



TaxNewsFlash

Canada

Year-End Review — Transfer Pricing Considerations

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Multinational enterprises (MNEs) should take time before the end of the 2023 calendar year to review and assess if their transfer pricing arrangements are producing arm's-length prices and review other time-sensitive transfer pricing matters. As the 2023 calendar year represents the fiscal year-end for many MNEs, it's a good opportunity to consider the evolving Canadian and global tax and transfer pricing landscape, and changing economic conditions that are expected to have an impact into 2024.

In particular, MNEs should take stock of the latest progress on many key global tax initiatives this past year. For example, the BEPS 2.0 Pillar Two global minimum tax rules will come into effect in 2024 in many countries, including Canada, the United Kingdom, Australia, Korea and some countries in the European Union. As part of the year-end review, MNEs should not only consider today's transfer pricing and international tax implications, but also look at the potential for future ramifications.

Transfer pricing — Recent global developments

In light of these and other important changes, MNEs may want to consider taking action to address the following developments:

- Finance's public consultation on Canadian transfer pricing rules
- Canadian MAP activity
- Expanded mandatory disclosure rules
- Digital Services Tax

- Sustained higher interest rates
- Pillar One — Amount B
- Pillar Two — Country-by-country compliance and mitigation
- Public country-by-country reporting
- Ongoing concerns about economic uncertainty
- Year-end adjustments
- Changing transfer pricing compliance requirements

Finance's public consultation on Canadian transfer pricing rules

MNEs may want to revisit their transfer pricing policies to assess the potential impact of changes included in Finance's consultation paper released in June 2023. These proposed changes are intended to provide more clarity on the application of the arm's-length principle and to better align the Canadian transfer pricing rules with evolving international standards and transfer pricing guidance published by the Organization for Economic Co-operation and Development.

In particular, Finance proposes amendments that would emphasize two elements for transfer pricing analysis:

- A first rule that would set the starting point of the comparison of arm's length transactions with reference to the economically relevant characteristics
- A second rule that relates to the hypothetical comparison of the conditions that the parties would include at arm's length in comparable circumstances.

Finance also proposes rules intended to ensure that a broader range of conditions are scrutinized, as opposed to only the pricing or other conditions stemming from intra-group contracts. Specifically, Finance proposes to replace the current recharacterization provisions with a non-recognition test and replacement rule when delineated transactions meet certain conditions. The legislative proposals also include certain administrative changes, such as:

- The adoption of the Master File for larger MNE groups
- Increasing the transfer pricing penalty threshold to \$10 million
- Streamlining benchmarking requirements for low value add services
- A safe harbor rule for relatively routine distribution activities

- Limits on the range of acceptable loan terms and conditions.

For details, see *TaxNewsFlash-Canada* 2023-24, “[Finance Unveils Consultation on Canadian Transfer Pricing Rules](#)”.

Canadian MAP activity

The OECD released its latest statistics on mutual agreement procedures (MAP) on November 14, 2023, which look at the 2022 calendar year and show that MAP continues to be an effective tool to eliminate double taxation arising from transfer pricing audit adjustments. According to the OECD’s report:

- Canada is completing transfer pricing MAP cases in 23.53 months, which is meeting the 24-month target and is better than the global statistic of 28.9 months
- Most of Canada’s MAP activity is with the United States, followed by France, Germany and Switzerland
- 74% of Canada’s MAP cases are achieving full double taxation relief, with another 7% achieving partial relief in Canada for transfer pricing cases.

The OECD also provided Canada with an award for having the fewest cases remaining in inventory that were initiated before 2016.

Expanded mandatory disclosure rules

Taxpayers should review significant new Canadian mandatory disclosure rules (MDR) that took effect in June 2023. Under these rules, Canadian businesses may need to report certain transactions occurring after June 22, 2023 to the CRA or face significant penalties. Certain corporate taxpayers also must disclose information about uncertain tax treatments reflected in their financial statements for taxation years that begin on or after January 1, 2023.

Affected taxpayers should assess these new reporting obligations and implement a process to identify and track these reporting requirements to help avoid both onerous penalties and being subject extended reassessment periods. Taxpayers should also be aware that they may also have similar obligations under Quebec’s disclosure rules. These new MDRs should be considered in light of the MNE’s intercompany transactions and transfer pricing policies.

For details, see *TaxNewsFlash-Canada* 2023-41, “[Mandatory Reporting — CRA Posts Notifiable Transactions](#)”, *TaxNewsFlash-Canada* 2023-21, “[Get Ready for New Mandatory Reporting Obligations](#)” and *TaxNewsFlash-Canada* 2023-27, “[Mandatory Reporting Rules — CRA Clarifies New Obligations](#)”.

Digital Services Tax

Large businesses should consider the impact of the revised draft legislative proposals for the new 3% Digital Services Tax (DST). Canada announced that it intends to move ahead with the new DST if the convention to implement Pillar One is not in force on January 1, 2024. The new DST would apply retroactively to certain services revenues from online marketplaces, social media, online advertising and user data (collectively “digital services revenue”) earned effective January 1, 2022.

As a result, MNEs with digital services revenue should review and assess if the revised proposals are applicable and determine how they will affect the underlying calculations. MNE’s should keep in mind that the DST applies to digital services revenue in Canada; the physical location of the MNE (in-Canada or outside Canada) and transfer pricing policies will not have any bearing on the DST.

For details, see *TaxNewsFlash-Canada* 2023-33, [“Businesses — Canada Revises Digital Tax Proposals”](#).

Sustained higher interest rates

It appears that 2024 could be another interesting year for the transfer pricing for financial transactions. MNEs will likely need to continue to balance the preference for an efficient capital structure and the various interest expenses requirements being proposed and imposed by tax authorities around the globe. Several countries, such as the Netherlands, Germany, and Brazil officially adopted some version of the OECD’s Chapter X Guidance on Financial Transactions. This adoption implies that MNEs need to pay attention to both sides of any financing transaction by analyzing the borrower and considering the decision-making and risk-taking ability of a lender, or the substance in a cash pool header.

The implementation of new limitations on interest deductibility (often as a percentage of EBIT or EBITDA) will create caps on total permissible interest deductions. In Canada, Finance has issued its proposed rules to limit the amount of interest and other financing expenses that may be deducted for Canadian income tax purposes. These complex rules, known as the excessive interest and financing expenses limitation (EIFEL) rules, generally limit the amount of net interest and financing expenses that may be deducted by affected corporations and trusts. These rules are proposed to apply to taxation years beginning on or after October 1, 2023. Finance is expected to release finalized legislation to implement these rules in the near future.

MNEs may want to reconsider how best to optimize their financing needs subject to the various constraints on debt capacity, applicable interest rates, and the total interest deductions.

For details, see *TaxNewsFlash-Canada* 2023-30, [“EIFEL Rules — Finance Further Revises Proposals”](#).

Pillar One — Amount B

MNEs should also consider the latest developments related to Amount B, the OECD’s project to simplify and streamline the application of the arm’s length principle to “baseline marketing and distribution activities”. Although the Inclusive Framework did not reach consensus on the OECD’s public consultation document for Amount B, this document specifies that in-scope transactions are expected to be priced by reference to a pricing matrix. The OECD Amount B Document presents the range of return on sales (ROS) results that distributors in the scope of Amount B would generally be expected to achieve, considering the distributor’s specific features such as the level of operating assets, operating expense or the industry in which they operate. The OECD has indicated it intends to include Amount B in its transfer pricing guidance as soon as January 2024.

MNEs should review the distributors in their supply chains to determine if these distributors are likely to be in scope of Amount B and, if so, perform modelling to understand the impact of the pricing matrix on their existing transfer pricing. Depending on the results of their modelling, some MNEs may want to consider potential steps to help ensure that they are more clearly included or excluded from Amount B, to determine the position in the Amount B pricing matrix befitting their functional profile, or to ease operational transfer pricing challenges associated with Amount B.

For details, see *TaxNewsFlash-Canada* 2023-28, [“OECD provides Pillar One and Pillar Two Update”](#).

Pillar Two — Country-by-country compliance and mitigation

The Pillar Two global anti-base erosion (GloBE) rules are coming into effect in many countries in 2024. MNEs with annual revenues above 750 million Euros will need to prepare for new Pillar Two-related financial reporting and compliance burdens. In order to collect the significant amount of data required for Pillar Two compliance, MNEs should review their Pillar Two calculations, identify data gaps, and work across different functional groups within the MNE to bridge those gaps.

With the implementation of Pillar Two making global progress, many MNEs are considering how to manage the impact of these rules within their group. For example, MNEs may explore how blending within a jurisdiction may result in a rate closer to 15%, determine how they could maximize the benefit of the substance-based income exclusion, or discuss with governments how incentive regimes could be amended in light of Pillar Two. MNEs may also consider restructuring out of jurisdictions that are no longer aligned with their business needs, in favour of jurisdictions that are better aligned and improve the MNEs GloBE outcomes.

In Canada, Finance has released 147 pages of draft legislation to enact a new Canadian Global Minimum Tax Act, which is largely based on and should be read in conjunction with the OECD's Pillar Two GloBE model rules and other OECD documents.

For details, see *TaxNewsFlash-Canada* 2023-31, "[Multinationals — Act Now to Meet Pillar Two Obligations](#)".

Public country-by-country reporting

MNEs that are categorizing data needed for Pillar Two compliance should also categorize additional country-level data that is expected to be needed under impending public country-by-country (CbC) reporting in the next few years. Public CbC reporting requirements will require MNEs to disclose parts of the CbC reports that previously were only disclosed to tax authorities with their tax return filings. Most MNEs likely do not have this data easily arranged by country. While they work through their Pillar Two data gaps, many MNEs are asking whether it may be a good time to reconfigure systems, collect the data, and consider if they should report each country's tax data beyond corporate income tax to provide a more complete picture of the tax they are contributing.

Taking action on these decisions is important since many countries and jurisdictions around the world continue to make progress on CbC reporting initiatives. In particular, the EU's public CbC reporting directive was approved in 2021 and comes into effect for calendar year MNEs in 2025, although some countries, such as Romania, have adopted reporting early. In addition, Australia's public CbC reporting will apply to periods beginning on or after July 1, 2024. The Financial Accounting Standards Board (FASB) also recently approved a proposal to require MNEs to provide a detailed breakdown of the income taxes they pay globally.

Ongoing concerns about economic uncertainty

Some MNEs may want to consider updating their transfer pricing based on actual or expected economic and business slowdowns. For example, MNEs expecting systemwide losses should consider where they expect to incur those losses and how they will support any transfer pricing associated with those losses. MNEs should prepare robust transfer pricing documentation that supports the extraordinary results. MNEs expecting systemwide losses may also want to revisit their transfer pricing policies and explore if the policies remain appropriate.

Year-end adjustments

MNEs that are struggling to perform their year-end adjustments correctly, or that realize they need to make large adjustments at year-end, should consider operational transfer pricing (OTP) solutions. OTP refers to the implementation of transfer pricing policies to effectuate or account for transfer prices in an organization's financial statements. OTP includes gathering and organizing data to apply the policies, setting transfer prices, and

monitoring and calculating adjustments. The increased scrutiny on transfer pricing results and the ever-changing tax regulatory landscape highlights the importance of strong OTP.

For MNEs that have made acquisitions during the year, it is important to understand applicable transfer pricing policies, identify the needed financial data to apply the policy, and book the appropriate transactions with the correct related parties. But even MNEs with no significant changes during the year may be required to make year-end adjustments, among others, if transactions are either based on budgeted financial data (particularly relevant in cases where there are exceptional or new costs incurred during the year that were not factored into the budgeted costs) or targeted margins (often the case with companies that operate as limited risk distributors, assemblers, tollers, contract manufacturers and limited risk service providers).

Transactions that show unexpected losses or unusual gains, even after the transfer pricing policy is applied, should be further analyzed to determine the causes of such variances from the intended results. Simply having results that fall outside the intended range does not necessarily imply that the applied transfer pricing policy is incorrect.

MNEs with intercompany financing transactions should review their loan agreements and accounting entries prior to year-end to help ensure they adhere to the terms and conditions (e.g., breached financial covenants, loans maturing/expiring with no new/amended loan agreement or updates to reflect arm's length interest rates).

Finally, it is also important to consider the impact of a year-end transfer pricing adjustment on customs compliance to help mitigate any unintended customs risks.

Changing transfer pricing compliance requirements

Transfer pricing documentation requirements continued to evolve this year and it is important for MNEs to assess the impact on compliance for 2024 and future years. Countries with significant changes in transfer pricing rules include:

- The United Kingdom
- Brazil
- Saudi Arabia
- Kenya
- Malaysia
- Seychelles.

Other countries to watch for transfer pricing changes in the future include:

- France

- Korea
- Luxembourg.

We can help

Your KPMG adviser can help you assess the effect of these new developments on your transfer pricing arrangements. For more details, contact a KPMG Transfer Pricing professional in Canada.

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