

Draft Legislation on Transfer Pricing

1. (1) Subsections 69(2) and (3) of the Income Tax Act are repealed.

(2) Subsection (1) applies to taxation years that begin after 1997.

2. (1) Section 233.1 of the Act is replaced by the following :

233.1 (1) The definitions in this subsection apply in this section.

“reportable transaction” means

(a) in the case of

(i) a reporting person for a taxation year who is not resident in Canada at any time in the year, or

(ii) a reporting partnership for a fiscal period no member of which is resident in Canada in the period,

a transaction or series of transactions that relate in any manner whatever to a business carried on in Canada by the reporting person or partnership in the year or period or a preceding year or period; and

(b) in any other case, a transaction or series of transactions that relate in any manner whatever to a business carried on by a reporting person (other than a business carried on by a reporting person as a member of a partnership) or partnership in a taxation year or fiscal period.

“reporting partnership” for a fiscal period means a partnership

(a) a member of which is resident in Canada in the period, or

(b) that carries on a business in Canada in the period.

“reporting person” for a taxation year means a person who, at any time in the year,

(a) is resident in Canada, or

(b) is non-resident and carries on a business (other than a business carried on as a member of a partnership) in Canada.

“transaction” includes an arrangement or event.

Reporting person's information return

(2) Subject to subsection (4), a reporting person for a taxation year shall, on or before the reporting person's filing-due date for the year, file with the Minister, in respect of each non-resident person with whom the reporting person does not deal at arm's length in the year and each partnership of which such a non-resident person is a member, an information return for the year in prescribed form containing prescribed information in respect of the reportable transactions in which the reporting person and the non-resident person or the partnership, as the case may be, participated in the year.

Reporting partnership's information return

(3) Subject to subsection (4), a reporting partnership for a fiscal period shall, on or before the day on or before which a return is required by section 229 of the *Income Tax Regulations* to be filed in respect of the period or would be required to be so filed if that section applied to the reporting partnership, file with the Minister, in respect of each non-resident person with whom the reporting partnership, or a member of the reporting partnership, does not deal at arm's length in the period and each partnership of which such a non-resident person is a member, an information return for the period in prescribed form containing prescribed information in respect of the reportable transactions in which the reporting partnership and the non-resident person or the partnership, as the case may be, participated in the period.

De minimis exception

(4) A reporting person or partnership that, but for this subsection, would be required under subsection (2) or (3) to file an information return for a taxation year or fiscal period, is not required to file the return unless the total of all amounts each of which is the total fair market value of the property or services that relate to a reportable transaction in which the reporting person or partnership and a non-resident person with whom the reporting person or partnership, or a member of the reporting partnership, does not deal at arm's length in the year or period, or a partnership of which such a non-resident person is a member, as the case may be, participated in the year or period, exceeds \$1,000,000.

Deemed member of partnership

(5) For the purposes of this section, a person who is a member of a partnership that is a member of another partnership is deemed to be a member of the other partnership.

(2) Subsection (1) applies to taxation years and fiscal periods that begin after 1997.

3. (1) The Act is amended by adding the following after section 246 :

Part XVI.1
Transfer Pricing

Definitions

247.(1) The definitions in this subsection apply in this section.

“arm’s length allocation” means, in respect of a transaction, an allocation of profit or loss that would have occurred between the participants in the transaction if they had been dealing at arm’s length with each other.

“arm’s length transfer price” means, in respect of a transaction, an amount that would have been a transfer price in respect of the transaction if the participants in the transaction had been dealing at arm’s length with each other.

“qualifying cost contribution arrangement” means an arrangement under which reasonable efforts are made by the participants in the arrangement to establish a basis for contributing to, and to contribute on that basis to, the cost of producing, developing or acquiring any property, or acquiring or performing any services, in proportion to the benefits which each participant is reasonably expected to derive from the property or services, as the case may be, as a result of the arrangement.

“transaction” includes an arrangement or event.

“transfer price” means, in respect of a transaction, an amount paid or payable or an amount received or receivable, as the case may be, by a participant in the transaction as a price, a rental, a royalty, a premium or other payment for, or for the use, production or reproduction of, property or as consideration for services (including services provided as an employee and the insurance or reinsurance of risks) as part of the transaction.

“transfer pricing capital adjustment” of a taxpayer for a taxation year means the total of

(a) the total of all amounts each of which is

(i) 3/4 of the amount, if any, by which the adjusted cost base to the taxpayer of a capital property (other than a depreciable property) or an eligible capital expenditure of the taxpayer in respect of a business is reduced in the year because of an adjustment made under subsection (2), or

(ii) the amount, if any, by which the capital cost to the taxpayer of a depreciable property is reduced in the year because of an adjustment made under subsection (2); and

(b) the total of all amounts each of which is that proportion of the total of

(i) 3/4 of the amount, if any, by which the adjusted cost base to a partnership of a capital property (other than a depreciable property) or an eligible capital expenditure of a partnership in respect of a business is reduced in a fiscal period that ends in the year because of an adjustment made under subsection (2), and

(ii) the amount, if any, by which the capital cost to a partnership of a depreciable property is reduced in the period because of an adjustment made under subsection (2),

that

(iii) the taxpayer's share of the income or loss of the partnership for the period

is of

(iv) the income or loss of the partnership for the period,

and where the income and loss of the partnership are nil for the period, the income of the partnership for the period is deemed to be \$1,000,000 for the purpose of determining a taxpayer's share of the partnership's income for the purpose of this definition.

“transfer pricing income adjustment” of a taxpayer for a taxation year means the total of all amounts each of which is the amount, if any, by which an adjustment made under subsection (2) (other than a transfer pricing capital adjustment of the taxpayer for a taxation year) would result in an increase in the taxpayer's income for the year or a decrease in a loss of the taxpayer for the year from a source if that adjustment were the only adjustment made under subsection (2).

Transfer pricing adjustment

(2) Where a taxpayer or a partnership and a non-resident person with whom the taxpayer or the partnership, or a member of the partnership, does not deal at arm's length (or a partnership of which the non-resident person is a member) are participants in a transaction or a series of transactions, and

(a) the terms or conditions made or imposed, in respect of the transaction or series, between any of the participants in the transaction or series differ from those that would have been made between persons dealing at arm's length, or

(b) the transaction or series would not have been entered into between persons dealing at arm's length,

any amounts that, but for this section and section 245, would be determined for the purposes of this Act in respect of the taxpayer or the partnership for a taxation year or fiscal period and the nature of such amounts shall be adjusted or recharacterized (in this section referred to as an "adjustment") to the quantum or nature of the amounts that would have been determined if

(c) where paragraph (a) applies, the terms and conditions made or imposed, in respect of the transaction or series, between the participants in the transaction or series had been those that would have been made between persons dealing at arm's length, or

(d) where paragraph (b) applies, the transaction or series entered into between the participants had been the transaction or series that would have been entered into between persons dealing at arm's length, under terms and conditions that would have been made between persons dealing at arm's length.

Penalty

(3) A taxpayer (other than a taxpayer all of whose taxable income for the year is exempt from tax under Part I) is liable to a penalty for a taxation year equal to 10% of the amount determined under paragraph (a) in respect of the taxpayer for the year, where

(a) the amount, if any, by which

(i) the total of

(A) the taxpayer's transfer pricing capital adjustment for the year, and

(B) the taxpayer's transfer pricing income adjustment for the year

exceeds

(ii) the total of all amounts, each of which is the portion of the taxpayer's transfer pricing capital adjustment or transfer pricing income adjustment for the year that can reasonably be considered to relate to a particular transaction, where

(A) the transaction is a qualifying cost contribution arrangement in which the taxpayer or a partnership of which the taxpayer is a member is a participant, or

(B) in any other case, the taxpayer or a partnership of which the taxpayer is a member made reasonable efforts to determine arm's length transfer prices or arm's length

allocations in respect of the transaction, and to use those prices or allocations for the purposes of this Act,

is greater than

(b) the lesser of

(i) 10% of the amount that would be the taxpayer's gross revenue for the year if the Act were read without reference to subsection (2), subsections 69(1) and (1.2) and section 245, and

(ii) \$5,000,000.

Contemporaneous documentation

(4) For the purposes of subsection (3) and the definition of qualifying cost contribution arrangement, a taxpayer or a partnership is deemed not to have made reasonable efforts to determine and use arm's length transfer prices or arm's length allocations in respect of a transaction or not to have participated in a transaction that is a qualifying cost contribution arrangement, unless the taxpayer or the partnership, as the case may be,

(a) makes or obtains, within 60 days after the end of the taxation year or fiscal period of the taxpayer or the partnership, as the case may be, in which the transaction is entered into, records or documents which provide a complete and accurate description of

(i) the property or services to which the transaction relates,

(ii) the terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction,

(iii) the identity of the participants in the transaction and their relationship to each other at the time the transaction was entered into,

(iv) the functions performed, the property used or contributed and the risks assumed, in respect of the transaction, by the participants in the transaction,

(v) the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the transaction, and

(vi) the assumptions, strategies and policies, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the transaction;

(b) for each subsequent taxation year or fiscal period, if any, in which the transaction continues, makes or obtains, within 60 days after the end of the year or period, records or

documents that completely and accurately describe any material changes in the year or period to the matters referred to in any of subparagraphs (a)(i) to (vi) in respect of the transaction; and

(c) provides the records or documents described in paragraphs (a) and (b) to the Minister within 60 days of service, made personally or by registered or certified mail, of a written request therefor.

Partner's gross revenue

(5) For the purpose of subparagraph (3)(b)(i), where a taxpayer is a member of a partnership in a taxation year, the taxpayer's gross revenue for the year as a member of the partnership from any activities carried on by means of the partnership is deemed to be that proportion of the amount that would be the partnership's gross revenue from the activities if it were a taxpayer (to the extent that that amount does not include amounts received or receivable from other partnerships of which the taxpayer is a member in the year), for a fiscal period of the partnership that ends in the year, that

(a) the taxpayer's share of the income or loss of the partnership from its activities for the period

is of

(b) the income or loss of the partnership from its activities for the period,

and where the income and loss of the partnership from its activities are nil for the period, the income of the partnership from its activities for the period is deemed to be \$1,000,000 for the purpose of determining a taxpayer's share of the partnership's income from its activities for the purpose of this subsection.

Deemed member of partnership

(6) For the purposes of this section, where a person is a member of a partnership that is a member of another partnership

(a) the person is deemed to be a member of the other partnership; and

(b) the person's share of the income or loss of the other partnership is deemed to be equal to the amount of that income or loss to which the person is directly or indirectly entitled.

Exclusion for loans to subsidiary

(7) Subsection (2) does not apply to a transaction that is a loan referred to in subsection 17(3).

Provisions not applicable

(8) Where subsection (2) would, if this Act were read without reference to section 67 and subsections 69(1) and (1.2), apply to adjust the quantum of an amount under this Act, section 67 and subsections 69(1) and (1.2) shall not apply to determine the quantum of the amount, if subsection (2) was applied to adjust or recharacterize the quantum or nature of the amount.

Anti-avoidance

(9) For the purposes of determining a taxpayer's gross revenue under subparagraph (3)(b)(i) and subsection (5), a transaction or series of transactions is deemed not to have occurred, if one of the purposes of the transaction or series was to increase the taxpayer's gross revenue for the purpose of subsection (3).

No adjustment unless appropriate

(10) Notwithstanding subsection (2), an adjustment (other than an adjustment that results in or increases a transfer pricing capital adjustment or a transfer pricing income adjustment of a taxpayer for a taxation year) shall not be made under that subsection unless, in the opinion of the Minister, the circumstances are such that it would be appropriate that such an adjustment be made.

Payment of penalty

247.1. (1) Every taxpayer shall on or before the last day of the second month after the end of a taxation year pay to the Receiver General any penalty to which the taxpayer is liable under this Part for the year.

Interest

(2) Where a taxpayer has failed to pay all or any part of a penalty payable under this Part by the taxpayer, the taxpayer shall pay to the Receiver General interest at the prescribed rate on the amount the taxpayer has failed to pay computed from the day on or before which the penalty was required to be paid to the day of payment.

Provisions applicable to Part

(3) Sections 152, 158, 159, 162 to 167 and Division J of Part I apply to this Part with such modifications as the circumstances require.

(2) Subsections 247(1), (2), (6), (7), (8) and (10) and subsection 247.1(3) of the Act, as enacted by subsection (1), apply to taxation years and fiscal periods that begin after 1997.

(3) Subsections 247(3), (4), (5) and (9) and subsections 247.1(1) and (2) of the Act, as enacted by subsection (1), apply with respect to adjustments made under subsection 247(2) of the Act, as enacted by subsection (1), for taxation years or fiscal periods that begin after 1998, except that

(a) subsections 247(3) to (5) and (9) of the Act, as enacted by subsection (1), do not apply with respect to a transaction completed before Announcement Date, and

(b) a record or document made or obtained or provided to the Minister of National Revenue by a taxpayer or a partnership before the day that is 60 days after the end of the taxpayer's first taxation year or the partnership's first fiscal period, as the case may be, that begins after 1998 is deemed for the purpose of subsection 247(4), as enacted by subsection (1), to have been so made, obtained or provided on a timely basis.

Draft Explanatory Notes

ITA
69(2) and (3)

Subsections 69(2) and (3) of the Act are, respectively, designed to prevent the overstatement of deductions and the understatement of revenues in computing the income of a taxpayer as a result of the misstatement of the prices charged (commonly known as “transfer prices”) in transactions with a non-resident person with whom the taxpayer does not deal at arm’s length. This is accomplished by re-stating the transfer prices for tax purposes so that they reflect the prices that would have been reasonable in the circumstances if the non-resident person and the taxpayer had been dealing at arm’s length.

Subsections 69(2) and (3) are repealed effective for taxation years that begin after 1997, as a consequence of the introduction of proposed new subsection 247(2) of the Act.

ITA
233.1

Section 233.1 of the Act provides that every corporation resident in Canada or carrying on business in Canada at any time in a taxation year shall, within six months from the end of the year, file an information return for the year containing prescribed information regarding transactions with non-resident non-arm’s length persons. A separate information return is required to be filed in respect of each such non-resident person.

Section 233.1 is amended in order to extend the filing requirements contained therein to partnerships and individuals (including trusts).

ITA
233.1(1)

Proposed new subsection 233.1(1) of the Act sets out a number of definitions for the purposes of the filing requirements in proposed new subsections 233.1(2) to (4).

A “reportable transaction” generally means a transaction or series of transactions that relate to a business carried on by a “reporting person” or a “reporting partnership”. However, in the case of

- a reporting person who is a non-resident throughout a taxation year, or
- a reporting partnership all the members of which are non-resident throughout a fiscal period of the partnership,

a reportable transaction refers to a transaction or series of transactions that relates to a business carried on in Canada by the reporting person or partnership in the year or period or a preceding year or period.

A “reporting partnership” for a fiscal period means a partnership that either carries on business in Canada in the period or a member of which is resident in Canada in the period.

A “reporting person” for a taxation year means a person, specifically, a corporation, trust or natural person, who, at any time in the year, is either resident in Canada or is non-resident and carries on business in Canada.

For the purposes of the above definitions and proposed new subsections 233.1(2) to (4) of the Act, a “transaction” includes an arrangement or an event, such as the payment of a dividend.

ITA

233.1(2)

Proposed new subsection 233.1(2) of the Act provides that a reporting person (see the definition in proposed new subsection 233.1(1)) is required to file an information return for a taxation year in prescribed form and containing prescribed information in respect of the reportable transactions (see the definition in proposed new subsection 233.1(1)) in which the reporting person and a non-resident non-arm’s length person (or a partnership of which that non-resident person is a member) participated in the year.

The information return must be filed by the reporting person’s filing-due date for the year. A separate return must be filed for each such non-resident person (or partnership).

Proposed new subsection 233.1(2) applies to taxation years and fiscal periods that begin after 1997.

ITA

233.1(3)

Proposed new subsection 233.1(3) of the Act provides that a reporting partnership (see the definition in proposed new subsection 233.1(1)) is required to file an information return for a fiscal period in prescribed form and containing prescribed information in respect of the reportable transactions (see the definition in proposed new subsection 233.1(1)) in which the reporting partnership and a non-resident non-arm’s length person (or a partnership of which the non-resident person is a member) participated in the period. An information return must also be filed by a reporting partnership under this subsection if a member of the reporting partnership does not deal at arm’s length with the above-mentioned non-resident person.

The deadline for filing the return is the same as the deadline for filing a partnership information return under section 229 of the Income Tax Regulations. If no section 229 return is required to be filed, the reporting partnership’s information return under proposed new subsection 233.1(3) must be filed by the day by which the section 229 return would be required to be filed if section 229 did apply to the reporting partnership.

Proposed new subsection 233.1(3) applies to taxation years and fiscal periods that begin after 1997.

ITA
233.1(4)

Proposed new subsection 233.1(4) of the Act provides an exception to the reporting requirements in proposed new subsections 233.1(2) and (3). More specifically, it provides that a reporting person or partnership is not required to file an information return for a taxation year or fiscal period, unless the total fair market value of the property or services that relate to reportable transactions in which the reporting person or partnership and a non-resident non-arm's length person (or a partnership of which the non-resident person is a member) participated in the year or period, exceeds \$1,000,000. Also included in determining whether a reporting partnership has exceeded the \$1,000,000 threshold, is the value of property or services that relate to reportable transactions in which the reporting partnership and a non-resident person (or a partnership of which the non-resident person is a member) participated, where a member of the reporting partnership does not deal at arm's length with the non-resident person (or the partnership).

Proposed new subsection 233.1(4) applies to taxation years and fiscal periods that begin after 1997.

ITA
233.1(5)

Proposed new subsection 233.1(5) of the Act provides that, for the purpose of proposed new subsection 233.1, a person who is a member of a partnership which in turn is a member of another partnership is considered to be a member of that other partnership.

Proposed new subsection 233.1(5) applies to taxation years and fiscal periods that begin after 1997.

ITA
247

Proposed new section 247 in proposed new Part XVI.1 of the Act is related to the issue of transfer pricing for property or services purchased and sold in cross-border transactions and the determination of amounts for tax purposes.

ITA
247(1)

Proposed new subsection 247(1) of the Act defines a number of terms for the purpose of proposed new section 247 dealing with transfer pricing.

An "arm's length allocation" means an allocation of profit or loss that would have occurred between the participants in a transaction assuming they had been dealing at arm's length with each other. Similarly, an "arm's length transfer price" means an amount that would have been a transfer

price in respect of a transaction assuming the participants in the transaction had been dealing at arm's length with each other.

The term "transfer price" is used in the definition "arm's length transfer price". It is defined as an amount paid or payable or received or receivable by a participant in a transaction as a price, a rental, a royalty, a premium or other payment for, or for the use, production or reproduction of, property or as consideration for services, as part of the transaction. For greater certainty, the term services includes the services of an employee and the insurance or reinsurance of risks.

The term "qualifying cost contribution arrangement" refers to an arrangement under which the participants collectively make reasonable efforts to establish a basis for contributing to, and to contribute on that basis to, the cost of producing, developing or acquiring any property, or acquiring or performing any services, in proportion to the benefits which each participant is reasonably expected to derive from the property or services as a result of the arrangement.

The terms "arm's length allocation", "arm's length transfer price" and "qualifying cost contribution arrangement" are relevant for the purposes of the penalty provision in proposed new subsection 247(3) of the Act for certain transfer pricing adjustments made pursuant to proposed new subsection 247(2) of the Act.

A "transfer pricing capital adjustment" of a taxpayer for a taxation year consists of two amounts. The first amount is the total of

- 3/4 of all reductions made under proposed new subsection 247(2) to the adjusted cost base of a non-depreciable capital property of the taxpayer or an eligible capital expenditure of the taxpayer and
- all reductions made under proposed new subsection 247(2) to the capital cost of a depreciable property of the taxpayer.

The second amount is relevant only if the taxpayer is a member of a partnership. It is equal to the total of all amounts each of which is that proportion of the total of

- 3/4 of all reductions made under proposed new subsection 247(2) to the adjusted cost base of a non-depreciable capital property of the partnership or an eligible capital expenditure of the partnership, and
- all reductions made under proposed new subsection 247(2) to the capital cost of a depreciable property of the partnership,

that the taxpayer's share of the income or loss of the partnership for the period is of the total income or loss of the partnership for the period.

If the income and loss of the partnership for the period are nil, the partnership is deemed to have income in the amount of \$1,000,000 for the purpose of determining the taxpayer's share of the partnership's income for the purpose of this definition.

A “transfer pricing income adjustment” of a taxpayer for a taxation year means the total of all amounts by which the taxpayer’s income for the year would increase or the taxpayer’s loss for the year from a source would decrease because of an adjustment made under proposed new subsection 247(2), assuming that that were the only adjustment made under that subsection.

The definitions “transfer pricing capital adjustment” and “transfer pricing income adjustment” are relevant for the purpose of the penalty in proposed new subsection 247(3).

ITA
247(2)

In general terms, proposed new subsection 247(2) of the Act requires that, for tax purposes, 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. Therefore, proposed new subsection 247(2) embodies the arm’s length principle.

More specifically, proposed new subsection 247(2) applies in situations where a taxpayer or a partnership and a non-resident person with whom the taxpayer, the partnership or a member of the partnership does not deal at arm’s length (or a partnership of which the non-resident person is a member) are participants in a transaction or a series of transactions and

- the terms or conditions of the transaction or series differ from those that would have been made between persons dealing at arm’s length, or
- the transaction or series would not have been entered into between persons dealing at arm’s length.

Where these conditions are met, proposed new subsection 247(2) may adjust or recharacterize any amounts that, but for that subsection and the general anti-avoidance rule in section 245, would have been determined for the purposes of the Act in respect of the taxpayer or the partnership. Such amounts may be adjusted or recharacterized to reflect the quantum or nature of the amounts that would have been determined if the participants had been dealing at arm’s length with each other.

Proposed new subsection 247(2) applies to taxation years and fiscal periods that begin after 1997.

ITA
247(3)

In general terms, proposed new subsection 247(3) of the Act provides that a taxpayer is liable to a penalty for a taxation year if the total amount of the taxpayer’s “reduced” transfer pricing income and capital adjustments for the year exceeds the lesser of 10% of the taxpayer’s gross revenue for the year and \$5,000,000. A taxpayer’s transfer pricing income and capital adjustments are reduced to the extent that they can reasonably be considered to relate to

- a transaction that is a qualifying cost contribution arrangement (see proposed new subsection 247(1)) and in which the taxpayer (or a partnership of which the taxpayer is a member) is a participant, or
- a transaction in respect of which the taxpayer (or a partnership of which the taxpayer is a member) made reasonable efforts to determine arm's length transfer prices or arm's length allocations (see proposed new subsection 247(1)), and to use those prices or allocations for tax purposes.

It should be noted, however, that no reduction may be made to a taxpayer's transfer pricing income and capital adjustments if the taxpayer (or a partnership of which the taxpayer is a member) has failed to document its transactions in accordance with the provisions of proposed new subsection 247(4). Briefly, that subsection requires a taxpayer (or a partnership of which the taxpayer is a member) to contemporaneously document the transactions that are governed by proposed new subsection 247(2) and to provide such documentation to the Minister of National Revenue within 60 days of a request therefor. If the taxpayer fails to comply with these requirements, proposed new subsection 247(4) deems the taxpayer not to have made reasonable efforts to determine arm's length transfer prices or arm's length allocations in respect of a transaction or not to have participated in a qualifying cost contribution arrangement.

If the taxpayer's "reduced" transfer pricing income and capital adjustments for the year exceed the lesser of \$5,000,000 and 10% of the taxpayer's gross revenue for the year, determined without reference to proposed new subsection 247(2), subsections 69(1) and (1.2) and section 245, the taxpayer is liable to a penalty for the year equal to 10% of the amount of the "reduced" transfer pricing income and capital adjustments.

The penalty in proposed new subsection 247(3) applies to adjustments made under proposed new subsection 247(2) for taxation years or fiscal periods that begin after 1998; however, adjustments made in respect of transactions completed before Announcement Date are not subject to the penalty.

ITA
247(4)

In broad terms, proposed new subsection 247(4) of the Act requires a taxpayer to document its transactions that are governed by proposed new subsection 247(2), failing which the taxpayer will be liable to the penalty (assuming the taxpayer's transfer pricing income and capital adjustments exceed the penalty threshold) in proposed new subsection 247(3).

More specifically, proposed new subsection 247(4) deems a taxpayer not to have made reasonable efforts to determine arm's length transfer prices or allocations in respect of a transaction nor to have participated in a transaction that is a qualifying cost contribution arrangement, unless the taxpayer (or the partnership) makes or obtains certain records or documents within 60 days of the end of the taxation year (or fiscal period) in which the transaction is entered into. Put another way, the taxpayer's transfer pricing income and capital adjustments otherwise determined for the

year will not be able to be reduced for purposes of calculating the penalty in proposed new subsection 247(3) unless certain documentation requirements have first been satisfied.

The records or documents which are required to be made or obtained must provide a complete and accurate description of

- the property or services to which the transaction relates,
- the terms and conditions of the transaction and how they relate to the terms and conditions of other transactions entered into between the participants,
- the identity of the participants and their relationship at the time the transaction was entered into,
- the functions performed, the property used or contributed and the risks assumed by the participants,
- the data and transfer pricing methods (for example, the comparable uncontrolled price method) considered and the analysis performed to determine the transfer prices or allocations of profits or losses or contributions to costs in respect of the transaction, and
- the assumptions, strategies and policies, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contributions to costs in respect of the transaction.

Where the transaction that is being documented spans more than one taxation year or fiscal period, the taxpayer or partnership must completely and accurately document any material changes occurring in the subsequent year or period to the matters listed above. Such documentation is required to be made or obtained by the taxpayer or partnership within 60 days after the end of the subsequent year or period.

All the documentation that must be prepared under this subsection is required to be provided to the Minister of National Revenue within 60 days of service, made personally or by registered or certified mail, of a written request therefor.

Proposed new subsection 247(4) applies to adjustments made under proposed new subsection 247(2) for taxation years that begin after 1998. It should be noted, however, that a record or document made or obtained or provided to the Minister within 60 days of the end of the taxpayer's first taxation year (or the partnership's first fiscal period) that begins after 1998 is deemed to have been made, obtained or provided on a timely basis.

ITA
247(5)

Proposed new subsection 247(5) of the Act provides a rule to determine a taxpayer's gross revenue from membership in a partnership for the purpose of the penalty provision in proposed new subsection 247(3). Under proposed new subsection 247(3), a taxpayer is not liable to a penalty for a taxation year unless the total of the taxpayer's "reduced" transfer pricing income and capital adjustments for the year exceeds the lesser of \$5,000,000 and 10% of the taxpayer's gross revenue for the year, determined without reference to proposed new subsection 247(2), subsections 69(1) and (1.2) and section 245.

Under proposed new subsection 247(5), the taxpayer's gross revenue for a taxation year as a member of a partnership is that proportion of the partnership's gross revenue for a fiscal period ending in the year (computed as though the partnership were a taxpayer and without reference to any amounts received or receivable from other partnerships of which the taxpayer is a member in the year), that the taxpayer's share of the income or loss of the partnership from its activities for the period is of the total income or loss of the partnership from its activities for the period. If the income or loss of the partnership for the period are nil, the partnership is deemed to have income in the amount of \$1,000,000 for the purpose of determining the taxpayer's share of the partnership's income for the purpose of this subsection.

Proposed new subsection 247(5) applies with respect to adjustments made under proposed new subsection 247(2) for taxation years and fiscal periods that begin after 1998; however, proposed new subsection 247(5) does not apply with respect to transactions completed before Announcement Date.

ITA
247(6)

Proposed new subsection 247(6) of the Act provides that, for the purpose of proposed new section 247, a person who is a member of a partnership which in turn is a member of another partnership is considered to be a member of that other partnership. It also provides that a member's share of the income or loss of the other partnership is deemed to be the amount to which it is directly or indirectly entitled.

Proposed new subsection 247(6) applies to taxation years and fiscal periods that begin after 1997.

ITA
247(7)

Proposed new subsection 247(7) of the Act effectively exempts interest-free and low interest loans made by a corporation resident in Canada to a non-resident subsidiary it controls from the application of proposed new subsection 247(2).

Proposed new subsection 247(7) applies to taxation years and fiscal periods that begin after 1997.

ITA
247(8)

Proposed new subsection 247(8) of the Act ensures that where

- proposed new subsection 247(2) would apply to adjust the quantum of an amount under the Act, assuming the Act were read without reference to section 67 and subsections 69(1) and (1.2), and
- subsection 247(2) is, in fact, applied to adjust the quantum or recharacterize the nature of that amount,

then section 67 and subsections 69(1) and (1.2) shall not apply to determine the quantum of that amount.

Proposed new subsection 247(8) applies to taxation years and fiscal periods that begin after 1997.

ITA
247(9)

Proposed new subsection 247(9) of the Act is an anti-avoidance rule intended to prevent taxpayers from artificially increasing their gross revenue for the purpose of the penalty in proposed new subsection 247(3). It provides that, for the purpose of the gross revenue penalty threshold in proposed new subparagraph 247(3)(b)(i) and the determination of a partner's gross revenue under proposed new subsection 247(5), a transaction or a series of transactions is deemed not to have occurred where a purpose of the transaction or series was to increase a taxpayer's gross revenue for the purpose of the penalty.

Proposed new subsection 247(9) applies with respect to adjustments made under proposed new subsection 247(2) for taxation years and fiscal periods that begin after 1998; however, proposed new subsection 247(9) does not apply with respect to transactions completed before Announcement Date.

ITA
247(10)

Proposed new subsection 247(10) of the Act provides that adjustments (other than adjustments that result in or increase a transfer pricing capital or income adjustment of a taxpayer for a taxation year) shall not be made under proposed new subsection 247(2) unless the Minister considers that such adjustments would be appropriate in the circumstances.

Proposed new subsection 247(10) applies to taxation years and fiscal periods that begin after 1997.

ITA
247.1(1)

Proposed new subsection 247.1(1) of the Act provides that where a taxpayer is liable to a penalty under proposed new subsection 247(3) for a taxation year, the taxpayer must pay that penalty to the Receiver General for Canada before the end of the second month of the following taxation year.

Proposed new subsection 247.1(1) applies to adjustments made under proposed new subsection 247(2) for taxation years and fiscal periods that begin after 1998.

ITA
247.1(2)

Proposed new subsection 247.1(2) of the Act levies an interest charge on the portion of a penalty which a taxpayer has failed to pay to the Receiver General in accordance with the terms of proposed new subsection 247.1(1).

Proposed new subsection 247.1(2) applies to adjustments made under proposed new subsection 247(2) for taxation years and fiscal periods that begin after 1998.

ITA
247.1(3)

Proposed new subsection 247.1(3) of the Act ensures that the provisions of Part I of the Act relating to assessments, payments, penalties, refunds, objections and appeals apply to proposed new Part XVI.1 of the Act.

Proposed new subsection 247.1(3) applies to taxation years and fiscal periods that begin after 1997.