



## Transfer pricing alert

### Advance Pricing Arrangement Program Report 2016

November 27, 2017

The Canada Revenue Agency (CRA) recently released its latest *Advance Pricing Arrangement (APA) Program Report 2016*, which covers both the 2015-2016 fiscal year (i.e., April 1, 2015 to March 31, 2016) and the 2016 calendar year. The report provides a summary of key aspects of and commentary on the CRA's APA program including program statistics, recent developments and current CRA practices as they pertain to the APA program.

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Key highlights from the report are as follows:

## **Transition to calendar year reporting**

This report is the first to include results for the calendar year, which will be the standard period for the report going forward. Given that it is a transitional year, the CRA has included APA results for both the 2015-2016 fiscal year and the 2016 calendar year in this report. The transition to calendar year reporting for the APA program follows the recent guidance released by Organisation for Economic Co-operation and Development's (OECD) on dispute resolution, aimed at enabling a comparison of the performance of a competent authority across countries.

## **Pre-file meetings**

In 2016, the CRA conducted 23 APA pre-file meetings with taxpayers; this number is generally consistent with the number of meetings conducted annually since the 2012-2013 fiscal year, at which time certain procedural changes were introduced by the CRA. These changes require taxpayers to submit an information package in advance of being granted a pre-file meeting date, with an increase in the level and detail of information expected of taxpayers when submitting the pre-file package. The CRA had conducted 34 pre-file meetings in the 2011-2012 fiscal year.

Of note, the CRA's *Information Circular 94-4R: International Transfer Pricing: Advance Pricing Arrangements (APAs)* (IC94-4R) - which provides taxpayers with comprehensive guidance on APAs and the process of pursuing an APA with the CRA - is being revised to include the above-mentioned changes. More specifically, the forthcoming version will include updated guidance around the pre-filing process, criteria used when accepting/rejecting APA requests, and the roles and responsibilities of taxpayers. Additionally, the updated version of IC94-4R will include updated guidance on APAs that are subject to the arbitration process under Canada's network of tax treaties, most notably the revised Canada-US tax treaty.

## **APAs completed and accepted**

During 2016, a total of 26 APAs were completed by the CRA; all but two were bilateral agreements with a foreign tax administration. This represents an increase over the 21 APAs completed during the 2015 calendar year but a decrease from the 31 APAs completed during the 2014-2015 fiscal year.

In contrast, the CRA only accepted 12 new APAs to the program during 2016, a decrease of nearly 50% from the 23 APAs accepted in the 2015 calendar year and the lowest level since the 2008-2009 fiscal year. This is primarily the result of a more than twofold increase in the number of applications pending, from eight in 2015 to 17 in 2016. Pending applications represent cases where a taxpayer had participated in a pre-file meeting but had not yet been informed of the status of the application in the APA program. Taking into consideration

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the withdrawal of three taxpayers previously accepted in the program, closing inventory of cases in process was 90 at the end of 2016.

At year's end, 90% of cases currently in process were on a bilateral or multilateral basis, as opposed to just 10% of APAs being pursued on a unilateral basis. The United States is the most common jurisdiction involved in APAs in Canada, making up 56% of total APAs in process.

### **Completion times down slightly**

Average completion time for bilateral/multilateral APAs during 2016 decreased to 47.3 months from acceptance in the program to completion of the APA, the lowest since the 2011-12 fiscal year. Similarly, the median time to completion decreased to 42.7 months, which is the lowest since the 2008-2009 fiscal year.

By comparison, the average completion time for bilateral/multilateral APAs in the United States was 48.7 months, with a median time of 46.7 months.<sup>1</sup> Average completion times for bilateral/multilateral APAs in EU countries vary significantly – for example, France and the United Kingdom reported lower average completion times of 26 and 30 months for APAs with non-European Union Countries, respectively, while Germany's average completion time for APAs with non-European Union countries is 53 months.<sup>2</sup>

Presented by phase of the APA process in Canada, average time spent on the first phase, due diligence, remains high relative to historic levels for the program, at 30.2 months in 2016. The average time spent on, the second and third phases, negotiations and post-negotiations, were 5.9 months and 11.3 months, respectively.

### **Predominance of transactions involving tangible property**

APAs involving transfers of tangible property remain the most common types of transaction in the APA program, making up 63% of APAs in process at the end of 2016. The balance of cases consisted of APAs involving intangible property and intra-group services, each representing 17% of all cases in process. Financing cases made up the smallest portion of APAs in process, at 3% at the end of 2016.

### **Transfer pricing methods**

The transactional net margin method (TNMM) continued to be the most common transfer pricing method for transactions covered by the APA program, representing 69% of cases. The profit split, comparable uncontrolled price and cost plus methods, each constitute approximately one-third of the remaining 30%, while the resale minus represents 1%.

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<sup>1</sup> Internal Revenue Service, [Announcement and Report Concerning Advance Pricing Agreements](#), March 27, 2017, page 12.

<sup>2</sup> EU Joint Transfer Pricing Forum, [Statistics on APAs in the EU at the End of 2015](#), October 20, 2016, pages 1-3.

## **Participation**

The CRA is currently actively engaged in bilateral and/or multilateral APA processes involving taxpayers from 15 different countries. As mentioned previously, the United States remains the most significant jurisdiction for the APA program.

Participation by industrial sector generally correlates with the pattern of Canadian trade. Automobile and other transportation equipment, health, computers and electronics, petroleum and metals and minerals sectors are all common in the APA program, making up over one half of all in process APAs.

## **Closing remarks**

The recent OECD base erosion and profit shifting (BEPS) initiative and the resulting changes in domestic legislation will lead to increased global tax controversy in coming years and increased uncertainty around transfer pricing outcomes. As a result, taxpayers may find it advantageous to consider the APA program to achieve certainty and to manage multilateral tax controversy over a period of several years. As the CRA continues to reduce its inventory, there may be willingness and opportunity to accept more cases and continue to reduce completion times of its APAs. The APA program remains an important element in a taxpayer's overall transfer pricing strategy.

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