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CRA Seeks to Recharacterize Transfer Pricing Transactions

A senior official of the Canada Revenue Agency (CRA) recently noted that CRA auditors have proposed to recharacterize transfer pricing transactions in 12 files referred to the CRA's Transfer Pricing Review Committee (TPRC). To date, the TPRC has not decided whether it will approve the application of the *Income Tax Act's* recharacterization rules in these cases. This information was presented at the KPMG Global Transfer Pricing Services Seminar Series on May 24 and 26, 2005, in Detroit and Chicago.

KPMG observation

The discretion to recharacterize transactions is a unique feature of Canadian transfer pricing law. The CRA gained this power in 1998, but there have been no reports of CRA auditors trying to exercise it until recently. While the TPRC has yet to approve any recharacterizations, the above statistic reveals that CRA auditors are willing to attempt to use this tool.

New transfer pricing guidance in the works

The official indicated that, in addition to the five existing transfer pricing memoranda, the CRA intends to publish new memoranda providing guidance on:

- the meaning of reasonable efforts
- time limitations for notification under Canada's tax treaties
- the use of external experts in transfer pricing cases
- bundling transactions in transfer pricing analyses.

KPMG observation

In its forthcoming advice on bundling transactions, it is expected that the CRA will in fact reiterate its preference for unbundling transactions and assigning transfer pricing values to the various bundled elements. In this memorandum, the CRA may also explain its reasoning behind its position that such unbundling is not the same as recharacterizing the transaction.

CRA hires more economists

On a final note, the official said that the CRA hired five new economists in May 2005 and plans to hire five more economists in the near future, which appears to confirm that the CRA is strengthening its resources in the transfer pricing area.

For details, please contact François Vincent [fvincent@kpmg.ca - (514) 840-2583], National Leader of KPMG's Transfer Pricing practice in Canada or your KPMG adviser or any of the following:

Calgary	Michael Hoffman	(403) 691 7984	mdhoffman@kpmg.ca
Montreal	François Vincent	(514) 840-2583	fvincent@kpmg.ca
	Stéphane Dupuis	(514) 840-2119	stephanedupuis@kpmg.ca
Toronto	Mary Furlin	(416) 228-7202	mfurlin@kpmg.ca
	James Gatley	(416) 228-7091	kgatley@kpmg.ca
	Robert Davis	(416) 228-7149	robertdavis@kpmg.ca
South Western Ontario	Joseph Devitt	(519) 747-8898	jdevitt@kpmg.ca
Vancouver	Gordon Denusik	(604) 691-3158	gdenusik@kpmg.ca
	Michael Glaser	(604) 691-3165	mglaser@kpmg.ca

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