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TPM-05

Contemporaneous Documentation

October 13, 2004

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.

Introduction

The purpose of this document is to provide a directive concerning requests for contemporaneous documentation.

Subsection 247(3) of the *Income Tax Act* (the Act) imposes a penalty where the net amount of adjustments exceeds a specific threshold. This penalty is intended to be a compliance penalty focusing on the effort that a taxpayer makes to determine an arm's length transfer price and not solely on the ultimate accuracy of the transfer price. Therefore, provided a taxpayer makes reasonable efforts to determine and use arm's length prices or allocations, the transfer pricing penalty would not apply.

Subsection 247(4) of the Act deems a taxpayer not to have made reasonable efforts to determine and use arm's length transfer prices or allocations unless the taxpayer has prepared or obtained records or documents which provide a description that is complete and accurate in all material respects of:

- (i) the property or services to which the transaction relates;
- (ii) the terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction;
- (iii) the identity of the participants in the transaction and their relationship to each other at the time the transaction was entered into;
- (iv) the functions performed, the property used or contributed, and the risks assumed for the transaction by the participants in the transaction;
- (v) the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, for the transaction; and
- (vi) the assumptions, strategies, and policies, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contribution to costs, as the case may be, for the transaction.

This documentation must be prepared or obtained on or before the taxpayer's documentation-due date (defined in subsection 247(1)) for the taxation year or fiscal period in which a transaction was entered into.

Taxpayers must provide these records or documents within three months of the receipt of a written request to do so. If the taxpayer does not provide the documents within three months, the taxpayer is deemed not to have made reasonable efforts to determine and use arm's length transfer prices or allocations for the purposes of the penalty in subsection 247(3) of the Act for the taxation year(s) under review.

The penalty and contemporaneous documentation provisions apply to transfer pricing adjustments made under subsection 247(2) of the Act for taxation years and fiscal periods that begin after 1998.

For the purposes of this document, all references to a "taxpayer" should be read to include a partnership.

While the focus of this document is on requests for transfer pricing documentation, it can also be applied to requests for documentation pertaining to establishing if an arrangement is a qualifying cost contribution arrangement as defined in subsection 247(1) of the Act.

Policy

There are three parts to the purpose of this policy:

- to create a consistent approach to transfer pricing audits amongst the tax services offices (TSOs) ;
- to facilitate the audit process with regards to transfer pricing; and
- to increase transfer pricing compliance.

Effective immediately, requests for contemporaneous documentation must be issued at the initial taxpayer contact stage in all cases where there are transactions or arrangements between a taxpayer and a non-resident person with whom the taxpayer does not deal at arm's length. If the auditors were not aware of these transactions at the initial taxpayer contact

stage, they must issue requests for contemporaneous documentation when they first identify the existence of such transactions. These requests should also be issued for each taxation year subsequently added during the audit or when commencing a new audit cycle to cover new transactions that may arise in different taxation years. All requests for contemporaneous documentation involving large files should be routed through the Large File Case Manager prior to being presented to the taxpayer.

Contemporaneous documentation requests can be issued by letter or by query sheet, but must be either hand delivered to the taxpayer or sent by registered or certified mail. Refer to Appendix A for a sample letter and to Appendix B for a sample query sheet. To ensure the Agency is consistent in its approach to requests for contemporaneous documentation, it is mandatory that any changes to the format of this letter be discussed with the field advisory services manager for your region.

If the contemporaneous documentation is not received within three months of the receipt of a written request, taxpayers will be deemed not to have made reasonable efforts. There can be no extensions of the three-month period for the application of this deeming provision as the wording in the statute is specific. However, auditors should accept and review documentation provided after the three-month deadline to arrive at an appropriate conclusion of the transfer pricing audit.

The contemporaneous documentation referred to in subsection 247(4) is not intended to be an exhaustive list of the records and documents necessary to substantiate that a taxpayer's transfer pricing is in accordance with the arm's length principle or that a taxpayer has made reasonable efforts to determine arm's length transfer prices or allocations; the determination of reasonable efforts is made based on the facts and circumstances of the taxpayer's situation. Likewise, the documentation required depends on the facts and circumstances of the transactions under review, and further requests for information could be made accordingly. In addition, any failure on the part of the taxpayer to provide the requested information does not relieve the auditor from having to employ other methods to obtain it, including the use of domestic or foreign-based requirements if they are deemed necessary.

Conclusion

Requests for contemporaneous documentation must be issued when conducting a transfer pricing audit. If you have questions, please contact the field advisory services manager responsible for your region.

Appendix A

ABC Canada Inc.
Address

Auditor
International Audit
(xxx) xxx-xxxx

Date

Attention: Mr.(or Mrs.) XYZ

**Re: Request for Contemporaneous Documentation
ABC Canada Inc.
Audit of «year 1» and «year 2» taxation years**

Mr.(or Mrs.) Tax Manager

Please be advised that I have been assigned to audit the international transactions of ABC Canada Inc. for the periods indicated above.

As provided in subsection 247(4) of the Income Tax Act (the Act), for the «first year under audit» taxation year (or the most recent year prior to «first year under audit» for which complete contemporaneous documentation has been prepared) of ABC Canada Inc., we request the following contemporaneous documentation with respect to transactions with related non-residents:

- a) Records or documents that provide a description that is complete and accurate in all material respects of:
- i) the property or services to which the transaction relates;
 - ii) the terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction;
 - iii) the identity of the participants in the transaction and their relationship to each other at the time the transaction was entered into;
 - iv) the functions performed, the property used or contributed, and the risks assumed, in respect of the transaction, by the participants in the transaction;
 - v) the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the transaction, and
 - vi) the assumptions, strategies and policies, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contribution to costs, as the case may be, in respect of the transaction.
- b) For each subsequent taxation year or fiscal period, if any, in which the transaction continues, provide records or documents that completely and accurately describe each material change in the year or period to the matters referred to in any of (a)(i) to (vi) above in respect of the transaction.

As specified in paragraph 247(4)(c) of the Act, ABC Canada Inc. must provide the transfer pricing records or documents to the Canada Customs and Revenue Agency within 3 months after service of this request.

If the requested contemporaneous documentation is not provided within 3 months after the service of this request, ABC Canada Inc. will be deemed to not have made reasonable efforts to determine and use arm's length transfer prices or arm's length allocations in respect of a transaction, or not to have participated in a transaction that is a qualifying cost contribution arrangement, for the purpose of the transfer pricing penalty provision in subsection 247(3) of the Act.

Should you require additional information concerning this request, please do not hesitate to contact the undersigned at (xxx) xxx-xxxx.

Yours sincerely,

Auditor
International Audit
xxx Tax Services Office

c.c. Large File Case Manager (for large case files)

Appendix B

[AUDIT QUERY SHEET](#) PDF; 19 KB

Date

Modified: 2008-03-03

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