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# Tax Alert – Canada

## Budget 2025 introduces revised transfer pricing rules

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 4 November 2025, the Minister of Finance and National Revenue, François-Philippe Champagne, tabled the 2025 federal budget, which included substantial draft legislative changes to Canada's transfer pricing rules in section 247 of the *Income Tax Act* (the Act). The proposed changes stem from a consultation paper titled *Consultation on Reforming and Modernizing Canada's Transfer Pricing Rules* (the consultation paper) released in June 2023 and the related stakeholder feedback received during the consultation period.

In this Tax Alert, we provide a summary of the key proposed revisions to the Canadian transfer pricing rules and takeaways for taxpayers.

Following the Crown's loss in the *Cameco* case at both the Tax Court of Canada and Federal Court of Appeal,<sup>1</sup> the government committed to a review of the transfer pricing rules in Canada. The consultation paper represented the Department of Finance's opening foray into potential legislative amendments and revised administrative measures applicable to transfer pricing in Canada.

The draft legislation released with Budget 2025 reflects Finance's conclusions derived from that consultation process.

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<sup>1</sup> *Cameco Corporation v. The Queen*, 2018 TCC 195; aff'd 2020 FCA 112.



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## Draft legislation

The primary revision in the draft legislation concerns the transfer pricing adjustment rule in section 247 of the Act. Under the current rules, the adjustment mechanism within section 247 is separated between a common pricing adjustment element and a recharacterization element. Under the proposed rules, this distinction has been removed, and an adjustment would only be made when the “actual conditions”, as determined by the Canada Revenue Agency (CRA), pertaining to a transaction differ from the “arm’s length conditions”, as also determined by the CRA. The new adjustment mechanism would apply to adjust the quantum or nature of the reported amount to what would have been determined if arm’s length conditions had applied. In doing so, the CRA could also consider the possibility that no transaction would have been concluded had the participants been dealing at arm’s length.

This non-recognition feature in the definition of “arm’s length conditions” appears to be largely directed at addressing difficulties experienced by the Crown in supporting its recharacterization position in the *Cameco* case. Throughout the consultation paper, several references to the *Cameco* case were discussed to explain the Department of Finance’s tax policy concerns with respect to the current rules. However, the Budget 2025 document notes that “In accordance with the Transfer Pricing Guidelines, and consistent with the interpretation rule, an in-scope transaction or series accurately analysed and determined should be replaced with an alternative transaction or series, or no transaction or series at all, only in exceptional circumstances.”<sup>2</sup> Consequently, this statement suggests that the non-recognition feature should only apply in limited circumstances, although no further details were provided in Budget 2025.

Other new definitions are also proposed. In particular, the term “economically relevant characteristics” is added, which is intended to delineate all of the information (i.e., “conditions”, with its own interpretive rule) that should be taken into account when setting and analyzing prices in intercompany transactions, with an emphasis on the functions and actual conduct of the parties. This proposed analysis is a much broader undertaking than the existing transfer pricing rules currently impose.

Other revisions attempt to ensure that Canada’s transfer pricing rules better align with the principles and approaches contained in the OECD *Transfer Pricing Guidelines*.<sup>3</sup> In this regard, the draft legislation indicates that any analysis and adjustments made under the Canadian transfer pricing rules are to be applied in a manner so as to best achieve consistency with the

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<sup>2</sup> Canada Strong Budget 2025, Tax Measures: Supplementary Information, page 354.

<sup>3</sup> OECD Transfer Pricing Guidelines refers to the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, Paris, 2022*.

guidelines.<sup>4</sup> However, application of the guidelines will be constrained by any carve-outs, which are to be defined by regulation but have not yet been identified.

## Administrative measures

In addition, Budget 2025 proposes changes to transfer pricing penalty provisions and documentation requirements, some of which were alluded to in the consultation paper. These changes include:

- ▶ Increasing the threshold for the transfer pricing penalty to apply from an assessment (from a \$5 million transfer pricing adjustment to a \$10 million adjustment).
- ▶ Clarifying the transfer pricing documentation requirements and also more closely aligning them with the new definitions, including, but not limited to, i) broadening the scope of potentially relevant transactions or series of transactions to be documented to include relevant transactions or series of transactions involving any other member of the multinational enterprise group, ii) broadening the scope of the functional analysis to include an analysis with respect to how the actual conduct of functions performed relates to the wider generation of value by the multinational group and taking into account industry practices, and iii) specifying a requirement to select and apply the most appropriate method in accordance with the OECD *Transfer Pricing Guidelines*. These elements will significantly impact the time and effort required to document intercompany transactions.
- ▶ Providing for to-be-determined simplified documentation requirements when prescribed conditions are met. Aspects considered in this regard in the consultation paper included alternative reporting formats for certain types of transactions, safe-harbours for low-value-added services, and standardized distribution returns.
- ▶ Reducing the time to provide transfer pricing documentation to the CRA from three months to 30 days (whereas the 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 would remain unchanged).

## Takeaways - impacts on taxpayers

The substantive elements of Canada's transfer pricing rules have not been revised since their original introduction in 1998. The draft legislative amendments in Budget 2025 primarily reflect the Department of Finance's intention to strengthen the enforceability of the Canadian transfer pricing rules in the litigation context. The proposals are also intended to harmonize Canadian legislation with the OECD *Transfer Pricing Guidelines*. Notwithstanding those intentions, transfer pricing is and will remain an inherently subjective endeavour that is highly susceptible to different outcomes based on the judgment of transfer pricing professionals, including taxpayers' advisors and the CRA's auditors and economists. Further, the outstanding elements of the proposed legislation, such as the Canadian opt-outs from the

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<sup>4</sup> As provided in proposed subsections 247(2.03) and (2.04) of the Act.

OECD guidance, will also be important in determining how the Canadian transfer pricing rules will ultimately apply.

It is unclear whether the draft legislative revisions, along with previously introduced changes to the CRA's enforcement powers, may in fact create additional avenues of uncertainty and broaden the current landscape for Canadian transfer pricing disputes. Interpretation of the proposed legislation will develop over time, but it may not result in either the government or taxpayers gaining any consistent or decisive advantage. The combined changes may also lead to more complex audits from the CRA, more difficulty in reaching resolution of those audits and ultimately more uncertainty for taxpayers.

Practically speaking, the most pressing aspects of the proposals are the broadening of the documentation requirements and the reduction in response time to 30 days. These proposed changes will greatly increase the impetus to ensure that documentation of transactions is comprehensive and contemporaneous. In this context, it will be important for taxpayers to pressure test the robustness of their existing transfer pricing policies and documentation.

## **Learn more**

For more information, please contact your EY or EY Law advisor or one of the following professionals:

### **Toronto**

**Marlon Alfred**

+1 416 932 5151 | [marlon.alfred@ca.ey.com](mailto:marlon.alfred@ca.ey.com)

**Andrew Clarkson**

+1 416 943 2146 | [andrew.clarkson@ca.ey.com](mailto:andrew.clarkson@ca.ey.com)

**Tara Di Rosa**

+1 416 943 2671 | [tara.dirosa@ca.ey.com](mailto:tara.dirosa@ca.ey.com)

**Matthew Sambrook**

+1 416 943 2080 | [matthew.sambrook@ca.ey.com](mailto:matthew.sambrook@ca.ey.com)

**Caton Walker**

+1 416 943 5240 | [caton.walker@ca.ey.com](mailto:caton.walker@ca.ey.com)

**Andrei Tarassov**

+1 416 943 2546 | [andrei.tarassov@ca.ey.com](mailto:andrei.tarassov@ca.ey.com)

**Mariam Imnaishvili**

+1 416 941 7795 | [mariam.imnaishvili@ca.ey.com](mailto:mariam.imnaishvili@ca.ey.com)

**Paula Kelley**

+1 416 932 5971 | [paula.kelley@ca.ey.com](mailto:paula.kelley@ca.ey.com)

## **Ottawa**

**Rene Fleming**

+1 613 598 4406 | [rene.fleming@ca.ey.com](mailto:rene.fleming@ca.ey.com)

**Paul Mulvihill**

+1 613 598 4339 | [paul.f.mulvihill@ca.ey.com](mailto:paul.f.mulvihill@ca.ey.com)

**Tony Wark**

+1 613 598 4322 | [tony.wark@ca.ey.com](mailto:tony.wark@ca.ey.com)

**Kevin O'Reilley**

+1 613 598 4892 | [kevin.oreilley@ca.ey.com](mailto:kevin.oreilley@ca.ey.com)

## **Quebec and Atlantic Canada**

**Alfred Zorzi**

+1 514 874 4365 | [alfred.zorzi@ca.ey.com](mailto:alfred.zorzi@ca.ey.com)

**Hélène Vaudrin**

+1 514 874 4661 | [helene.vaudrin@ca.ey.com](mailto:helene.vaudrin@ca.ey.com)

## **British Columbia**

**Tina Berthaudin**

+1 604 891 8207 | [tina.berthaudin@ca.ey.com](mailto:tina.berthaudin@ca.ey.com)

**Greg Noble**

+1 604 891 8221 | [greg.noble@ca.ey.com](mailto:greg.noble@ca.ey.com)

**Adrian Tan**

+1 604 891 8318 | [adrian.tan@ca.ey.com](mailto:adrian.tan@ca.ey.com)

## **Prairies**

**Andreas Ottosson**

+1 403 592 9966 | [andreas.ottosson@ca.ey.com](mailto:andreas.ottosson@ca.ey.com)

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