KPMG

TaxNewsFlash

Canada

2024 Transfer Pricing Review — Year-End Tune-Up

December 4, 2024
No. 2024-47

Multinational enterprises (MNEs) with December year-ends should review and assess their existing transfer pricing arrangements before the end of the year. As part of this review, MNEs should determine whether they should initiate any year-end transfer pricing adjustments to ensure these arrangements are consistent with the MNE's business operations, objectives and the arm's length principle. An in-depth review should also entail considering other developing transfer pricing issues to help mitigate the need to make significant transfer pricing adjustments for 2025.

Top transfer pricing concerns
This publication outlines several critical areas that MNEs should consider before they close their books for 2024 and have top of mind for 2025:

- Year-end adjustments
- Pillar One — Amount B
- Pillar Two — Global Minimum Tax
- CRA audits and Canadian mutual agreement procedures (MAP) activity
- Potential tariffs on imported Canadian goods

Year-end adjustments

MNEs should consider whether they need to make transfer pricing adjustments before the end of the year. In particular, this can be important for MNEs that implemented significant changes in 2024. However, all MNEs should consider this review to ensure that the transfer prices reported in their books are consistent with their business operations and the transfer pricing policies set at the beginning of the year.

As part of this review, MNEs should analyze transactions that lead to unexpected losses or unusual gains, even after applying the transfer pricing policy, to determine what is causing the unintended results. These losses and gains may not necessarily result from an incorrect transfer pricing policy, mitigating the need to make a year-end adjustment.

MNEs that have entered into intercompany financing transactions should review their accounting entries to ensure they are consistent with the terms and conditions of the relevant loan agreements (e.g., breached financial covenants, loans maturing/expiring with no new/amended loan agreement or updates to reflect arm's-length interest rates). In addition, not only is it essential for MNEs that have made acquisitions during the year to understand the applicable transfer pricing policies, they also must identify the necessary financial data to apply the policies and book the appropriate transactions with the correct related parties.

Even MNEs that did not make significant changes during the year may still be required to make year-end adjustments if they recorded the transfer prices based on budgeted financial data, which they must "true up" before year-end. This review is particularly relevant in cases where the MNE incurs exceptional or new costs during the year that it did not factor into the expenses budgeted. MNEs may also need to make year-end adjustments to achieve targeted margins for entities operating as limited-risk distributors, assemblers, tollers, contract manufacturers or limited-risk service providers.

Note that, when making year-end transfer pricing adjustments, it is important to consider the impact of those adjustments on cross-border customs compliance to help mitigate any unintended customs risks (e.g., increased tariffs).

KPMG observations
MNEs that need help performing their year-end adjustments correctly or realize they need to make significant adjustments at year-end should consider operational transfer pricing (OTP) solutions. OTP involves implementing 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.

Pillar One — Amount B

MNEs should consider the latest developments related to Amount B under Pillar One, the OECD's project to simplify and streamline the application of the arm's-length principle for baseline marketing and distribution activities. The OECD introduced a Simplified and Streamlined Approach that calculates the range of return on sales (ROS) that in-scope distributors would generally earn based on their industry, operating asset intensity, operating expense intensity and the country in which they operate. The OECD intends to incorporate the Simplified and Streamlined Approach into the OECD Transfer Pricing Guidelines.

MNEs should determine whether distributors in their supply chains are likely to be in scope for Amount B and, if so, perform modelling to understand the impact of the new pricing matrix on their existing transfer pricing arrangements. Depending on the results of the modelling, some MNEs may want to consider potential options to ensure that their distributors are more clearly included or excluded from Amount B's scope, in respect of a particular industry grouping or a particular position in the Amount B pricing matrix that is suitable for their operations. MNEs should also review the accuracy of their balance sheet data, particularly when they are required to segment that data for their distribution activities.

Although Amount B may affect how in-scope distributors calculate their returns in countries that choose to adopt it, existing documentation practices will largely remain the same, other than adding an appendix containing the Simplified and Streamlined Approach calculations to replace the appendix containing the traditional benchmarking study. For distributors involved in intercompany transactions with a counterparty in jurisdictions that do not adopt Amount B, documentation may become more complex. In that case, the documentation will require an Amount B analysis and traditional benchmarking for parties in the non-Amount B jurisdictions.

For details, see *TaxNewsFlash-Canada* 2024-25, "OECD Issues Additional Tax Guidance on Pillar One & Two".

KPMG observations
Generally, countries can choose whether to apply Amount B. Although Finance recently noted that Canada does not intend to adopt the Simplified and Streamlined approach at this time, Amount B may serve as a reference point for tax authorities worldwide. Currently there remains uncertainty over which countries will ultimately implement or apply Amount B, and several jurisdictions have expressed an interest to adopt and apply Amount B, including Argentina, Brazil, Costa Rica, Mexico and South Africa (members of the G20 or OECD, respectively). These countries are included in the list of covered jurisdictions.

Pillar Two — Global Minimum Tax

Many countries, including Canada, have implemented or are implementing the Pillar Two global anti-base erosion (GloBE) rules. These detailed and complex rules introduce a top-up tax to ensure that affected MNEs pay a minimum 15% corporate tax rate in each country they operate. MNEs with annual revenues above EUR 750 million are within the scope of the rules and will need to prepare for new Pillar Two-related financial statement disclosures and compliance obligations.

Canada enacted the Global Minimum Tax Act (GMTA) in June 2024 to implement rules generally consistent with the OECD's commentary and Pillar Two GloBE model rules. Specifically, under the GMTA, Canada implemented the Income Inclusion Rule and the Qualified Domestic Minimum Top-Up Tax, effective for fiscal years of qualifying MNEs that begin on or after December 31, 2023. In addition, Finance recently released draft legislation to implement a proposed Undertaxed Profits Rule (another component of Pillar Two) for fiscal years that begin on or after December 31, 2024. The latest draft legislation has yet to be included in a bill.

Considering these developments, MNEs should take a proactive approach to evaluate and prepare for the impacts of this global minimum tax, including reviewing Pillar Two considerations in their circumstances, working to identify and resolve data gaps early in the process and budget for multi-stakeholder complexities and resourcing needs to manage potential system changes over a multi-year period. The calculations are complex, with potentially hundreds of data points required across multiple countries. Given the significant amount of data needed for Pillar Two compliance, MNEs may need to use considerable automation in order to minimize implementation burdens.

For information on the enactment of the GMTA, see *TaxNewsFlash-Canada* 2024-27, "Canada Enacts Bundle of Outstanding Tax Measures".

KPMG observations
KPMG's comprehensive solution portfolio, KPMG BEPS 2.0 Automation Technology (KBAT), provides an end-to-end service that can support MNEs in navigating Pillar Two planning, implementation, and compliance.

CRA — Audit and Canadian MAP activity

Audit activity

Transfer pricing continues to be a focus for tax authorities worldwide, and Canada is no exception. In particular, there has been a noticeable increase in transfer pricing audits on the treatment of government subsidies, which may continue as the government introduces additional subsidies (e.g., clean energy tax credits). Transfer pricing adjustments may arise in industries where companies receive government subsidies to attract foreign investments (e.g., shared services, video game or software development) or previously received subsidies related to COVID-19 relief measures (e.g., Canada Emergency Wage Subsidy).

In taking preventative action, MNEs should remember the CRA's long-standing administrative position on the transfer pricing treatment of government subsidies, that taxpayers should not reduce their cost base by the amount of government subsidies received unless arm's-length parties would do the same in similar circumstances. However, MNEs should also keep in mind that the CRA treats foreign tax credits received by a taxpayer's foreign affiliates differently (contrary to a recent Tax Court of Canada decision).

Tax authorities continue to pursue other audit activities, including scrutinizing manufacturing plant closures, which may involve the transfer of existing sales contracts, inventory, equipment or personnel, renegotiating existing supplier agreements, or costs related to the closures, such as severance payments.

Canadian MAP activity

MNEs that have received a reassessment, resulting in double taxation or taxation that does not agree with a tax treaty, arising from transfer pricing audit adjustments, should consider Canada's MAP as a potentially effective dispute resolution mechanism to eliminate double taxation. The OECD's latest report on MAP, which presents statistics for the 2023 calendar year, shows the effectiveness of MAP, including that:

- Canada is completing transfer pricing MAP cases in 28.89 months, which is better than the global statistic of 32 months but overshooting the 24-month target
- Consistent with the previous year, most of Canada's MAP activity is with the United States, followed by France and Germany
- 82% of Canada's MAP cases achieve complete relief from double taxation, while another 2% achieve partial relief for transfer pricing cases in Canada.

As with 2022, the OECD awarded Canada for having the fewest cases remaining in inventory initiated before 2016.

Potential tariffs on imported Canadian goods

Canadian businesses should consider how they may be affected by significant U.S. tariffs that the United States could introduce next year. U.S. President-elect Donald Trump recently posted on social media that he is considering an executive order to enact a 25% tariff on all products entering the United States from Canada and Mexico starting January 20, 2025. If the United States enacts these changes, Canada may respond with retaliatory tariffs on U.S. goods, as has previously happened.

For details, see *TaxNewsFlash-Canada* 2024-45, "U.S. Vows 25% Tariffs on Imported Canadian Goods".

KPMG observations

A 25% tariff on goods imported into the United States from Canada may disrupt existing transfer pricing policies for certain Canadian multinationals selling goods through a U.S. related party distributor that earns a guaranteed target operating margin. The CRA may increasingly scrutinize this type of transfer pricing policy on the basis that these guarantees of profit will shift taxable income from Canada to the United States. As these transfer pricing issues may have an immediate impact on customs valuations, Canadian businesses in this situation may only have a short time to reconsider their transfer pricing policies and focus more on the transfer price the U.S. related party distributor will pay for the goods it purchases, rather than the profits that it should earn from its activities.

Canadian businesses that have yet to expand into the United States may find that this possible 25% tariff provides an excellent incentive to explore how different business models and transfer pricing can mitigate their impact. Now might be the right time for these businesses to set up a distribution warehouse closer to their biggest customers or expand their capacity through a U.S. manufacturing facility.

KPMG's Trade and Customs group can help assess the effect of any potential tariffs and discuss ways to mitigate their impact.

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.

Quebec

Demet Tepe
Canadian National Transfer Pricing Leader
dtepe@kpmg.ca

Marie-Pierre Thivierge
Partner, Transfer Pricing
mariepierrethivierge@kpmg.ca

GTA

Anthony Brown
Partner, Transfer Pricing
adbrown@kpmg.ca

Calgary

Michael Hoffman
Partner, Transfer Pricing
mdhoffman@kpmg.ca

Michelle Sledz
Partner, Transfer Pricing
msledz@kpmg.ca

Fang Qin
Partner, Transfer Pricing
fqin@kpmg.ca

GVA

Rob Davis
Partner, Transfer Pricing
robertdavis@kpmg.ca

Michael Glaser
Partner, Transfer Pricing
mglaser@kpmg.ca

Craig Reeder
Partner, Transfer Pricing
creeder@kpmg.ca

Mike Debruijn
Partner, Transfer Pricing
mdebruijn@kpmg.ca

Maria Cherkasova
Partner, Transfer Pricing
mcherkasova@kpmg.ca

Gordon Denusik
Partner, Transfer Pricing
gdenusik@kpmg.ca

Brad Rolph
Partner, Transfer Pricing
brolph@kpmg.ca