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TPM-02

Repatriation of funds by Non-residents - Part XIII Assessments

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Please note that the following Transfer Pricing Memorandum, although correct at the time of issue, has not been updated to reflect subsequent legislative changes since the date of issue. As a result, some information may no longer be valid.

This memorandum does not replace the law found in the Income Tax Act and its Regulations. It is provided for your reference. As it may not completely address your particular situation, it would be advisable to refer to the Income Tax Act, any applicable Regulation, and relevant case law. You may also want to contact a tax services office of the Canada Revenue Agency for more information.

Repatriation of funds by Non-residents - Part XIII Assessments

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Introduction

This document explains how to apply the repatriation policy to international transfer pricing under subsection 247(2) of the *Income Tax Act* (the Act) and Part XIII tax.

As set out in paragraph 212 of Information Circular [IC87-2R, International Transfer Pricing](#), a taxpayer may be granted relief from Part XIII tax when the tax relates to a transfer pricing adjustment and the following conditions are met:

- *the Canadian taxpayer agrees in writing to the proposed transfer pricing adjustments (such an agreement does not restrict the Canadian taxpayer or the non-arm's length party from seeking relief under the Mutual Agreement Procedure article of Canada's tax treaties);*
- *the adjustments did not arise from a transaction that may be considered abusive; and*
- *the foreign corporation repatriates the funds equivalent to the gross amount arising from the transfer pricing adjustment immediately or agrees in writing to repatriate such amount within a reasonable time.*

The wording of these conditions has led to the following questions about what they mean and how they apply:

- What transactions are considered abusive?
- How long is "a reasonable time" when it comes to repatriation?
- What constitutes a repatriation payment?
- Should the CRA obtain a waiver of the right to object and appeal before granting repatriation?
- Should the CRA assess interest on Part XIII tax when there is repatriation?

Abusive transactions

Circumstances that may indicate an abusive transaction include the following:

- A penalty under the Act is applied to the transaction or series of transactions.
- The taxpayer has failed to provide records or documents requested under paragraph 247(4)(c) of the Act relating to the transaction(s).
- The taxpayer or a related non-resident has failed to honour a requirement issued under the Act relating to the transaction(s).
- The Transfer Pricing Review Committee has approved the application of paragraph 247(2)(b) or the General Anti-Avoidance Rule (GAAR) Committee has approved the application of subsection 245(2) as a secondary basis to justify the assessment.

Within a reasonable time

Repatriation must be completed within 180 days from the time the repatriation agreement is signed. No extensions will be granted. Part XIII will be assessed after 180 days if no evidence of repatriation is provided.

The repatriation agreement will contain the steps that both the Canadian taxpayer and the related non-resident will take to carry out the repatriation. The agreement will also state how much time it should take to carry out those steps. Both the Canadian taxpayer and the related non-resident must sign the agreement. The auditor will rely on this agreement to determine if repatriation has been carried out.

Repatriation payment

Repatriation can be accomplished by:

- Offsetting the Canadian company's inter-company accounts payable to the non-resident

in the year of the transfer pricing adjustment. This method of repatriation might have an effect on other items. For example, interest may have been charged on the inter-company balance. These interest charges may have to be amended based on the revised inter-company balances.

- Creating or adjusting a shareholder loan account. This may result in a Part XIII assessment because of the subsection 15(2) or subsection 15(9) implications. Repaying the shareholder loan may result in a refund under subsection 227(6.1) of all or a portion of the tax previously assessed under Part XIII because of subsection 15(2).
- Offsetting against a separate downward transfer pricing adjustment that relates to the same non-resident taxpayer. See [Downward Transfer Pricing Adjustments under Subsection 247\(2\)](#) for further details on this subject.

Repatriation must be achieved in the tax year of the transfer pricing adjustment. One or more of the above methods may be necessary to meet this objective.

Where offsets are not available until tax years after that of the transfer pricing adjustment, the only option available to the taxpayer will be to create or adjust a shareholder loan account. Offsets may then be used as repayments of the shareholder loan.

Transferring money or its equivalent to the Canadian corporation cannot meet the requirement of repatriating the funds in the tax year of the transfer pricing adjustment. Transferring funds would be used in combination with creating or adjusting a shareholder loan account. The transfer of funds would then be a repayment against the shareholder loan account.

The repatriation will be reflected in the financial records of the Canadian corporation.

Waiving the right to object or appeal

As set out in paragraph 212 of IC87-2R, *International Transfer Pricing*, the Canadian taxpayer must agree in writing to the transfer pricing adjustment before repatriation is granted.

The taxpayer must provide an unconditional waiver of the right to object to a transfer pricing adjustment before a request for repatriation is granted. If the taxpayer decides not to sign the waiver at the audit stage, a request for repatriation may still be considered during the appeal process.

Signing the waiver does not prevent the taxpayer from seeking recourse to Competent Authority.

When an audit agreement between the CRA and the Canadian corporation leads to the final transfer pricing adjustment, it would be appropriate to seek a waiver of the right to object, whether or not repatriation is granted.

Interest on Part XIII assessments

Where the facts support it, a transfer pricing adjustment may result in applying subsection 15(1) or subsection 56(2) to a related non-resident. The result is an amount subject to Part XIII tax. Where repatriation is granted, Part XIII will be assessed as follows:

- If repatriation can be achieved by offsetting the adjustment amount against an inter-company liability in the year of the transaction, there are no subsection 15(1) or 56(2) implications for the non-resident shareholder and thus no Part XIII tax.
- Where creating or adjusting a loan to the shareholder is used to repatriate the funds, a Part XIII assessment may be made as a result of applying subsection 15(2) or 15(9) to the shareholder loan. Interest will be charged on the assessment but there will be no penalty under subsection 227(8) for failing to deduct or withhold tax.

From a practical standpoint, where a shareholder loan is used to repatriate funds, a *Notice of Assessment* should be issued and a *Notice of Reassessment* should be issued immediately after to recognize any repayments to the loan account.

See the attached schedule for examples of how this applies.

General Comments

- Both the non-resident and the Canadian taxpayer must agree in writing to the repatriation and to completing all appropriate transfers and entries in the financial records of the Canadian taxpayer within a reasonable time. Without this signed agreement, repatriation will not be accepted. A copy of the signed written agreement must be submitted to the auditor and will be placed in the permanent document envelope.
- When the auditor concludes that repatriation could be allowed, the taxpayer should be made aware this option is available.
- The existence of a tax treaty does not affect the decision to accept repatriation.

Examples of repatriation in conjunction with Part XIII

All examples assume that subsection 15(1) or 56(2) will apply to the non-resident as a result of the transfer pricing assessment, triggering Part XIII tax.

Example #1

Taxation Year	Transfer Pricing Adjustment	Canadian Inter-company Accounts Payable To Non-Resident Corp	Canadian A/P To N/R Corp Balance After Repatriation
1997	\$3 million	\$15 million	\$12 million
1998	\$4 million	\$7 million	nil
1999	\$5 million	\$12 million	nil

The taxpayer may choose to make the repatriation by offsetting the amount required against the amount owing to the non-resident. For 1997, inter-company accounts payable would be reduced from \$15 million to \$12 million ($15 - 3$). In 1998, repatriation would reduce the accounts payable from \$7 million to nil ($7 - 4 - 3$). In 1999 the balance would be reduced from \$12 million to nil ($12 - 5 - 4 - 3$). The nil balance would be the starting point for balances in subsequent years.

As 100% of the amounts are repatriated in the year of the transfer pricing adjustment, no Part XIII tax is assessed.

If there were inter-company interest charges on this account, they would have to be amended to reflect the revised balances. This could result in additional Part I and Part XIII tax.

Example #2

Taxation Year	Transfer Pricing Adjustment	Canadian Inter-company Accounts Payable To Non-Resident Corp	Canadian A/P To N/R Corp Balance After Repatriation
1997	\$3 million	\$3 million	nil
1998	\$4 million	\$5 million	(\$2 million)
1999	\$5 million	\$4 million	(\$8 million)

The taxpayer may choose to make the repatriation by offsetting the amount required against the amount owing to the non-resident. For 1997, inter-company accounts payable would be reduced from \$3 million to nil ($3 - 3$).

In 1998, repatriation would reduce the accounts payable from \$5 million to nil (5 – 4 – 3). The excess would be considered a shareholder's loan of \$2 million. The provisions of subsection 15(2) or subsection 15(9) would be applied to the \$2 million. Both result in Part XIII tax implications because of paragraph 214(3)(a). The eventual repayment of the remaining \$2 million may result in an assessment under subsection 227(6.1) to clear the Part XIII tax that relates to the amount under subsection 15(2). If subsection 15(9) were the basis for the Part XIII tax, the eventual repayment of the \$2 million would eliminate future Part XIII taxes but it would not create a refund of Part XIII taxes that relate to the periods when the loan was outstanding.

The results for 1999 would be similar to those of 1998. The shareholder's account would have a balance of \$8 million. There would be subsection 15(2) or 15(9) implications with the resulting Part XIII tax.

Date

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