



Transfer pricing alert

Canada extends reassessment periods and increases CRA funding

March 19, 2018

Canada's 2018 federal budget, released February 27, 2018, proposes new tax measures that will have an impact on multinational enterprises (MNEs). The changes with transfer pricing implications primarily involve extending the reassessment period in select circumstances as well as increased funding for the Canada Revenue Agency (CRA). The budget also stated that the Canadian government will conduct a detailed analysis of the US tax reform to assess any potential impact on Canada.

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Longer reassessment periods

Three of the tax measures announced in the budget are aimed at extending the period during which the CRA can issue a reassessment:

1. The extension by three years of the reassessment period for income arising in connection with a foreign affiliate. By default, the CRA has a three or four year period after the date of an initial assessment to make a reassessment. Currently, a three year extended reassessment period is allowed in respect of a transaction involving the taxpayer and a related non-resident person. The proposed amendment broadens this extended reassessment period to include all income arising in connection with a foreign affiliate of a taxpayer. This change reflects the added complexity and difficulty in gathering information in respect of foreign affiliates. This provision applies to taxation years beginning on or after February 27, 2018.
2. An expanded "stop-the-clock" rule, designed to extend the reassessment period by the amount of time taken to contest any requirement for information issued, or compliance order sought, by the CRA. This rule may affect transfer pricing-related reassessment periods, especially since transfer pricing audits tend to be particularly complex and detailed, potentially involving significant information requests which may be in the form of requirements for information or compliance orders. This change will only impact challenges instituted after the law is enacted.
3. Extending the reassessment period by an additional three years in situations where a taxpayer carries back a loss incurred as a result of a transaction with a non-arm's length non-resident person. The change is intended to ensure that where a loss arises in a taxation year and is carried back to be used in a prior taxation year, the latter year will not become statute barred before the CRA issues a reassessment in respect of the year in which the loss is incurred.

This change will only impact the carryback of losses incurred in taxation years that end on or after February 27, 2018. The following example provided in the 2018-2019 federal budget document clarifies the change:

A loss arises in a taxpayer's 2017 taxation year. The taxpayer carries back this loss and deducts it against income in its 2014 taxation year. In 2023, the CRA determines that the actual amount of the 2017 loss is less than the amount claimed as a consequence of an adjustment to a transaction involving a taxpayer and a non-resident person with whom the taxpayer does not deal at arm's length.

Under existing rules, the 2014 taxation year would be statute barred by the time of the reassessment in 2023. The proposed measures ensure that the CRA would, in the situation described, be able to reassess the 2014 taxation year to the extent that the reassessment relates to the adjustment of the loss carried back.

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Additional CRA funding

The 2018 federal budget proposes to invest an additional \$90.6 million over five years to support the CRA in its efforts to prevent tax evasion and improve tax compliance. This additional funding builds on previous substantial increased investments, including the investment announced in the 2016 federal budget of \$444.4 million over five years, and the investment announced in the 2017 federal budget of an additional \$523.9 million over five years for these purposes. The 2016 budget noted that the additional funding would be used to hire additional auditors and specialists, develop a robust business intelligence infrastructure, increase verification activities and improve the quality of investigative work that targets criminal tax evaders.

While some MNEs may be concerned that the frequency of audits will increase with increased CRA funding, it is also anticipated that the additional resources may improve the efficiency and quality of the CRA's audits, which would be a benefit to MNEs. It is anticipated that, among other things, the increased funding may be spent on hiring and training auditors to conduct principled and technically sound audits, as transfer pricing disputes rise in number and complexity.

Additional funding is also provided for the Tax Court of Canada, which is a welcome development as it will assist in improving efficiency in dealing with disputes that must be settled by the courts. Therefore, while the number of transfer pricing audits may increase, taxpayers may experience more efficient audits, principled positions, and earlier resolution of disputes.

Other transfer pricing comments

While the government did not introduce any other tax measures directly related to transfer pricing, it did reiterate that Canada has adopted the revised OECD Transfer Pricing Guidelines and has played an important role in the course of the base erosion and profit shifting (BEPS) project. Specific reference was made to additional guidance due from the OECD over the course of 2018, on the attribution of profits to permanent establishments, the use of the profit split method and the treatment of hard-to-value intangibles, among others. While no changes or updates were announced, country-by-country reporting was also mentioned in the budget, reiterating that these reports will be an important tool in combatting BEPS by providing the CRA and other tax authorities with new information to better assess transfer pricing risks.

Next steps and issues to consider

The above measures which extend the period of time for the CRA to reassess taxpayers, while enhancing the resources available to CRA, reemphasize the importance for Canadian taxpayers of maintaining clear and robust information and documentation relating to their foreign operations. This need is magnified where MNEs have personnel changes or systems and operational constraints in various jurisdictions, and face the challenge of responding to the CRA's detailed queries about historical years in the course of an audit.

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