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# Tax Alert – Canada

## Highlights from the CRA's 2017 APA Program Report

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 12 July 2018, the Canada Revenue Agency (CRA) released its *Advance Pricing Arrangement (APA) Program Report* for the 2017 calendar year.

The 2017 APA Program Report provides an overview of the operations of the Canadian APA program, including statistical analyses of APAs completed and in process.

In 2017, there were 36 APAs completed, the most completions seen in the last 10 years. Interest in the program remained high, with 24 applications received in 2017, a number in line with the historic annual average.

### **High number of APAs completed; closing inventory down**

In 2017, 36 APAs were completed – up significantly from the 26 cases completed in 2016, and a record high since the program's inception in 1990. Of the 36 completed cases, 30 were bilateral APAs, while the remaining 6 cases were unilateral (not requiring negotiation with a treaty partner). Of cases in process on 31 December 2017, 88% involved taxpayers seeking a bilateral APA, while the remaining 12% involved taxpayers seeking a unilateral APA.

In 2017, 16 cases were accepted into the APA program. The historic high is 39 new cases (2013-2014). "Acceptance" occurs after the taxpayer has made an application to enter the program, by providing a submission containing information required by the CRA under Information Circular 94-4R, or specified in the pre-filing meeting. At year's end, there were also an additional 23 cases with applications pending, indicating continuing high interest in the program.

Closing inventory stands at 67 cases at the end of calendar 2017, the lowest level experienced in the last ten years. This result reflects cases moving through the system as intended, and likely indicates a current capacity for additional caseload.

### **Time to completion up marginally**

Average time to completion for bilateral cases concluded in the year is 48.5 months, marginally higher than that reported in 2016 (47.3 months). It is difficult to truly compare this measure from year to year, since it may be unduly influenced by outlier cases that have taken an exceptionally long or short time to complete. Nonetheless, this is below the 49.2 months average reported for the last six years.

The report also provides a breakdown of the average time in each of the three stages of a bilateral APA once it is accepted into the program. The first stage, referred to as the due diligence stage, begins at the acceptance date and concludes with the completion of the CRA's position paper setting out its views on the transactions and the proposed transfer pricing methods. The second stage encompasses the negotiation phase with the foreign competent authority. Lastly, the third stage involves completing the drafting and signing of the agreements with the foreign competent authority and with the Canadian taxpayer.

The 2017 report notes that it took, on average, 25 months from the date of acceptance for the CRA to complete its due diligence stage, compared to 30.2 months in 2016, 34.3 months in 2015-16, 31.5 months in 2014-15 and 30 months in 2013-14. While this may appear to be a lengthy period, many things affect case processing times, including complexity of the transfer pricing issues, limited government and taxpayer resources dedicated to a request, coordinating site visits, and providing and analyzing information.

For all completed APAs in 2017, the second stage, i.e., the negotiation of the APA with a foreign tax administration, took, on average, approximately 9.8 months to complete in 2017, higher than 5.9 months in 2016, 6 months in 2015-16 and 5.8 months in 2014-15. The work during this stage is not limited to negotiation and frequently requires significant analysis, research and fact-finding, to help resolve differences between the CRA's and a foreign tax administration's transfer pricing positions for the transactions covered by the APA.

In 2017, it took an average of 13.7 months following the completion of negotiations to draft the APA, to obtain agreement on wording with both the foreign tax administration and the taxpayer, followed by signatures from the CRA's Competent Authority Services Division and the taxpayer. Average time to completion for the two unilateral APAs completed in the year was 12.5 months. The 2017 bilateral average is longer than the historical average of 12.3 months for this stage. However, depending on the complexity of the transfer pricing methodology agreed to during negotiations, the time needed to finalize an APA can vary from case to case.

## **Pre-filing meetings steady**

The Canadian competent authority held 24 pre-filing meetings in 2017, including renewals and new applicants, one more than the 23 pre-filing meetings held in 2016. The historic high of 38 pre-filing meetings occurred in 2007-08. At the end of the year, 23 cases were under consideration for acceptance. These are cases where a pre-filing meeting has been held, but the CRA has not yet indicated that the cases will be accepted into the program.

## **Withdrawals**

A withdrawal may occur when either the taxpayer chooses of its own accord not to move forward with the APA or the CRA informs the taxpayer that it considers that the proposed covered transactions are not well suited to the program.

In 2017, there were five withdrawals from the program – two during the application stage and three after acceptance into the program. No indication is provided in the report of the specific reasons for these withdrawals.

## **TNMM remains the most prevalent transfer pricing methodology**

Among in-process APAs, the transactional net margin method (TNMM) is being considered in 70% of cases at the 2017 year end. Among these TNMM cases, operating margin is the most-used profit-level indicator. Historically, 80% of completed cases have used the TNMM. Among in-process cases, 54% considered operating margin as the profit-level indicator, followed by total cost plus (10%), return on assets (3%) and Berry ratio (3%).

Of APAs in process, 30% of cases consider other methodologies: 12% of APAs use the cost plus method, 10% use the profit split method, 7% use comparable uncontrolled price/transaction method, and 1% use the resale price method.

## **Industries and geographies**

The 2017 report also provides statistics on participation in the APA program by industrial sector. More than half of the in-process APA program cases involve taxpayers with operations in the following sectors:

- Automobile and other transportation equipment (25%)
- Metals and minerals (12%)
- Health (9%)
- Petroleum (9%)
- Food and beverages (9%)

The 2017 report also provides statistics on participation by country and by Canadian provinces. In 2017, the CRA was engaged in bilateral or multilateral APA processes involving taxpayers from 15 different jurisdictions (United States, United Kingdom, Switzerland, Japan,

South Korea, Germany, Netherlands, Ireland, India, Sweden, China, Denmark, Chile, France and Hong Kong). At the end of 2017, APAs involving the United States represented 53% of all APAs in process.

The distribution of APAs across Canada broadly reflects the allocation of Canadian corporate headquarters within the country. Taxpayers headquartered in Ontario represent more than half of all APAs in process, totalling 40 cases or 60%. There are 7 cases, or 10%, involving taxpayers headquartered in the province of Quebec; 19 APAs, or 29% of cases, from Western Canada (British Columbia, Alberta, Saskatchewan and Manitoba); and 1 case, or 1%, from the Atlantic Provinces.

## Looking ahead

Improvements made to the program over the past several years should serve the CRA well to maintain its completion rate and timelines in 2018, providing cause for continued optimism for the APA as a program of choice for Canadian taxpayers seeking certainty for their transfer pricing transactions.

To view the full *Advance Pricing Arrangement Program Report*, go to <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/competent-authority-services/advance-pricing-arrangements/2017-apa-program-report.html>

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