entity that is designated as a "surrogate parent entity") files a CbC report in a jurisdiction that will provide a copy of the CbC report to Canada.

5. Penalty for non-compliance with CbC reporting obligations

The penalty for failure to file a CbC report on time will be \$500 per month for up to 24 months, or \$1,000 per month for up to 24 months if a demand is served and not complied with.

6. CbC report data requirements not described

The draft legislative proposal addressing CbC report requirements did not include specific detail as to what the "prescribed form" of the report will contain. It is expected that the prescribed form will be consistent with the OECD Guidance.

7. Other revised transfer pricing guidance

The July 29, 2016 draft legislation deals solely with the CbC reporting obligation. Draft legislation for other OECD transfer pricing developments were not included. For example, the OECD Guidance introduces a three-tiered documentation structure that, in addition to the CbC report, includes master file and local file requirements. The draft legislation does not contain any specific references to a potential adoption of the master file/local file approach, or any significant revisions to the existing documentation requirements currently described in subsection 247(4) of the Act.

Implications for businesses

The new CbC reporting requirements will involve increased compliance effort to gather and prepare the necessary information. Certain data may not be readily available to MNEs on a global level, and many will have to upgrade their existing information systems or introduce new internal measures to be able to retrieve and gather the required data. While the earliest filing deadline is December 31, 2017, businesses should be proactive in assessing their ability to comply with the requirements.

The new CbC reports are meant to provide tax authorities around the world with high-level overviews of the global operations of large MNEs to enhance transparency. While the information is intended solely to “assist tax administrations in performing effective risk assessments” and not as a means of calculating transfer pricing adjustments, the questions that tax administrations may ask as a result of their review of the CbC reports may ultimately lead to adjustments.

Looking ahead

The draft legislation lacks certain details, such as exactly what must be included in the CbC report or the manner of making designations - for example, regarding a surrogate parent filing or for one Canadian entity in a group filing on behalf of other Canadian entities. It is expected that further guidance will be provided.

The CbC draft legislation reflects that Canada is committed to the OECD's BEPS project and will continue to work with the international community in the interest of global transfer pricing consistency. It will be incumbent upon MNEs to be proactive in identifying and compiling the requisite data in order to ensure proper compliance with CbC requirements. As well, MNEs should be certain to analyze and fully understand the data being provided in order to consider how it may be interpreted by a tax authority.

Interested parties are invited to provide comments on the draft legislation by September 27, 2016.

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