



TaxNewsFlash

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MNEs — Prepare for Canada's New Transfer Pricing Rules

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Multinational enterprises (MNEs) must consider significant 2025 federal budget changes that overhaul Canada's transfer pricing adjustment rules and documentation requirements. Among other measures, the budget proposes a new transfer pricing adjustment rule and a requirement for taxpayers to analyze cross-border transactions between non-arm's-length persons based not only on the contractual terms of the transaction or series, but also on other economically relevant characteristics. According to the Department of Finance Canada (Finance), these changes are intended to better align the Canadian transfer pricing rules with international standards and transfer pricing guidance published by the Organisation for Economic Co-operation and Development (OECD Guidelines). The revised transfer pricing rules and documentation requirements will apply to taxation years beginning after November 4, 2025.

Affected taxpayers should assess the impact of these proposed transfer pricing changes, which are broader than the proposals released in Finance's 2023 transfer pricing consultation paper. In particular, these new rules appear to enhance the CRA's discretion to impose notional related-party transactions that differ from the taxpayer's actual related-party transactions, which may result in less certainty and significant transfer pricing income adjustments, among other issues.

It is also especially important that taxpayers prepare to follow these new transfer pricing rules, given the proposed enhancements to the CRA's audit powers that allow it to more easily obtain both domestic and foreign-based information from taxpayers and levy significant non-compliance penalties in addition to transfer pricing penalties.

Background

Finance released a transfer pricing consultation paper and accompanying legislative proposals in 2023, including amendments to the transfer pricing adjustment rule and revisions to certain administrative practices. Finance first announced this consultation in the 2021 federal budget, and indicated that the changes were intended to discourage the inappropriate shifting of income out of Canada.

Generally, where one entity within a multinational group agrees to buy or sell goods or services with another group entity, taxpayers are required to use arm's-length transfer prices or arm's-length allocations such that an appropriate amount of profit on these transactions is reported in Canada under the transfer pricing rules in section 247 of the Income Tax Act (Canada). Where transfer prices do not reflect arm's-length terms and conditions, the current rules provide that the CRA can adjust a Canadian taxpayer's transfer prices. In general, applying the arm's-length principle is based on a comparison of the non-arm's-length parties' prices or profit margins with the prices or profit margins of arm's-length parties engaged in similar transactions.

Finance released draft legislation on August 15, 2025 that provides the CRA with enhanced audit powers to more easily obtain information. This includes allowing the CRA to require answers to questions, information or documents from taxpayers orally under oath or affirmation (or by affidavit) and a new penalty for non-compliance. For details, see *TaxNewsFlash-Canada* 2025-35 "[Finance Releases Plethora of Draft Legislation](#)"

Transfer pricing adjustment rule

In the budget, Finance proposes a new transfer pricing adjustment rule that allows a transaction, or series of transactions, to be adjusted or, in certain circumstances, replaced with an alternative transaction or series (or no transaction or series). The rule allows the CRA to make such a change where:

- There is a transaction, or series of transactions, between a taxpayer and a non-resident person with whom the taxpayer does not deal at arm's-length, and
- The transaction or series (once it has been analyzed and determined) includes actual conditions different from "arm's-length conditions".

Where both these conditions are met, the CRA can adjust the relevant amounts to the quantum or nature of the amounts that would have been determined if the arm's-length conditions for the transaction or series would have applied. The actual conditions are determined by both the contractual terms of the transaction or series and other economically relevant characteristics.

Finance also proposes to add an interpretation rule to provide that Canada's transfer pricing rules are applied to achieve consistency with the "Transfer Pricing Guidelines".

KPMG observation

As originally described in 1997 federal budget, one objective of the existing transfer pricing rules was to ensure that all the various transfer pricing methods described in the 1995 OECD Guidelines were available to taxpayers. The new rules go a step further and, for purposes of determining whether the actual conditions differ from arm's-length conditions, expressly require taxpayers to select and apply the most appropriate transfer pricing method in accordance with the Transfer Pricing Guidelines.

Under the new rules, the Transfer Pricing Guidelines are initially the 2022 OECD Guidelines, but Finance may prescribe regulations that modify or replace the 2022 OECD Guidelines. The 2022 OECD Guidelines include various administrative measures (e.g., low-value adding services) that tax administrations may adopt. It is uncertain whether Finance has adopted any of these administrative measures, in the absence of specific language in future regulations.

Comparability analysis

The budget proposals also include a new transaction determination rule, which require taxpayers to determine controlled transactions based on prescribed economically relevant characteristics. Specifically, this analysis focuses on what conditions would have existed had the parties been dealing at arm's length in comparable circumstances. The new rules define "arm's-length conditions" and state that a transaction, or series of transactions, is considered to include conditions that differ from arm's-length conditions where either:

- A condition does not exist as an actual condition, but would have existed had the parties to the in-scope transaction or series been dealing at arm's length in comparable circumstances, or
- The parties would not have entered into the transaction or series, or would have entered into a different transaction or series, had they been dealing at arm's length in comparable circumstances.

This analysis must consider the following comparability factors set out in the new definition of "economically relevant characteristics":

- Contractual terms of the intercompany transaction (only to the extent that they are consistent with the actual conduct of the parties) and other relevant transactions
- Functions performed (taking into account the assets used, risks assumed, value created, surrounding circumstances, and industry practices)
- Characteristics of any property transferred or service provided

- Economic and market context
- Business strategies.

The first two comparability factors require consideration of the parties' actual conduct, which is intended to ensure that the factual substance of the transaction or series is considered (rather than solely its legal form).

KPMG observation

The new rules include broad definitions of “arm’s-length conditions”, “actual conditions”, “economically relevant characteristics” and “transaction or series”, which may require taxpayers to consider transactions that may not be directly related to the controlled transaction under analysis.

Additionally, the rules' new focus on the economic substance of a controlled transaction rather than its legal form could create challenges and uncertainty for taxpayers, as there may be differences in interpretation with the CRA and ultimately the courts over these factors. As a result, taxpayers should review their existing transfer pricing policies and documentation to assess whether further analysis and documentation are warranted.

Documentation requirements

The budget also proposes revisions to Canada's contemporaneous documentation rules, including requiring taxpayers to describe:

- The entire series of transactions (not only individual transactions)
- The contractual terms of other relevant transactions involving one of the transacting parties or any other member of the multinational group
- The functions performed considering the economically relevant characteristics, which include assets and risks assumed, value creation, circumstances of the transaction or series, and industry practices
- The selection and application of the most appropriate transfer pricing method (to demonstrate that the transfer prices are based on arm’s-length conditions).

KPMG observation

Taxpayers will have to determine whether their existing documentation meets the new standard for reasonable efforts. Taxpayers who do not make reasonable efforts are subject to a transfer pricing penalty equal to 10% of a transfer pricing adjustment where the adjustment exceeds the lesser of 10% of the taxpayer's revenue or \$10 million (previously this threshold was \$5 million).

Even though the new rules are effective for taxation years beginning after November 4, 2025, the CRA has already started to ask taxpayers to provide the additional information

identified in the 2025 federal budget Notice of Ways and Means Motion during recent transfer pricing audits. This information requires a significant amount of resources to obtain. Taxpayers should undertake a gap analysis to determine what additional information they will need to ensure their existing transfer pricing documentation meets the new requirements.

Administrative changes

In addition, the new rules introduce certain administrative changes, including measures to:

- Increase the transfer pricing penalty threshold to an amount equal to the lesser of 10% of revenue or \$10 million adjustment, from an amount equal to the lesser of 10% of revenue or \$5 million
- Reduce the time for taxpayers to provide transfer pricing documentation to 30 days (from three months), while maintaining the contemporaneous documentation requirement for taxpayers and partnerships (to make or obtain the appropriate records or documentation by their documentation-due date for any given year or period).
- Simplify documentation requirements where prescribed conditions are met.

KPMG observation

Canadian taxpayers have generally followed the OECD Guidelines when determining their transfer pricing policies and documenting the basis for those policies. At this time, it is unclear whether implementing the Canadian changes may result in different interpretations across various jurisdictions.

Notably, it appears that Finance has opted not to incorporate certain administrative measures contemplated in the 2023 consultation paper, including the introduction of prescribed rates or safe harbour returns for relatively routine distribution and administrative activities.

Finance has not yet issued any details regarding the regulations for the simplified documentation requirements.

We can help

Your KPMG adviser can help you assess the effect of these new developments. For more details, contact a KPMG Transfer Pricing Professional in Canada.



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