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TPM-02R: Transfer-Pricing Secondary Adjustments and Repatriation

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Where the CRA makes an upward transfer-pricing adjustment (referred to as "the primary adjustment"), a secondary adjustment may be required on the basis that a benefit has been conferred on a non-resident person for the excess amount paid to, or insufficient amount received from, the non-resident. The benefit is usually deemed to be a dividend and is subject to part XIII withholding tax unless relief is granted through a repatriation agreement under which the benefit is repaid to the Canadian taxpayer. On June 1, 2021, the CRA updated its guidance on this subject by issuing *Transfer Pricing Memorandum* TPM-02R, "Secondary Transfer Pricing Adjustments, Repatriation and Part XIII Tax Assessments." Generally speaking, the revised guidance is not good news for taxpayers; it describes in greater detail the circumstances in which such relief will not be granted.

TPM-02R replaces *Transfer Pricing Memorandum* TPM-02, "Repatriation of Funds by Non-Residents—Part XIII Assessments," and certain paragraphs from *Information Circular* IC87-2R (which was cancelled in December 2019). Both of these documents predated the 2012 legislative amendments to add specific provisions on secondary adjustments and repatriation to the transfer-pricing regime. The CRA previously relied on the general provisions on benefits in subsections 15(1), 56(2), and 246(1) and paragraph 214(3)(a) to assess part XIII withholding tax. Under these rules, relief for repatriation was purely administrative and was provided where the Canadian taxpayer agreed to the primary adjustment in writing, the adjustment did not arise from a transaction that may be considered abusive, and the non-resident repaid the benefit (being the gross amount of the transfer-pricing adjustment).

Subsections 247(12) to (15) now provide authority for (1) assessing a deemed dividend equal to the underlying transfer-pricing adjustment and (2) granting relief from the associated part XIII withholding tax (and potentially eliminating it) where there is an acceptable repatriation agreement. TPM-02R expands on item 2 by explaining that the CRA will not provide such relief in circumstances where

- the government's Transfer Pricing Review Committee has approved the application of paragraphs 247(2)(b) and (d),
- the government's GAAR Committee has approved the application of GAAR as an assessing position,
- other anti-avoidance provisions apply,
- the taxpayer or the non-resident has failed to honour a requirement or compliance order, or

- in any other circumstance in which the minister does not concur with the repatriation.

Note that these circumstances are described in more detail than in previous CRA documents, and they apply even where repatriation has taken place. Of course, the CRA may simply be formalizing its existing administrative practice, with no change in policy (as expressed in its prior statement that relief would be granted only where the adjustments did not arise from a transaction that may be considered abusive).

As an aside, there is an interesting interpretive point regarding the withholding tax rate on the secondary adjustment (which also applies to other treaty-based issues, outside the transfer-pricing context). TPM-02R confirms that the 25 percent withholding rate provided in the ITA may be reduced under a treaty. But keep in mind that the CRA accepts that taxpayers are entitled to rely on the most favourable rule found in any authoritative version of the treaty (CRA document no. 2015-0581521C6, May 28, 2015). For example, the English and French versions of the Canada-Switzerland tax treaty are both authoritative, but their text is not identical. Article 10(2)(a) of the English version (which reduces the applicable withholding rate to 5 percent if the dividend recipient holds at least 10 percent of the voting stock and capital of the dividend payer) does not refer to an indirect shareholding. However, the French text does include a lookthrough rule. The result is that when a dividend is paid to an entity that is an indirect parent entity of the Canadian taxpayer, the taxpayer is entitled to rely on the 5 percent reduced withholding tax rate.

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