CRA transfer pricing Memoranda on downward transfer pricing adjustments

September 23, 2022

Background

On June 21, 2022, the Canada Revenue Agency (CRA) replaced its Transfer pricing memorandum (TPM) on downward transfer pricing adjustments, TPM-03 dated October 20, 2003, with the revised TPM-03R.

TPMs are issued periodically by the CRA to communicate the government's transfer pricing policy and provide guidance on specific aspects of transfer pricing legislation.

TPM-03R provides updated guidance on how downward pricing adjustments should be directed within the CRA, and how they will be managed. The revised memoranda also emphasizes that downward transfer pricing adjustments "are not intended to serve as a vehicle for taxpayers to implement retroactive tax planning or base erosion and profit shifting strategies, nor are their intended to achieve double non-taxation".

The policies described in TPM-03R are effective as of June 21, 2022.

Downward transfer pricing adjustments

Generally, transfer pricing adjustments are based on a finding that a Canadian taxpayer has received too little or paid too much in a transaction with a non-arm's length non-resident person.

Subsection 247(2) of the *Income Tax Act* allows the CRA to adjust the value of transactions with non-arm's length non-residents for tax purposes, to ensure that non-arm's length parties conduct their transactions under terms and conditions that would have prevailed if the parties had been dealing at arm's length with each other.

A downward transfer pricing adjustment includes any adjustment under subsection 247(2) that reduces the income, increases the loss, or increases capital expenditures, of the taxpayer, or would have that effect, if it were the only adjustment made under subsection 247(2). This could arise where transfer prices paid by a Canadian resident

on goods or services are increased, or where transfer prices of sales by the Canadian resident are decreased.

Subsection 247(10) restricts downward transfer pricing adjustments. An adjustment will not be made unless, in the opinion of the Minister of National Revenue, "the circumstances are such that it would be appropriate that the adjustment be made".

Downward transfer pricing adjustments are only available in limited circumstances.

Where to send a request for a downward transfer pricing adjustment

Taxpayers should send their requests to the Director of the Competent Authority Services Division (CASD), in accordance with Information Circular 71-17R6, *Competent Authority under Canada's Tax Conventions*, where:

- the request is independent of a transfer pricing audit;
- the request is as a result of an upward adjustment initiated by a foreign tax authority; or,
- the request is for an adjustment involving a transaction in a non-treaty country and relates to a taxation year not currently under a transfer pricing audit.

Taxpayers should send their requests to their local CRA tax services office (TSO) where:

- the request for a downward transfer pricing adjustment is for a year currently under a transfer pricing audit, and the request does not relate to an upward adjustment initiated by a foreign tax authority.

Circumstances in which the Audit Division will consider a downward transfer pricing adjustment

With regards to downward transfer pricing adjustments that involve a transaction in a treaty country, generally auditors will only consider these if they:

- are closely linked to an upward transfer pricing adjustment;
- relate to the same taxation year and the same non-resident as the upward audit adjustment; and,
- do not exceed the upward audit adjustment.

Where auditors recommend that downward requests be denied, taxpayers may still be eligible for relief under Mutual Agreement Procedure (MAP) procedures of an applicable tax treaty.

Also, auditors will recommend that requests not be accepted by the relevant delegated authority if the taxpayers cannot demonstrate, to the CRA's satisfaction, the absence of retroactive tax planning, base erosion and profit shifting strategies, or double non-taxation.

Approval of the delegated authority

Once auditors have completed their review of a potential downward adjustment, they must prepare a referral seeking approval of the delegated authority. The authority to determine the appropriateness of an adjustment for the purposes of subsection 247(10) has been delegated to the CRA's Director of the International Tax Directorate (ITD) and the Assistant Directors of Audit.

The referral will be made to an Assistant Director of Audit where the file under audit has a downward transfer pricing adjustment of less than $10,000,000. If the adjustment is of $10,000,000 or greater, the referral must be made to the Director of the ITD.

Repatriation

In order for downward pricing adjustments to be considered appropriate, repatriation must be carried out within 90 days of signing a repatriation agreement. Repatriation refers to the repayment of the amount, or a portion of the amount, of the benefit conferred as a consequence of a primary transfer pricing adjustments. Taxpayers should refer to Transfer Pricing Memorandum TPM-02R, *Secondary Transfer Pricing Adjustments, Repatriation and Part XIII Tax Assessments*.

Takeaways

- The CRA considers that downward transfer pricing adjustments "are not intended to serve as a vehicle for taxpayers to implement retroactive tax planning or base erosion and profit shifting strategies, nor are their intended to achieve double non-taxation".
- Downward transfer pricing adjustments are only allowed in limited circumstances.
- Where a downward transfer pricing adjustment request involves a treaty country, the adjustment will only be applied at the audit stage if it is closely linked to, and does not exceed, the upward audit adjustment.
- Of particular interest is the CRA's view of what constitutes "retroactive tax planning", as illustrated by the suggestion in Example A of Appendix A, which describes a situation in which a downward pricing adjustment creates additional income in the non-Canadian jurisdiction that is sheltered from taxation by losses created on a corporate reorganization.

If you have further questions about transfer pricing, reach out to your BLG lawyer, the authors of this article, or any member of BLG's Tax Group.

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