Study on Transfer Pricing

Robert Turner, C.A.
Ernst & Young, Toronto

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Prepared for the
Technical Committee on Business Taxation

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Abstract

Changes in manufacturing processes, increased data communication and networking, and the increasing role of services and valuable intangibles in the economy as well as the creation of trading zones (such as the European Community) enable businesses to operate more effectively transnationally. As a result, related party trade is growing both in volume and in scope. The implications of intra-company transfer pricing policies for government revenues can be significant as such prices can affect customs, excise and sales taxes as well as income taxes paid in relevant countries.

This paper has been prepared to provide the Committee with an overview of transfer pricing procedures and policies and the international environment governing such practices. The results of two recent surveys of taxpayers provide an overview of the taxpayer's perspective on transfer pricing issues. The paper summarizes recent transfer pricing guidelines issued by the Organisation for Economic Co-operation and Development, provides an overview of the tax rules applying in various countries to related party transactions and compares these approaches to those found in Canada. The study offers, for the Committee's consideration, possible changes or alternative approaches for the Canadian tax system having regard to the Committee's stated objectives of:

- promoting job creation and economic growth,
- protecting the Canadian tax base,
- simplification, and
- enhancing fairness by ensuring that all businesses share the cost of providing government services.

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Introduction

Canada, a member of the G-7 (Group of Seven leading industrial countries), is often identified as the largest trading partner of the United States both for imports and exports. What is often left unsaid is that most of this trade is between related parties.[1] Recently obtained information from Revenue Canada indicates that in 1993, related-party transactions of $248 billion were reported to it, $166 billion of which was between related parties in Canada and the United States (approximately five times the volume for the second-largest country, the United Kingdom).[2] In a country that raises less than $20 billion in tax from corporations, the potential impact on tax revenues of these related-party transactions is significant.

As noted by the Organisation for Economic Co-operation and Development (OECD), "the role of multinational enterprises (MNEs) in world trade has increased dramatically over the last 20 years."[3] Changes in manufacturing processes, increased data communication and networking, and the increasing role of services and valuable intangibles in the economy as well as the creation of trading zones (such as the European Union) enable businesses to operate more effectively transnationally. As a result, related-party trade is growing both in volume and in scope.[4]

The OECD notes: "One of the most difficult issues that has arisen is the establishment for tax purposes of appropriate transfer prices. Transfer prices are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises. .... Transfer prices are significant for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions."[5]

"When transfer pricing does not reflect market forces and the arm's-length principle, the tax liabilities of the associated enterprises and the tax revenues of the host countries could be distorted."[6]

It is therefore not surprising that, with increasing globalization of trade and with changes in the nature of business functions that need to be carried out to compete successfully, tax administrations are increasingly concerned about the impact of transfer pricing on their tax base. Similarly, transfer pricing and the increasing attention it is getting from tax authorities in various countries around the world is of pressing concern to MNEs. However, its relevance is not

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[1] This phenomenon is consistent with trade between other countries. See, for example, *Global Warming*, Journal of Accountancy – International Edition, Dodsworth and Hobster, April 1996, wherein it was noted that more than one half of world trade takes place between related parties.
[2] *Analysis – T-106 Data, 1991-1993*, obtained from Revenue Canada under the *Access to Information Act*. Form T-106 is used to report transactions between related corporations. In a similar analysis for 1990-91, Revenue Canada estimated that there was a 20% shortfall in the number of T-106 filings.
[3] *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, OECD, Paris, 1995, p. P-1.
[4] For example, the opening up of the Eastern Bloc as well as parts of the Far East has created new trading opportunities for MNEs and has changed trading patterns.
[5] OECD, s*upra.* P-3,4.
[6] OECD, *supra.,* I-1, para. 1.3.

restricted only to billion-dollar MNEs; transfer pricing affects every entity doing business in more than one country. This includes many smaller, often privately held companies that operate in Canada and the United States. For all companies, particularly smaller ones, it is important that transfer pricing legislation and related administrative policies be clearly understood and as easy as possible to comply with.

The focus on transfer pricing is being led by the U.S. tax authority, the Internal Revenue Service†(IRS), with the support of the U.S. Congress and other U.S. political leaders. For the most part, other countries around the world, including members of the OECD, have reacted defensively to U.S. initiatives in this area. While most countries, including Canada, have chosen to react administratively, a small number of countries, including France, Australia and Mexico, have enacted, or are considering, tougher legislation to deal with intercompany transfer pricing matters.

In the United States, the concern about transfer-pricing manipulation has led to detailed rules, and has resulted in arguably onerous compliance and documentation rules backed up by fairly hefty tax penalties. These actions, in particular the penalty provisions, have the attention of companies dealing with the United States.[7]

International tax authorities have also responded to the U.S. initiatives, generally by increased scrutiny of MNE related-party transactions. The OECD released major revisions in 1995 to its 1979 Transfer Pricing and Multinational Enterprises guidelines; further updates were issued in 1996. Australia has announced new compliance requirements and France and Japan have announced transfer-pricing initiatives as well.

This paper summarizes the tax rules that apply in various countries to related party transactions and compares these approaches to those found in Canada. It also identifies possible changes or alternative approaches that may be considered for the Canadian tax system regarding the following objectives:

- promoting job creation and economic growth;
- protecting the Canadian tax base;
- simplification; and
- enhancing fairness by ensuring that all businesses share the cost of providing government services.

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[7] In a 1996 Ernst & Young survey of over 200 MNEs with operations in the United States, 89% of respondents indicated that concern about U.S. penalties had caused them to document their transfer-pricing policies in a manner consistent with the IRS regulations.

Executive summary

Impact of transfer-pricing issues

- Transfer-pricing administration and enforcement policies may give increase to the threat of double taxation, and such policies may become an impediment to the free flow of goods, services or capital, thereby impeding economic growth and job creation.[8]
- The existence of penalty or documentation provisions, combined with aggressive transfer-pricing audit procedures by foreign jurisdictions, poses a threat to the Canadian tax base as companies may seek to over-comply with tax rules in such foreign jurisdictions.
- In the interests of flexibility and simplicity, Canada is, at present, best served by general, rather than overly detailed, tax provisions relating to transfer-pricing methods and practices.

Basis for determining non-arm's-length transaction prices

- Canada should continue to apply the transactional methods endorsed by the OECD when evaluating intercompany transfer pricing used between related parties.
- The general and flexible "reasonable in the circumstances" criterion of section†69 of the *Income Tax Act* does not require amendment.

Administrative policies and guidelines

- *Information Circular IC 87-2* should be updated and re-issued as soon as possible.[9] The Circular should be more comprehensive in scope and should contain more extensive examples. As well, the circular should be more specific in identifying the administrative approaches applied by Revenue Canada in evaluating the transfer pricing methods used by taxpayers.
- Customs and Goods and Services Tax (GST) principles should be more consistent with the Income Tax approach to resolving transfer pricing disputes.[10]
- An executive interchange program between the department and the private sector should be initiated, where appropriate, to encourage the sharing of expertise.
- Revenue Canada should provide guidance on how it intends to use T-106 and tax return reporting in its transfer-pricing enforcement and review.

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[8] When the "threat" of double taxation does become a reality, taxpayers may use the various problem-resolution channels available to them, including the competent authority process under the mutual agreement provision found in our various tax treaties.

[9] IC 87-2 was released in 1987. The circular is presently being revised to reflect the department's current views on transfer pricing, taking into account the recent recommendations of the OECD.

[10] The *Income Tax Act* (Canada) and the *Customs and Excise Tax Acts* are separate and distinct legislation, enacted to satisfy different and particular needs. As well, different international agreements and processes may apply to these differing types of taxes and may restrict Revenue Canada's ability to achieve this consistency.

Examination practices

- Revenue Canada should continue the specialized training and status of personnel involved in transfer-pricing audits. Involvement of these trained specialists should be mandatory in all transfer-pricing reviews.
- Transfer-pricing specialist personnel in the Tax Service Office (TSO) should include legal and economic support.
- Until more experience is gained by TSO personnel, proposed transfer-pricing reassessments should be referred to the International Tax Directorate in Ottawa to ensure consistency across the country. Taxpayers should be allowed to participate in the referral process.

Burden of proof

- Taxpayers should be expected to be able to support the reasonability of related-party transfer pricing through contemporaneous documentation. The extent of the documentation needed will vary from case to case, but will likely need not be as extensive as that required for U.S. tax purposes.

Administration, penalties and compliance requirements

- Given the need to balance fairness and simplicity against the pressures of detailed information reporting and the penalties applied under other tax regimes, and given the need to balance flexibility and uncertain rules against inflexibility and very detailed rules, Canada is well served by less-specific rules than those followed in the United States.
- Revenue Canada's initiatives in increasing its review of related-party transactions are warranted. As well, Revenue Canada's continuing advocacy of increased use of simultaneous examinations is desirable.[11] Real-time audits of transfer-pricing transactions should be considered.
- Canada should introduce specific penalties for under reporting of income due to transfer-pricing manipulation. Such penalties should differentiate between taxpayers who act in reasonable good faith (as evidenced by contemporaneous documentation) and those who do not.

The advance-pricing agreement program

- The advance-pricing agreement (APA) program is vital to fair and open administration of the tax system and to keep our system competitive and fair.

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[11] It is understood that Revenue Canada is actively promoting the simultaneous-audit program with our treaty partners.

- The APA program requires additional resources and a "fast-track" APA or informal APA procedure should be made available for smaller companies.[12]

Competent Authority

- Canadian taxpayers should be kept fully aware of progress of Competent Authority procedures affecting them.[13]

Background

This section of the report provides general background on the use and implications of transfer-pricing policies and the impact that transfer pricing has on the reported profits of enterprises operating internationally. This section describes common transfer-pricing procedures and outlines the transfer-pricing regimes found in various countries including Canada, the United States, Australia and Japan.[14] This section of the report also describes the findings of surveys conducted by Ernst & Young during 1995 and 1996 on transfer-pricing issues.

What is transfer pricing?

Multinational enterprises (MNEs) carry on business in more than one country either directly, through branches, or indirectly through subsidiaries. Whatever the form, the activities of an MNE's individual operating units are rarely completely self-sustaining or independent with the result that transactions take place between these units. The price at which goods, services or capital are exchanged between the related parties, the transfer price is determined by the transfer-pricing policies used within the related group.

The transfer price received or charged for goods, services or financing will be included in the income of supplier, and the corresponding cost or payments will be deducted from the profits of the legal entity benefiting from the transaction and making the payments.[15] Often the amount of these charges represents one of the largest inclusions or deductions in computing the income of one or both of the related parties.

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[12] Currently Revenue Canada has accepted two smaller, fast-track APAs on a trial basis to determine how its program might be adapted to meet the needs of smaller corporations in the area of transfer pricing.

[13] In May 1995, the International Tax Directorate of Revenue Canada released an update to its *Information Circular IC 71-17R4* on the Canadian Competent Authority process. The revisions reflected the need for greater co-operation and involvement by affected taxpayers in the process.

[14] The tax administrations of these countries have formed the Pacific Association of Tax Administrators (PATA) to promote co-operation and administrative consistency among them. In 1995, PATA members released common guidelines relating to bilateral and multilateral APAs.

[15] The governing tax law of the respective country of the payer and the payee may affect the timing and or amount of the income inclusion or deduction for the intercompany charge.

From a business perspective, there are many dimensions to deciding what to charge for the intercompany exchange of goods or services. Compensation and performance measurement may push in one direction; the demand for simplicity may push in another; and tax considerations may push in a third. Other factors may come into play as well. Governments, through their tax systems, have a vested interest in ensuring that appropriate profits are reported in their jurisdiction. Government concerns are heightened when one of the parties to a related-party transaction is subject to tax at a rate that is considerably less than that applying in the other related party's country. In addition to tax-rate pressures, other government pressures can be brought to bear on the transfer-pricing decision, including heavy penalties or restrictive measures dealing with related-party transactions.

Are there accepted methods for transfer pricing?

There is general agreement among governments, often by way of bilateral tax treaties, that transfer pricing between related parties should adhere to an arm's-length standard; that is, that related companies should carry out their transactions between themselves on the same basis as would have applied had they been dealing at arm's-length.[16] Through the OECD, 25 of the world's leading industrialized countries, including Canada, have stated their acceptance of the arm's-length standard for setting inter-company transfer prices and have set out guidelines for methods that should be used in adhering to the standard.[17]

Notwithstanding this agreement on the arm's-length standard, various countries have different ways of interpreting the standard and applying the generally accepted methods.[18] It is these differences that cause uncertainty and introduce tax risk to the equation. The MNE is then left to balance the conflicting interpretations in a manner that exposes it to the least amount of financial risk. This determination is affected by the geographic source of the greatest volume of transactions (e.g. a U.S.-based MNE will likely have more related-party transactions to be reported in the U.S. than in any other single country, and therefore its tax risk is likely to be more significant in the U.S. than in any other country). It is also affected by the existence of tax and other financial penalties, as noted elsewhere in this paper.

The attitude of MNEs to the transfer-pricing policies and administrative procedures developed by various governments has been the subject of two Ernst & Young surveys in the past year.[19]

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[16] See for example Article IX of the *Convention on Income Taxes 1980* (as amended) between Canada-United States of America wherein it is provided that an arm's-length standard is to apply between related parties.

[17] OECD, *supra,* Chapter 1. The accepted standards are based on transactional methods and are: comparable uncontrolled price (CUP), comparable uncontrolled transaction (CUT), resale price minus method (RSM), cost plus, transactional net margin method (TNMM), and profit split method (PSM).

[18] Compare, for example, the U.S. Internal Revenue Code requirement of an arm's-length result and the Canadian *Income Tax Act*'s standard of an amount that would be reasonable in the circumstances between parties dealing at arm's length. The U.S. standard has led to a "bottom-line approach" that may require post-transaction adjustment, whereas Canada takes at a transaction-by-transaction approach.

[19] There have been other surveys carried out by other parties, for example, a survey by Charles River & Associates in the United States. Such survey results have been fairly consistent with those of the Ernst & Young surveys described in this paper.

Ernst & Young global survey of multinational corporations – 1995[20]

In 1995, Ernst & Young International arranged for an independent survey of multinational companies operating in eight countries, including Canada, the United States, the United Kingdom and Japan.[21] The survey also asked the tax authorities in the various surveyed countries to comment on various aspects of the transfer-pricing developments and the use of advance pricing agreements (APAs).[22]

The results of this survey clearly establish the following:

- transfer pricing is vitally important to MNEs in all surveyed countries;
- the more MNEs are subject to tax audit on transfer-pricing methods†(TPMs), the more they take the reactions of tax authorities into account when establishing or revising TPMs; and
- most MNEs are familiar with the concept of APAs, and expect their use to increase in the future.

In the survey 80 percent of MNEs indicated that transfer pricing was the most important international tax issue facing them today. Approximately one half of all respondents said it was the most pressing tax issue of any kind for them. Although Canadian respondents were consistent with the rest of the world on these questions, they were the most likely to face queries at home on their transfer pricing.[23] Overall 83 percent of respondents indicated that their TPMs had attracted tax authority review.

When asked about audits of their foreign subsidiaries, MNEs uniformly identified the United States as most active in conducting transfer-pricing audits; surprisingly, Revenue Canada was well down the list.[24]

The survey also asked how likely companies were to take the possibility of a revenue authority enquiry into account when setting a TPM. Not surprisingly, given the U.S. regulations and penalty regime, over 90 percent of U.S. MNEs indicated that they would do so to some or to a great extent. It was a little surprising to find that Canadian and UK MNEs closely followed the U.S. in this regard.[25] Even in Germany and France, where the tax authorities are less aggressive in reviewing TPMs, just over 70 percent of respondents considered the prospect of review significant enough to take it into account in setting TPMs.

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[20] Transfer Pricing: Risk Reduction and Advance Pricing Agreements, Ernst & Young, 1995.

[21] In this 1995 survey, 25 companies were surveyed in each of Australia, Canada, France, Germany, the Netherlands and the U.K.; 50 U.S. and 10 Japanese companies were surveyed.

[22] The Canadian, German, Dutch and U.K. authorities commented on the survey results or on the APA process.

[23] Over 90% of Canadian MNE respondents have faced queries from Revenue Canada; 48% of the Canadian respondents were involved in Revenue Canada reviews of their transfer pricing at the time of the survey.

[24] 36% of Canadian respondents indicated that they were facing a review by a foreign tax authority. 34% of all MNEs that have faced an enquiry in a subsidiary country report that they are currently under review by the IRS, and 34% report they have been reviewed by the IRS in the past; for Canada, the figures are 12% and 11% respectively.

[25] 88% and 84% respectively.

Larger MNEs treated the risk more seriously than smaller MNEs, and companies that had experienced revenue enquiries in the past were more likely to take the risk into account than were companies that had not faced such inquiries.[26]

Approximately one third of respondents claimed that they set up a defensible policy with adequate supporting documentation. Almost one third adapted their TPMs to the practice of local tax authorities. Only one quarter stated that they use an arm's-length market-based approach.
A number of MNEs also indicated that they tailor TPMs to the more conservative approach of certain countries, most notably the United States.[27] The particular mention of U.S. rules seems to support the fear of other countries, including Canada, that U.S. rules and penalty provisions have caused MNEs to skew their TPMs to "over comply" with the U.S. rules.[28]

MNEs were asked to identify the types of transactions that come under review. They responded in the following order:

- charges for administrative or management services;
- royalties and other charges for intangibles;
- transfer pricing for goods for resale;
- financing transactions; and
- charges for technical services.

Clearly, administrative and management charges are the easiest for the revenue authorities to trace and audit. For these charges, the three-part audit determination of existence, benefit and no-duplication accompanied by a "no-markup" approach make it easy for the auditor to assess reasonability of the charges.[29]

Transfer pricing for goods or intangibles is somewhat more difficult to evaluate and is open to more subjective judgment in many cases. Nonetheless, various unpublished Canadian surveys indicate that Revenue Canada auditors are increasingly willing to look at goods and royalties when auditing international transactions. In the United States, while interest and royalties are the most frequently adjusted transactions, the dollar adjustments for transfers of goods are larger.[30]

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[26] 46% of larger MNEs said they considered the possibility of review by revenue authorities to a great extent when setting a TPM; only 26% of smaller companies would do so to a great extent. Only 17% of companies that had not been subjected to tax authority review of their TPM considered the possibility of an investigation when setting a TPM.
[27] 7% of respondents tailored their TPM to U.S. rules. Other respondents cited Germany, Canada and Japan.
[28] This concern is reinforced by the 1996 survey of documentation practices, *infra.* On the other hand, a number of companies, concerned about the exposure to penalties, have applied for bilateral APAs.
[29] Many Revenue Canada auditors state that these are "easy marks" for some type of adjustment, as companies often get lazy in backing up these charges.
[30] The above comments reflect information obtained from the IRS.

The survey also covered competent authority procedures. Respondents were generally dissatisfied with the competent authority process (52 percent in Canada) generally due to the amount of time involved (many years) and the uncertainty as to the outcome of the process. To some extent this was mirrored by comments on the APA process. Despite the current lack of use of APAs by Canadian-based MNEs, almost all of them were familiar with the APA concept and some 80 percent of them expected the use of APAs to increase in the future.[31]

Ernst & Young survey of transfer-pricing documentation - 1996[32]

Recognizing the importance of transfer pricing and the growing compliance burden for documenting transfer-pricing policies, particularly for U.S. purposes, Ernst & Young sought responses from MNEs on these documentation issues. Responses were received from over 200 MNEs, 90 percent of which were based in the United States. As was the case for the 1995 survey, transfer pricing was identified as the major tax concern facing MNEs.

Almost 90 percent of the respondents indicated that the reasons for documenting their transfer-pricing policies included the objective of minimizing exposure to U.S. penalties. Almost two thirds of them indicated that they documented the facts in anticipation of an IRS audit and half of them were seeking an evaluation of their transfer-pricing exposure. Slightly more than 40 percent of the respondents were attempting to substantiate their methodology for non-U.S. purposes. Almost three quarters of the respondents indicated that their documentation included all or most of the documentation required under the U.S. transfer-pricing regulations.[33]

The respondents made it clear that they were less concerned about non-U.S. documentation requirements: one third indicated that they would not prepare documentation for foreign tax authorities. Approximately one half said they would use U.S. documentation for foreign purposes, mostly without modification. Only one in four indicated that they would prepare separate documentation for foreign purposes. This response is, perhaps, attributable to the lack of documentation requirements and/or the lack of meaningful penalties in most countries.

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[31] However, slightly less than half of Canadian respondents thought their company would use an APA.
[32] 1995 Transfer Pricing Documentation Survey, The Year in Review, Ernst & Young, 1996.
[33] U.S. documentation requirements are discussed at page 12.

Despite the fact that the use of a results-based comparable profits method[34] (CPM) is generally resisted by other countries,[35] 49 percent of respondents use this method, alone or in combination with another method, for pricing the transfer of goods, while 37 percent use it for intangibles. Approximately one half of the respondents used more than one method for pricing goods, and one quarter used more than one method for intangibles. Since use of CPM is not accepted by the OECD[36] without reservation, the extent to which it is used by the respondents indicates the impact of the detailed U.S. regulations and penalties on the transfer pricing decision. This influence was recognized by many of the respondents: 25 percent of those using CPM expected to recast CPM for foreign purposes as another method and 10 percent of those using CPM expected to be challenged in foreign jurisdictions. Some 40 percent were unsure of the impact of using CPM, and 25†percent expected no foreign difficulties.

Approximately one half of respondents were under audit in their transfer-pricing policies, and many had been asked to supply documentation by foreign jurisdictions, as shown below.

Country	No. under audit	No. asked to supply documents
Canada	28	16
United Kingdom	24	7
Germany	13	3
Australia	10	8
United States	19	n/a
Other	22	11

The above results confirm Revenue Canada's increased activity in this area and its diligence in seeking documentation, despite the absence of legislative or regulatory documentation requirements or penalties.

[34] Under this method, the profit performance of a related party is compared with the profit performance of arm's-length companies performing similar functions. Detailed procedures are set out in the *Regulations to the U.S. Internal Revenue Code*.
[35] See, for example, joint release 94-3 issued by Revenue Canada and the Department of Finance on January 7, 1995.
[36] OECD, *supra,* paragraph 3.1. The OECD guidelines suggest that the TNMM can be used as a last resort as a profit-based method; the CPM is dismissed as a method unless it corresponds with the arm's-length principle. Some U.S. authors have suggested that the TNMM is equivalent to CPM; this position is not generally accepted (see, for example, a speech presented by Carole Gouin of Revenue Canada at the June 6-7, 1996 meeting of the Canadian and U.S. branches of the International Fiscal Association, in Montreal).

The survey also found that over 60 percent of respondents used external advisors in the process of completing their documentation requirements. The costs of completing these requirements were relatively high, whether in dollars expended or in person hours, as illustrated by the following table:

Sales volume	Median cost	Median hours
< U.S. $500 million	U.S. $45,000	120
U.S. $500 million to $1 billion	U.S. $50,000	165
U.S. $1 to 5 billion	U.S $100,000	200
> U.S. $5 billion	U.S. $150,000	500

The amounts expended, in both dollars and in time, were higher for non-U.S. companies than for U.S.-based MNEs. The above table illustrates that the costs of compliance fall relatively more heavily on smaller companies.

OECD transfer-pricing guidelines

A comprehensive update to the 1979 transfer-pricing guidelines was issued in mid-1995. The guidelines were issued in loose-leaf, rather than bound, form to allow more frequent updates.[37] Essentially, the revised guidelines reaffirm the arm's-length standard in setting intercompany transfer prices. The guidelines include a stated preference for transaction-based methods rather than profit-based methods for setting transfer prices. Nonetheless, two profit-based methods – the TNMM and the profit split method (PSM) – are identified as acceptable.[38]

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[37] The first update, dealing with services, was issued in 1996.

[38] OECD, *supra*, Chapter III. The TNMM has been variously described as both supporting and eliminating the use of the U.S. comparable profits method for setting inter-company transfer prices. There have been two articles commenting on the TNMM. The first article by Robert Culbertson (Tax Notes International, Aug. 7, 1995), concludes that the CPM and the TNMM are the same. Another article by Michel Taly (Tax Notes International, Jan. 29, 1996) warns that "U.S. tax practitioners who conclude from Culbertson's article that, in essence, the use of CPM in establishing transfer prices is completely acceptable to European tax administrations may find their U.S.-based multinational clients facing serious transfer pricing problems in Europe in the future." Both Culbertson and Taly were participants in the OECD negotiations, and yet both seem to have come away with a different understanding of the consensus.
Revenue Canada prefers that a transaction-based method be used; it does employ the PSM when appropriate (often as a means of evaluating the reasonability of another method). It currently appears that Revenue Canada expects the TNMM to be used rarely, if at all.

Those involved in transfer pricing should be aware of the varying importance attributed to the OECD guidelines by various tax authorities. In the United Kingdom, the guidelines are applied by the Inland Revenue; in Germany, acceptance of the guidelines has been reserved.[39] In Canada, the guidelines are supported[40] although there is some question as to whether the TNMM has practical application. In the United States, the guidelines are virtually ignored at the field level, and the IRS regulations will be applied.[41]

U.S. developments

A number of important developments have taken place in the United States during the past several years, the most notable being the finalization of 482†regulations governing related-party transactions which are now in effect.[42] Essentially, these regulations require that contemporaneous documentation be used to support the best method for determining the results of intercompany transactions, otherwise any adjustments made may attract penalties of either 20 percent or 40 percent of the tax understatement.[43] The United States has also issued detailed rules on cost-sharing arrangements and has updated its APA procedures.

The final regulations set out the following 10 principal documents necessary to support the use of the best method:[44]

- an overview of the taxpayer's business, including economic and legal factors affecting pricing;
- a description of corporate structure affecting related-party transactions;
- supporting documents and agreements;
- descriptions of the selected TPM(s) and reasons for selecting the TPM(s);
- descriptions of rejected methods and reasons for rejecting them;
- descriptions and analyses of related-party transactions;
- descriptions and analyses of comparables used to support the choices made;
- explanation of economic analysis and projections;
- a description of relevant data obtained between the end of the year and the time the tax return was filed; and
- a general index of principal supporting documents.

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[39] Germany believes that too much credence has been given to profit-based methods.
[40] Press release dated July 28, 1995; the U.S. Treasury department issued a similar release at that time.
[41] The IRS position is that the IRC regulations are consistent with the guidelines.
[42] Generally, U.S. companies were required to have contemporaneous documentation supporting their TPMs at the time they filed their 1994 tax returns in the United States; for companies with December 31 year ends, this information had to be compiled on or before September 15, 1996.
[43] A 20% penalty applies if the amount of tax at issue is more than $5 million or 10% of gross receipts; for adjustments over $20 million or 20% of gross receipts, a 40% penalty applies. There are special provisions for smaller companies and for reasonable cause.
[44] These documents are to be prepared contemporaneously with the filing of the corporation's U.S. tax return and must be provided to the IRS within 30 days of being requested.

In addition to this contemporaneous documentation, which must be available but need not be filed with the tax returns, the IRS requires that certain information on related-party transactions and offshore activities be included when filing.[45]

At the IRS audit level, taxpayer experience has varied. In some districts, there has been a stepped-up scrutiny of foreign-owned companies; in other districts, there has been no noticeable change in scrutiny. Generally, one can expect an IRS field-office economist or industrial engineer to be consulted by the international tax agent assigned to the case.

Other country developments:

Australia

In addition to supporting and expanding the use of APAs, the Australian Taxation Office (ATO) has issued comprehensive transfer pricing rules. The ATO has also issued draft tax rulings which outline its position on the following:

- selection and application of transfer pricing methodologies;
- documentation requirements; and
- penalties for non-compliance.

The ATO has expanded its tax audit and tax strategy review program by conducting transfer-price risk-assessment reviews that comprise a very specific and detailed review of a taxpayer's transfer-pricing practices. The ATO has set out its guidelines as to how taxpayers should evaluate their exposure to penalties and their risk of transfer-pricing adjustments.

The ATO bases its penalty regime on two criteria: first, whether the taxpayer had a dominant purpose of tax avoidance, and second, whether the taxpayer has a reasonably arguable position regarding compliance with the arm's-length principle. The rates of penalty vary generally between 10 and 50 percent of the tax adjustment, but are more commonly between 10 and 25 percent where there is no purpose of tax avoidance. The ATO has a residual discretion to remit transfer-pricing penalties.

The ATO expects that all taxpayers will create and maintain contemporaneous documentation of their TPMs. This documentation should include the following:

- documents created in the ordinary course of business;
- a functional analysis;
- support for the method chosen; and
- documents prepared in the course of review of the TPM.

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[45] IRS forms 5471 and 5472 are used to report this information.

The ATO requires that taxpayers complete a reporting form outlining the nature and extent of transactions between related parties.[46]

Japan

Transfer-pricing rules were first introduced in 1986 to ensure that Japan can tax its fair share of international income. Since then, the Japanese tax authority, the NTA, has proposed tax reassessments exceeding $1.5†billion. The NTA has stepped up its transfer-pricing enforcement over the past three years. In October†1993, the NTA announced a policy detailing the transition to a new phase of aggressive monitoring and expanded the scope of its examinations. This appears to be in response to developments in the United States. In 1995, the NTA formed special teams at the regional and national levels to investigate transfer-pricing matters.

The NTA has endorsed the use of a pre-confirmation system, similar to APAs, and several are under negotiation. Japan is a member of PATA and adopted, in September 1994, the association's Guidelines on Bilateral Advance Pricing Agreements.

Korea

Korea has announced comprehensive transfer-pricing rules and has implemented an APA procedure.

Mexico

The *Hacienda* announced transfer pricing rules for *Maquiladoras*. These regulations can impute a minimum return to a *Maquiladora,* unless the company can establish an arm's-length relationship from its operations. Various filing and notification requirements are contained in the legislation. It is understood that Mexico has completed a number of APAs with the U.S. and is planning to introduce a formal APA program.

France

France recently announced penalty provisions for non-compliance with the arm's-length standard.

Canadian developments

A number of important developments have taken place in Canada. Revenue Canada has become more visible in reviewing international transactions. It is apparent that several district offices are selecting companies for audit on the basis of their T-106 filings; the T-106 forms themselves have been expanded for filings after 1995. Penalties have also been increased for non-compliance, but generally are limited to $48,000 in extreme cases. Routine cyclical audits frequently involve referrals to international specialists within the local tax service office (TSO). Furthermore, some TSOs specialize in particular industries. Unlike the IRS, Revenue Canada TSOs do not appear to have ready access to local economists and process engineers; however, the international division in Ottawa does have an Economics Analysis Group that provides support to the TSOs.

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[46] Revenue Canada referred to the ATO and IRS reporting forms when developing its T-106 form.

Until recently, the majority of Revenue Canada audits would focus on intercompany service charges. These audits would generally follow a predictable pattern: a request for foreign-based information, a proposal to travel, at the taxpayer's expense, to the foreign location to examine its books and records, and a request for a functional analysis and for interviews with foreign personnel. If the requested information is not submitted, Revenue Canada may invoke Section 231.6 of the *Income Tax Act* to obtain foreign-based information relevant to the determination of a Canadian taxpayer's income.

In the past, audits would often result in a partial disallowance of intercompany charges and the use of subsection 15(1) or (2) to assess the non-resident parent as well. Queries relating to transfer pricing for tangible goods or intangibles were somewhat rare. That has now changed. Field auditors now routinely ask for functional analyses to support TPMs for tangible goods; as well, royalties are under review. Increasingly, the auditor will rely on information obtained from other audits as guidelines in determining whether a particular pricing approach gives results within a reasonable range.

Looking ahead, it is possible that Revenue Canada auditors will start asking for copies of the documentation required for U.S. tax purposes.[47]

Unlike the U.S., Canada has little experience in the courts dealing with TPMs or valuation. Rather, transfer-pricing cases, such as *Indalex,*[48] have been fought on the basis of artificiality or avoidance. However, preliminary court documents have been filed on a transfer-pricing case (SmithKline) that will deal with the reasonability of a particular transfer price.

Under the current Canadian *Income Tax Act*, a person is liable to a penalty to a maximum of $2,500 for failure to file or for late filing the T-106 information return. Where Revenue Canada has served a demand for filing the T-106 and the taxpayer has not complied within 90 days, an additional penalty of $1,000 per month applies to a maximum of $24,000.

Draft legislation released on March 5, 1996, increased the penalties related to the T-106 for returns due after April 29, 1997. The penalty for failure to file the T-106 has been increased to $500 per month to a maximum of 24†months ($12,000). Where Revenue Canada has served a demand to file the T-106, within a specified period, and the taxpayer has not complied, the penalty continues to be $1,000 per month with a maximum of $24,000.

The draft legislation proposes an additional penalty of $24,000 per T-106 in circumstances amounting to gross negligence, where the taxpayer has made or participated in, assented to or acquiesced in making a false statement, or omitting information.

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[47] It is unclear at this time whether this information can be obtained through the IRS under the Treaty in the event the taxpayer refuses to provide the information to Revenue Canada directly.
[48] 88DTC 6053 (FCA).

Subsection 163(2) and 239(1) deal with circumstances where false statements or omissions of information lead to an understatement of Canadian taxes, and consequently, penalties that range from 50 to 200 percent of the tax underpayment may apply. There is little, if any, experience in the application of these penalties to transfer-pricing matters.

The APA process

In certain countries, including Canada, taxpayers may approach tax authorities to seek advance approval of a transfer-pricing method or methods. Such procedures are available on a unilateral, bilateral or multilateral basis. The procedures for applying for an APA in Canada are set out in Revenue Canada's *Information Circular†94-4*. The 1995 Ernst & Young survey (*supra*) found that Canadian companies are well aware of the APA process although they are somewhat reluctant to use it, because they consider the process to be too time-consuming and expensive. The general experience has been that it takes companies as long to document their TPMs as it does for the revenue authorities to evaluate the APA submission. Currently, Revenue Canada is testing a "fast-track" APA procedure for taxpayers with relatively low transaction volumes.

Summary and discussion of suggested actions

A distinguishing feature of transfer pricing policies, procedures and enforcement is that these matters cannot be viewed in isolation but must be viewed in a broad international context. As noted by the OECD, "In the case of tax administrations, specific problems arise at both policy and practical levels. At the policy level, countries need to reconcile their legitimate right to tax a taxpayer based upon income and expenses that can reasonably be considered to arise within their territory with the need to avoid the taxation of the same item by more than one tax jurisdiction. Such double or multiple taxation can create an impediment to cross-border transactions in goods or services and the movement of capital. At a practical level, a country's determination of income and expense allocation may be impeded by difficulties in obtaining pertinent data located outside its own jurisdiction."[49]

These comments summarize the difficulties facing jurisdictions that wish to protect their tax base while not unduly encumbering the flow of goods, services and capital. In the recommendations that follow, an attempt has been made to achieve this balance; in doing so, significant reliance has been placed on the discussion of these issues by the OECD, as reflected in its transfer-pricing guidelines.

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[49] OECD, *supra*, p. P-1, para. 4.

Basis for determining non-arm's-length prices

- Canada should continue to apply the transactional methods endorsed by the OECD when evaluating intercompany transfer pricing used between related parties.[50]
- The general and flexible "reasonable in the circumstances" arm's-length criterion of section 69 of the *Income Tax Act* does not require amendment.

Revenue Canada has acknowledged its general acceptance of the OECD guidelines and revisions to *Information Circular 87-2* to confirm this acceptance are anticipated. The OECD guidelines agree with the transactional-based approach of the *Income Tax Act*. Revenue Canada should continue to endorse and follow the OECD guidelines as they appear to achieve the balance needed between protecting the domestic tax base without creating double taxation.

It is recognized as a fundamental principle of Canadian taxation that members of a related domestic or international group must be taxed on the basis as though they deal at arm's length with each other. However, common ownership allows group members to act with a common objective; such an objective is rarely found in true arm's-length transactions. Nonetheless, most MNEs do attempt to take into account various factors when setting intercompany transfer prices and, with the encouragement of tax authorities, to use reasonable pricing methods.[51]

Consequently, the OECD states that "tax administrations are encouraged to take into account the taxpayer's commercial judgement about the application of the arm's-length principle in their examination practices and to undertake their analyses of transfer pricing from that perspective."[52]

In paragraph 1.12 (p. I-5) of its guidelines, the OECD makes an important point: "The arm's-length principle usually requires taxpayers and tax administrations to evaluate uncontrolled transactions and the business activities of independent enterprises, and to compare these with the transactions and activities of associated enterprises, it can demand a substantial amount of data. …. It should be recalled at this point that ***transfer pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and the taxpayer***." (emphasis added).

Some have suggested that Canadian transfer-pricing rules should be made more specific and translated into legislation. As noted previously and pending the outcome of the SmithKline case, there have been no cases dealing with transfer pricing as the sole matter. Accordingly, it is not known whether the current tax legislation has sufficient teeth to deal with transfer pricing abuses.

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[50] Revenue Canada endeavours to apply three preferred transactional methods, CUP, resale minus, and cost plus. When it is not possible to do so, or if Revenue Canada considers it more appropriate, other methods, including profit splits, may be used. Each of these approaches is approved by the OECD.

[51] At paragraph 1.2 the OECD states: "Tax administrations should not automatically assume that associated enterprises have sought to manipulate their profits... The consideration of transfer pricing should not be confused with the consideration of problems of tax fraud or tax avoidance even though transfer-pricing policies may be used for such purposes."

[52] OECD, *supra*, P-5.

In the meantime other jurisdictions, most notably the United States have set out detailed tax rules and procedures.

It is suggested that, while detailed legislation may be attractive from a purely domestic perspective, it may not allow for the degree of judgment and flexibility required in an international context. Accordingly, a system that sets out a general standard (i.e. transactional arm's-length pricing method) and comprehensive guidelines for applying the standard (such as the OECD Guidelines) should be preferred, particularly for a country that imports capital. It is suggested that the present provisions of section 69 of the *Income Tax Act* are sufficient for this purpose. Nonetheless, as recommended below, Canada should enact documentation standards and penalty provisions targeted at transfer-pricing abuses.

Administrative policies and guidelines

- Information *Circular IC 87-2* should be updated and reissued as soon as possible. It should be more comprehensive in scope and should contain more extensive examples. As well, the Circular should be more specific in identifying the administrative approaches applied by Revenue Canada in evaluating the TPM used by taxpayers.
- Customs and Goods and Services Tax (GST) principles should be more consistent with the Income Tax approach to resolving transfer-pricing disputes.
- An executive interchange program should be initiated between the department and the private sector, where appropriate, to encourage the sharing of expertise.
- Revenue Canada should provide guidance on how it intends to use T-106 and tax-return reporting in its transfer-pricing enforcement and review.

As recommended above, the Canadian transfer-pricing principle and policies should be based on the principles enunciated in the OECD guidelines. Canada's application of transfer-pricing policies is set out in its *Information Circular IC 87-2*. This circular was based on the 1979 OECD guidelines and is in the process of being updated. If Canada is to continue to follow the OECD guidelines in general, it is important that any exceptions to the Guidelines be known as soon as possible. Accordingly, Revenue Canada should complete its revisions to the Circular and consider announcing any differences between the Guidelines and the revised circular, before it is released.

The circular should be expanded to make it more comprehensive. In Australia, the ATO has issued a detailed draft ruling (similar to an information circular) that could serve as a model for Revenue Canada's revised circular.

The OECD guidelines apply to income tax matters. In addition, transfer pricing can affect the amount of customs or excise taxes raised. Different international conventions and agreements, such as the General Agreement on Tariffs and Trade (GATT), apply for customs purposes. Nonetheless, taxpayers are often left with the dilemma that what is acceptable for income tax purposes may be challenged for customs or excise tax purposes or vice versa. With the integration of Revenue Canada's customs, excise and income tax divisions, more consistency in application of standards is to be expected.

As noted by the OECD, determining appropriate transfer prices is not an exact science - a great degree of judgment most be brought to bear. Revenue Canada, and taxpayers, have benefited in the past from exchanges of personnel. This practice has been followed, for example, in the rulings directorate. Transfer pricing expertise and experience could be another area where such exchanges are appropriate. It is recognized that there are some issues that would have to be overcome before embarking on such a program. Transfer-pricing issues, while perhaps not as technically complex as rulings, do involve a significant period of time being spent to gather and evaluate relevant information. Potentially, more sensitive commercial information must be disclosed in the course of a transfer-pricing review, and enterprises would not wish to share this information with a competitor participating in an exchange program. Nonetheless, this is an idea that should be evaluated as a way to make business experience available to Revenue Canada's transfer-pricing specialists.

Revenue Canada has compiled information from T-106s submitted by taxpayers. It is using this information to initiate tax programs and audits.[53] Revenue Canada should provide general guidance to taxpayers on how this information is to be used. At present, taxpayers do not know how responses to various questions on the T-106 will affect them, or other taxpayers. For example, the SIC codes used for T-106 purposes are somewhat more condensed than the general SIC numbers, and it is often possible to use more than one (or none) of the T-106 codes to describe a taxpayer. At this time taxpayers are uncertain as to the implications of choosing one code over another. It is recommended that Revenue Canada provide more guidance to, and seek suggestions from, taxpayers on the use and completion of this important form.

Examination practices

- Revenue Canada should continue the specialized training and status of personnel involved in transfer-pricing audits. Involvement of these trained specialists should be mandatory in all transfer pricing reviews.
- TSO transfer-pricing specialist personnel should include legal and economic support.
- Until more experience is gained by TSO personnel, proposed transfer-pricing reassessments should be referred to the International Tax Directorate in Ottawa to ensure consistency across the country. Taxpayers should be allowed to participate in the referral process.

As noted in the Ernst & Young studies referred to above, Revenue Canada has been very active in auditing international transactions and MNEs. Revenue Canada has increasingly used trained transfer-pricing personnel in its audits of MNEs. This is desirable from both Revenue Canada's perspective and that of taxpayers, particularly given the judgment that must be brought to bear in identifying and resolving transfer-pricing issues.

[53] See footnote 2, *supra*.

Taxpayers are increasingly using non-traditional resources in dealing with sophisticated transfer-pricing issues. For example, the U.S. regulations generally result in an economist or process engineer being used to complete and evaluate functions performed by the related parties. Revenue Canada auditors will likely require more direct access to these specialists when dealing with transfer-pricing issues, and plans should be made to meet these needs and to provide the necessary resources.

Transfer-pricing disputes can be quite complex and expensive, as the time and effort needed to develop and document a position can be considerable.[54] Interpretation of transfer-pricing principles can be quite subjective. It is therefore not surprising that the evaluation of a particular transfer-pricing policy will vary from taxpayer to taxpayer and between individual Revenue Canada auditors, as such decisions will reflect not only the relevant facts and circumstances, but also the experiences of the individuals involved. Accordingly, it is important the consultations be open and that as much experience as is available be brought to bear.

As noted above, transfer-pricing disputes do not only have domestic implications. From an international perspective, consistency is expected in similar circumstances. Accordingly, it is important that Revenue Canada's application of transfer-pricing policies be as consistent as possible. Under Canada's tax treaties, a mechanism is in place for resolving potential double-taxation issues through the competent authority process with the other country(ies). Canada's competent authority personnel have considerable experience in resolving these matters successfully.

Consequently, it is important that those involved in potential transfer-pricing adjustments receive the benefit of this experience, before reassessments are first proposed. While a taxpayer may request such assistance, smaller taxpayers are often reluctant to do so because of concerns about the time and money that may be involved. Revenue Canada may be in a better position to initiate such consultations and should do so as a matter of course to ensure national consistency.

Burden of proof

- Taxpayers should be expected to be able to support the reasonability of related-party transfer pricing through contemporaneous documentation. The extent of documentation needed will vary from case to case, but will likely not be as extensive as that required for U.S. tax purposes.

Under Canada's tax system, the burden of proof in tax disputes often lies with the taxpayer. However, in transfer-pricing disputes, it appears that Revenue Canada must show that the taxpayer's method was not reasonable in the circumstances. In effect, the burden of proof is shifted. This may not be an inappropriate result, particularly given the potential for double taxation.

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[54] See comments on the 1996 Ernst & Young documentation survey, *supra*.

However, taxpayers must assume some responsibility for supporting their transfer-pricing policies, even in the absence of a pending tax audit or challenge. As noted in the 1996 Ernst & Young study, few respondents intended to prepare documentation for non-U.S. purposes. From a domestic perspective, particularly given the continuing controversy about the CPM, this is probably not acceptable. In the absence of voluntary documentation, it seems appropriate for Canada to introduce documentation requirements of its own.

It is recommended that this documentation be restricted to sufficient information to support the reasonability of the method chosen by the taxpayer for transfer-pricing purposes. Unlike the U.S. system, which requires the best method be selected, choice of a reasonable price should not require that all other methods be evaluated.[55]

It is suggested that the following documentation be required:

- an outline of the business and intercompany relationships;
- details of intercompany transactions;
- the transfer-pricing method(s) chosen;
- relevant supporting information and analysis, including comparables;
- special conditions, e.g. market penetration strategies, affecting intercompany pricing; and
- a functional analysis.

In the case of companies dealing with related parties in the United States, most of this information should be available from the documentation required under the U.S. transfer-pricing legislation, resulting in relatively little incremental cost in developing supporting documentation for Canadian tax purposes.

Penalties and compliance requirements

- Given the need to balance fairness and simplicity against the pressures of detailed information reporting and the penalties applied under other tax regimes, and given the need to balance flexibility and uncertain rules against inflexibility and very detailed rules, Canada is well served by less specific rules than those followed in the United States.
- Revenue Canada's initiatives in increasing its review of related-party transactions are warranted; and its continuing advocacy of increased use of simultaneous examinations is desirable. Real-time audits of transfer-pricing transactions should be encouraged.
- Canada should introduce specific penalties for underreporting of income due to transfer-pricing manipulation. Such penalties should differentiate between taxpayers who act in reasonably good faith (as evidenced by contemporaneous documentation) and those who do not.

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[55] Revenue Canada suggests that all methods need to be considered. For example, the APA program requires that a taxpayer explain why a particular method is not considered appropriate for the transaction(s).

Compliance with transfer-pricing principles and standards concerns all tax authorities. When one or more tax regimes impose penalties to ensure compliance with their system, other tax authorities will be rightly concerned that taxpayers will be motivated to over-comply with that authority's rules.[56] Canada faces that very situation – with its largest trading partner, the United States.

It has been suggested that some balance is needed and that Canada should introduce penalties for non-compliance. In designing any penalties, the following principles should be applied.[57]

- "No fault" or automatic penalties should not be applied. Severe penalties which apply based on the mere existence of an understatement are inappropriate, particularly when such understatement is due to an error made in good faith.
- The amount of penalty should be significant enough to warrant attention but not unreasonable. A 20 to 30 percent penalty may be appropriate where evidence of reasonable good faith is lacking.
- Penalties should be related to the lack of reasonable documentation and to situations where good faith is lacking.

Given that most T106 filings appear to involve the United States,[58] it is relevant to look to the approach used there. Penalties can be avoided in the United States if there is reasonable documentation in accordance with its penalty regulations. As U.S. affiliates of Canadian taxpayers must comply with the U.S. documentation requirements, and as there are differences in the application of the arm's-length standard between the U.S. and Canada, it seems appropriate to base the good-faith standard on whether the taxpayer has compiled documentation reflecting Canadian standards. In addition, the availability of Canadian-oriented documentation should enhance the ability of the taxpayer and Revenue Canada to deal with transfer-pricing audits on a timely and more cost-effective basis.

Revenue Canada should have the discretion to waive any transfer pricing penalties pursuant to subsection 220(3.1) of the *Income Tax Act.* This discretion would be appropriate, for example, if the tax reassessed by Revenue Canada is subsequently adjusted pursuant to the competent authority procedures of one of Canada's tax treaties.

The advance-pricing agreement program

- The APA program is vital to fair and open administration of the tax system and to keep the Canadian system competitive and fair.

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[56] The OECD makes a similar observation at paragraph 4.26 of its Guidelines (*supra*).

[57] The OECD guidelines comment that the member states concur that sizable no-fault penalties are unduly harsh in good-faith situations and should not be applied where taxpayers have made a reasonable effort to comply with the arm's-length standard, OECD, *supra*, para. 4.28.

[58] See footnote 2.

- The APA program requires additional resources and a "fast-track" APA or informal APA procedure should be made available for smaller companies.[59]

The APA program is a welcome development and provides a reasonable means to reduce transfer-pricing exposure. The APA program is still in its early stages and, with the exception of modified procedures for smaller, fast-track APAs, should be continued in its present form until more cases have been considered and resolved.

Competent Authority

- Canadian taxpayers should be kept fully aware of progress of Competent Authority procedures affecting them.

Taxpayers involved in the competent authority process have expressed concern with the amount of time involved in competent authority resolution of matters and with their perceived lack of involvement in the process. As noted by the OECD, the competent authority procedure is not a process of litigation and the taxpayer's participation should be subject to the discretion of the competent authorities.[60] As the procedure is a negotiation between governments, this conclusion is probably appropriate. Nonetheless, in recognition of the frustrations expressed by taxpayers, the Canadian competent authority should endeavour to keep them informed on a timely basis as to the progress of discussions with the other competent authority.

[59] Currently Revenue Canada has accepted two smaller, fasttrack APAs for consideration.
[60] OECD, *supra*, para. 4.58.

Technical Committee on Business Taxation

The Technical Committee was established by the Minister of Finance, at the time of the March 1996 federal budget, to consider ways of:

- improving the business tax system to promote job creation and economic growth,
- simplifying the taxation of businesses to facilitate compliance and administration, and
- enhancing fairness to ensure that all businesses share the cost of providing government services.

The Technical Committee will report before the end of 1997; consultations with the public will follow the release of the report.

The Technical Committee is composed of a panel with legal, accounting and economic expertise in the tax field. The members are:

Mr. Robert Brown
Price Waterhouse
Toronto, Ontario

Mr. James Cowan
Stewart McKelvey Stirling Scales
Halifax, Nova Scotia

Mr. Wilfrid Lefebvre
Ogilvy Renault
Montreal, Quebec

Professor Nancy Olewiler
Department of Economics
Simon Fraser University
Burnaby, British Columbia

Mr. Stephen Richardson
Tory, Tory, Deslauriers & Binnington
Toronto, Ontario

Professor Bev Dahlby
Department of Economics
University of Alberta
Edmonton, Alberta

Mr. Allan Lanthier
Ernst & Young
Montreal, Quebec

Professor Jack Mintz (Chair)
Faculty of Management,
University of Toronto (on leave)
Clifford Clark Visiting Economist
Department of Finance
Ottawa, Ontario

Mr. Norm Promislow
Buchwald Asper Gallagher Henteleff
Winnipeg, Manitoba

The Technical Committee has commissioned a number of studies from outside experts to provide analysis of many of the issues being considered as part of its mandate. These studies are being released as working papers to make the analysis available for information and comment. The papers have received only limited evaluation; views expressed are those of the authors and do not necessarily reflect the views of the Technical Committee.

A list of completed research studies follows. They may be requested from:

Distribution Centre
Department of Finance
300 Laurier Avenue West
Ottawa, Ontario K1A 0G5
Telephone: (613) 995-2855
Facsimile: (613) 996-0518

They are also available on the Internet at http://www.fin.gc.ca/

Technical Committee on Business Taxation Completed Research Studies

- ☐ **WORKING PAPER 96-1**
  Comparison and Assessment of the Tax Treatment of Foreign-Source Income in Canada, Australia, France, Germany and the United States
  Brian Arnold (Goodman Phillips & Vineberg)
  Jinyan Li and *David Sandler* (University of Western Ontario)

- ☐ **WORKING PAPER 96-2**
  Why Tax Corporations
  Richard Bird (University of Toronto)

- ☐ **WORKING PAPER 96-3**
  Tax Policy and Job Creation: Specific Employment Incentive Programs
  Ben Cherniavsky (Technical Committee Research Analyst)

- ☐ **WORKING PAPER 96-4**
  The Effects of Taxation on U.S. Multinationals and Their Canadian Affiliates
  Jason Cummins (New York University)

- ☐ **WORKING PAPER 96-5**
  The Integration of Corporate and Personal Taxes in Europe: The Role of Minimum Taxes on Dividend Payments
  Michael Devereux (Keele University)

- ☐ **WORKING PAPER 96-6**
  International Implications of U.S. Business Tax Reform
  Andrew Lyon (University of Maryland)

- ☐ **WORKING PAPER 96-7**
  The Economic Effects of Dividend Taxation
  Ken McKenzie (University of Calgary)
  Aileen Thompson (Carleton University)

- ☐ **WORKING PAPER 96-8**
  Capital Tax Issues
  Peter McQuillan and *Cal Cochrane* (KPMG Toronto)

- ☐ **WORKING PAPER 96-9**
  Compliance Issues: Small Business and the Corporate Income Tax System
  Robert Plamondon (Ottawa)

- ☑ **WORKING PAPER 96-10**
  Study on Transfer Pricing
  Robert Turner (Ernst & Young, Toronto)

- ☐ **WORKING PAPER 96-11**
  The Interaction of Federal and Provincial Taxes on Businesses
  Marianne Vigneault (Bishop's University)
  Robin Boadway (Queen's University)

- ☐ **WORKING PAPER 96-12**
  Taxation of Inbound Investment
  Gordon Williamson (Arthur Andersen, Toronto)