

How to be audit ready in the face of Canada's new transfer pricing rules

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Key Takeaways

- Key changes to Canada's transfer pricing rules include a single adjustment provision, a shift from contractual terms to actual conduct and consistency with OECD Transfer Pricing Guidelines.
- The amendments expand documentation requirements and shorten the response time to 30 days for CRA requests, increasing compliance pressure.
- Taxpayers should review their transfer pricing policies and intercompany agreements to ensure alignment with the new rules.

Canada's new transfer pricing rules are in effect for tax years beginning after the 2025 federal budget (i.e., 2026 for calendar year taxpayers). It will be many years before the courts weigh in on the impact of the amendments, but the time for multinationals to ready themselves for CRA audit scrutiny is now. Below, we outline the key changes in the amendments and the practical steps that taxpayers can take today.

Key changes in Canada's new transfer pricing rules

The amendments make three overarching changes to Canada's transfer pricing rules:

1. **Single adjustment provision:** There is now a single adjustment provision that compares the "actual conditions" of a transaction or series involving non-arm's length participants to "arm's length conditions". The definition of "arm's length conditions" recognizes that independent parties might not have transacted at all, or might have undertaken a different transaction, which means that the possible recharacterization of a transaction is subsumed under the arm's length comparison. The prior rules required that the specific conditions of a standalone provision be met before transactions could be recharacterized for transfer pricing purposes.
2. **Shifting emphasis from legal form to "actual conduct":** New rules and definitions shift the focus from legal form to the conduct of the parties. An interpretive provision requires

the analysis of a transaction or series to be determined with reference to “economically relevant characteristics”. The statutory list of “economically relevant characteristics” includes contractual terms, but only if they are not inconsistent with the actual conduct of the parties. The next item in the list is the actual conduct of the parties followed by other factors such as the surrounding circumstances, including economic, geopolitical and industry-specific considerations.

3. **Consistency rules:** The amendments introduce a consistency rule that calls for the transfer pricing provisions to be applied in a manner that is consistent with the OECD Transfer Pricing Guidelines, as well as a requirement to use the most appropriate transfer pricing method described by those Guidelines.

Reviewing transfer pricing policies and intercompany agreements

Taxpayers should review their transfer pricing policies from the perspective of whether they are ready to withstand scrutiny under the new rules. For example, do the OECD Guidelines’ concepts of control over risk and financial capacity to bear risk impact the characterization or pricing of the intercompany transaction, or are these concepts already reflected in the group’s existing transfer pricing policies? What sources of information and documentary support are available to respond to CRA audit queries that are framed in terms of the newly incorporated concepts included in “economically relevant characteristics”?

In addition, given the emphasis in the amendments on “actual conduct” of the parties, taxpayers should review their intercompany agreements to ensure that their terms reflect how the parties operate in practice. For example, where a multinational group’s intercompany agreements have become outdated and the practices have evolved since the agreements were drafted, they should be updated to reflect the current practices to ensure that they are appropriately considered as part of “economically relevant characteristics”.

Reviewing contemporaneous documentation

The amendments also make changes to the “contemporaneous documentation” requirements. Failing to meet those requirements can cause a taxpayer to be deemed not to have made “reasonable efforts” to use arm’s length pricing, and therefore to be subject to a transfer pricing penalty if they are subject to an adjustment. The changes to the documentation requirements correspond to changes to the substantive rules and broaden the scope of transactions that need to be documented. Taxpayers should review the contents of their transfer pricing reports to ensure that they satisfy the new rules. As noted below, documentation must not only exist but must also be provided to CRA within 30 days of a request to satisfy the requirements; completing and finalizing reports on a contemporaneous basis is therefore critical to compliance under the new regime.

The prior documentation rule required a taxpayer to have documented the “transaction” that was subject to a transfer pricing adjustment, as well as certain information about other related transactions between the participants to the adjusted transaction. The amendments require documentation of a “*transaction or series of transactions*” (emphasis ours) as well as other transactions or series involving *either* of the participants *or any other member of the group*. Based on these changes, taxpayers need to consider whether they need to expand the scope of transactions for which they are preparing reports. In particular:

- The expansion to include series means that taxpayers may now need to document transactions that were not previously described in their documentation. Taxpayers should carefully consider whether the tested intercompany transaction is part of a broader series

of transactions that should be described — even if the other transactions within that series would not themselves fall within the ambit of the transfer pricing rules.

- There is a heightened requirement for taxpayers to consider other relevant transactions within the group. If there are other relevant transactions within the multinational group that impact the tested transaction, the taxpayer must provide descriptions of those transactions as well. This means that taxpayers may be required to examine other similar transactions within the group, or other transactions that lead to or are connected with the tested transaction. For example, if the Canadian taxpayer is part of a global residual profit split, it may no longer be acceptable to describe only the Canadian component of the profit split.

In addition, given that the comparison to arm's length conditions now contemplates the question of whether the parties would have done a different transaction or might not have transacted at all, it may also be prudent to present the other options realistically available to the parties besides entering into the controlled transaction, and explain why this transaction makes commercial sense in light of those other options.

Taxpayers should review the revised documentation rule in 247(4) to confirm that their transfer pricing reports continue to satisfy the checklist of items that must be completely and accurately described. The transfer pricing report is the first opportunity that a taxpayer has to persuade the CRA that its transfer pricing satisfies the arm's length principle, so it is equally important that the report is prepared with the objective of persuasion in mind.

Documentation checklist

The following checklist summarizes the key areas taxpayers should review and potentially update in their transfer pricing reports to ensure compliance with the amendments.

- Document "series of transactions", not just the individual transaction.
- Describe transactions across the broader group that are relevant to the tested transaction.
- Discuss the realistic alternatives available to the parties and why the controlled transaction makes commercial sense compared to those alternatives.
- Justify why the selected transfer pricing methodology is the most appropriate per the OECD Guidelines and explain why other potential methods were not appropriate (e.g., not capable of being reliably applied).
- Cross-check the transfer pricing report against the full list of items that must be completely and accurately described in revised subsection 247(4). Below is a comparison of the documentation requirements in "old" paragraph 247(4)(a) to the current requirements, with affected language in bold.

Before November 4, 2025

(a) [...]

(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 contributions to costs**, as the case may be, in respect of the transaction;

[...]

After November 4, 2025

(a) [...]

(i) the property or services to which the transaction **or series** relates,

(ii) the **contractual terms of the transaction or series** and their relationship, if any, to the **contractual terms** of each other transaction **or series that is relevant to the transaction or series and that involves at least one of the participants or any other member of the multinational enterprise group**,

(iii) the identity of the participants and their relationship to each other at the time the transaction **or series** was entered into,

(iv) the functions performed **by each of the participants in the transaction or series, based on their actual conduct**, taking into account (A) assets used and risks assumed, **(B) how those functions relate to the wider generation of value by the multinational enterprise group to which the participants belong**, (C) **circumstances surrounding the transaction or series**, and (D) **industry practices**,

(v) the data and methods considered and the analysis performed to determine **amounts that are based on arm's length conditions and to select and apply the most appropriate method in accordance with the Transfer Pricing Guidelines** in respect of the transaction or series, and

(vi) the **economic circumstances**, assumptions, policies and **business strategies**, if any, that influenced the determination of **the amounts that are based on arm's length conditions** in respect of the transaction or **series**;

[...]

Administrative measures

The transfer pricing amendments include a number of administrative measures. The time to provide contemporaneous documentation in response to a CRA request has been reduced significantly, from three months to just 30 days, which will place additional pressure on taxpayers to have transfer pricing documentation ready *before* an audit begins.

The absolute penalty threshold has increased from C\$5 million to C\$10 million, a helpful change to the rule that exempts smaller adjustments from transfer pricing penalties.

The amendments also contemplate that alternative transfer pricing documentation requirements in prescribed circumstances (i.e., “simplified” documentation) could be prescribed by regulation, though no regulations have been released to date.

Conclusions

Given their stated rationale of aligning Canada’s rules more closely with the OECD Guidelines, the transfer pricing amendments ultimately may not produce significantly different outcomes for most taxpayers than the prior regime.

However, the expanded scope of required documentation, together with the shortened 30-day deadline to respond to contemporaneous documentation requests, increases the stakes for taxpayers who are not audit ready. Multinational groups should review their transfer pricing policies, intercompany agreements, and documentation now to ensure that they will withstand scrutiny under the new rules — before a CRA audit begins.