



Canada Revenue
Agency

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ADVANCE PRICING ARRANGEMENT

PROGRAM REPORT 2009-2010

Competent Authority Services Division
International and Large Business Directorate
Compliance Programs Branch
Canada Revenue Agency



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Executive Summary

This past fiscal year marks the twentieth anniversary of the Canada Revenue Agency's (CRA) Advance Pricing Arrangement (APA) program. Over the past two decades, the APA program has grown significantly, due to its appeal amongst taxpayers seeking prospective certainty with respect to their intercompany transfer pricing.

A summary of this report's key findings is provided below:

- Over the course of the 2009-10 fiscal year, the CRA conducted 31 pre-file meetings with taxpayers. Although less than the number of pre-file meetings held in each of the previous two years, taxpayers' interest in the APA program continues to be strong.
- Opening with an active case inventory of 84 APAs, the CRA accepted an additional 29 cases into the program in 2009-10. With the completion of 16 APAs and the withdrawal of 2 taxpayers from the program, closing inventory at the end of the fiscal year was 95.
- Bilateral APAs continued to be the mechanism of choice of taxpayers seeking prospective transfer pricing certainty. At the close of the fiscal period, almost 90% of all cases currently in progress involved taxpayers seeking an APA on a bilateral or multilateral basis, as opposed to just over 10% of taxpayers seeking an APA on a unilateral basis.
- For bilateral cases completed in 2009-10, the average time to conclude an APA from start to finish (i.e. from acceptance into the program to completion) was approximately 49 months. Of this time, an average period of 17 months related to the time needed by the CRA to undertake its due diligence, carry out a transfer pricing analysis, and to prepare a position paper. The average time needed to successfully conclude negotiations with a foreign tax administration was approximately 10 months.
- Almost one half of the cases pertained to the transfer of tangible property, representing 49% of in progress APAs at the end of 2009-10. In comparison, cases involving intangible property and intra-group services represented 29% and 21% of cases, respectively.
- The most frequently employed transfer pricing methodology continues to be the transactional net margin method (TNMM). A TNMM was proposed in 53% of all in-progress cases. The profit split and gross margin methodologies (i.e. resale minus and cost plus) were the next most popular methods having each been proposed in 19% of cases. Only 9% of cases involved the use of a comparable uncontrolled price (CUP).



- Cases involving taxpayers with operations falling in the realm of the auto and other transportation equipment, computers and electronics, and metals and minerals sectors continued to represent almost one half of all in-progress cases in the APA program at the close of the fiscal year. They represented 24%, 13%, and 11%, respectively, of the total inventory at the end of 2009-10.



Introduction

For the past eight years, the CRA has been issuing an annual report on its APA program. These reports, which are targeted to taxpayers, professional tax representatives, and international tax administrations, have several objectives. These include:

- To increase awareness of the CRA's APA program;
- To notify readers of any changes to the program;
- To provide an overview on the operational results of the program; and,
- To discuss any factors that may impact the program in future years.

Maintaining the approach of previous years' publications, the *2009-2010 Advance Pricing Arrangement Annual Report* continues to place a heavy emphasis on statistical analysis and quantitative data with a particular aim of providing insight to the approaches taken by the CRA and its treaty partners on difficult transfer pricing issues.

This report covers the twentieth anniversary year of the CRA's APA program. The APA program was initially established as a result of a co-operative joint pilot project with the Office of the Chief Counsel in the United States. Although the APA program was not formally launched until July 1993, over the period of 1990 to 1992, cases were accepted into the program on a trial basis.

Over the past two decades, the program has become progressively popular with taxpayers seeking prospective certainty with respect to their intercompany transfer pricing. As evidence to the growth in the popularity of the APA program, the first five years of the program saw the CRA engage in a total of 22 pre-file meetings and accept 16 taxpayers into the program. In contrast, during the five-year period ending with fiscal year 2009-10, the CRA participated in a total of 144 pre-file meetings and accepted 120 taxpayers into the program.

With the close of fiscal year 2009-10, there have now been 253 cases accepted into the program since its inception. Of these, the CRA has successfully completed 142 APAs with Canadian taxpayers, of which 113 involved bilateral or multilateral agreements with other foreign tax administrations. It is also worth mentioning that in only 12 instances has a taxpayer elected to leave the program prior to the completion of a successful APA, and on only 4 occasions has the CRA been unable to reach an agreement with a foreign tax administration and/or taxpayer following a series of bilateral negotiations.



Background

The APA program is delivered through the CRA's Competent Authority Services Division (CASD), which is part of the International and Large Business Directorate (ILBD), Compliance Programs Branch (CPB). The program is a proactive service offered by the CRA to assist taxpayers in resolving transfer pricing disputes that may arise in future tax years. The primary objective of the program is to provide increased certainty with respect to future intercompany transfer pricing issues in a manner consistent with the *Income Tax Act* (ITA), and guidance delivered through the CRA's information circulars (IC) and by the Organisation of Economic Cooperation and Development (OECD).

The APA process is based on cooperation and the free flow of information. It is different from an audit in that it focuses on prospective or future tax years rather than tax years that have already elapsed. In essence, an APA is an arrangement between a taxpayer and a tax administration that sets out an appropriate transfer pricing methodology, to be used on a prospective basis, for establishing a transfer price between related parties that embodies the arm's length principle as described by the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* and the CRA's current version of IC 87-2 *International Transfer Pricing*.

Although APAs are actively promoted by the CRA, the APA process is generally initiated by Canadian taxpayers through contact with the CASD. For further information on the CRA's APA program, please refer to the current version of IC 94-4 *International Transfer Pricing: Advance Pricing Arrangements (APAs)*.



A Year in Review: 2009-10

The following section provides a statistical overview of the CRA's APA program along with current trends, issues, and changes to the program. For comparative purposes, the information presented in this year's report follows the order of the information presented in the 2008-09 publication. Items of particular interest that will be examined in further detail include:

- General interest in the APA program;
- Program inventory and annual production;
- Common transfer pricing issues;
- Selection of transfer pricing methodologies;
- Participation in the APA program by industrial sector;
- Bilateral and multilateral APAs by foreign jurisdiction; and,
- A geographic breakdown of the APA program by Canadian province.

To enhance the transparency of the APA program, a number of changes were introduced in last year's report to standardize the information presented to readers on a year-to-year basis. This entailed a move towards the use of consistent measures and the reformulation of the methodology used to account for annual APA production and inventory turnover. A summary of these changes can be found in Appendix A at the end of this report.



General Interest in the APA Program

The first step in the APA process is the APA pre-file meeting. The meeting, which takes place between a taxpayer and the CRA, is an opportunity for the taxpayer to learn more about the APA program and for the CRA to obtain clarification on the taxpayer's business, industry, and most importantly, the requested covered transaction. The primary objective of the meeting is to explore the suitability of the taxpayer and covered transaction for the APA program.

Although a taxpayer's acceptance into the APA program is not determined during the pre-file stage, the number of pre-file meetings held in a given year does provide a preliminary forecast of future years' inventory. It can also be used to gauge the current level of interest in the CRA's APA program.

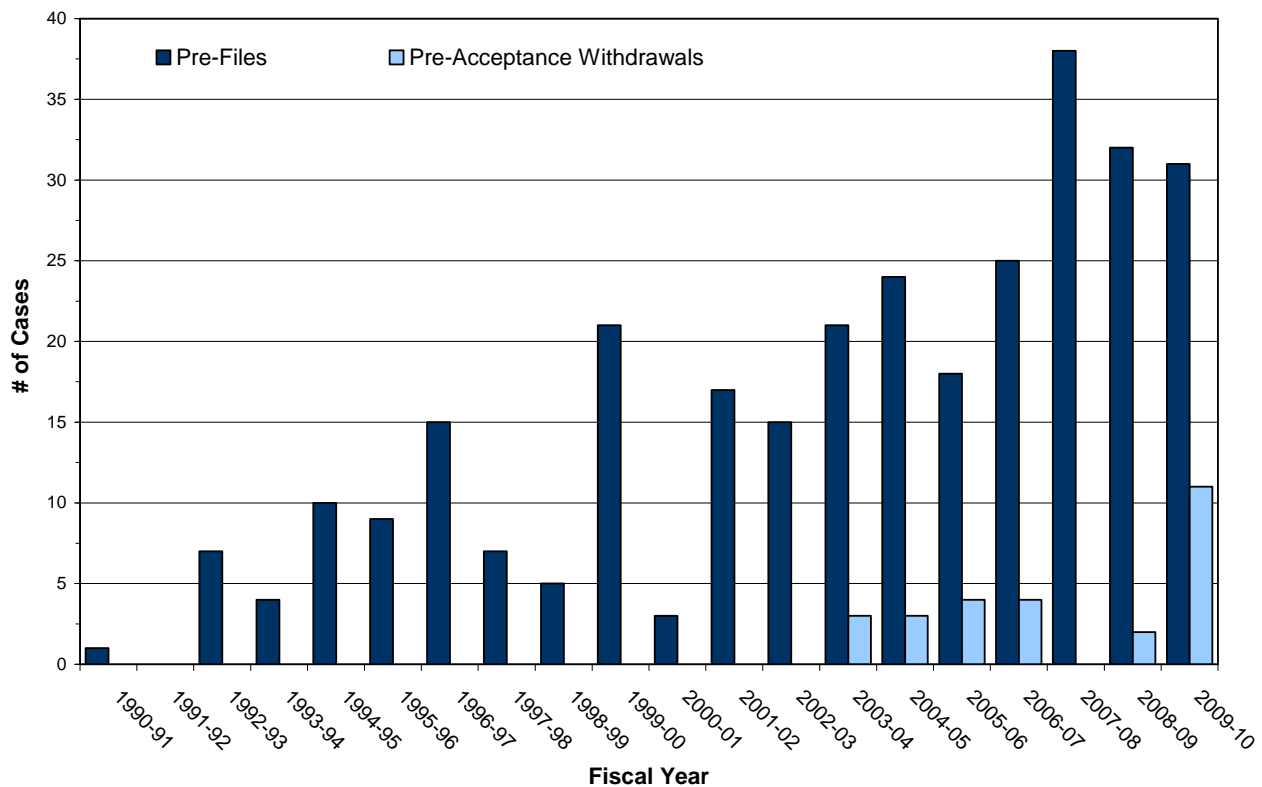
Annual APA Production									
Fiscal Year	Pre-Files	Pre-Acceptance Withdrawals	Opening Inventory	Incoming Inventory: Accepted APAs	Itemized Outgoing Inventory:			Total Outgoing Inventory	Closing Inventory
					APAs Completed	APAs Unresolved	Post-Acceptance Withdrawals		
2009-10	31	11	84	29	16	0	2	18	95
2008-09	32	2	63	32	10	1	0	11	84
2007-08	38	0	48	23	8	0	0	8	63
2006-07	25	4	41	18	9	0	2	11	48
2005-06	18	4	33	18	10	0	0	10	41
2004-05	24	3	37	14	17	1	0	18	33
2003-04	21	3	37	17	17	0	0	17	37
2002-03	15	0	37	16	15	0	1	16	37
2001-02	17	0	29	13	5	0	0	5	37
2000-01	3	0	30	11	11	0	1	12	29
1999-00	21	0	26	12	5	0	3	8	30
1998-99	5	0	33	1	5	0	3	8	26
1997-98	7	0	35	7	7	2	0	9	33
1996-97	15	0	20	18	3	0	0	3	35
1995-96	9	0	14	8	2	0	0	2	20
1994-95	10	0	4	10	0	0	0	0	14
1993-94	4	0	3	3	2	0	0	2	4
1992-93	7	0	1	2	0	0	0	0	3
1991-92	0	0	1	0	0	0	0	0	1
1990-91	1	0	0	1	0	0	0	0	1
Total	303	27		253	142	4	12	158	



Historically, the CRA has averaged 15 pre-file meetings per year or approximately 22 meetings annually when computed over the past decade. During the 2009-10 fiscal year, the CRA conducted a total of 31 pre-file meetings. Despite trending down from fiscal year 2007-08, the long term trend suggests that there continues to be strong interest in the CRA's APA program from taxpayers seeking prospective certainty with respect to their intercompany transfer pricing.

A cursory review of recent APA applicants indicates that the rise in pre-file meetings over the past decade can be attributed in part to taxpayers that had previously been involved in the APA program and are now returning for an APA renewal or for additional coverage — a tribute to the program's increasing maturity and success. Nonetheless, much of the interest continues to arise from new taxpayers seeking prospective certainty with respect to their intercompany transfer pricing.

APA Pre-File Meetings and Pre-Acceptance Withdrawals



As first presented in last year's report, APA withdrawals are now segmented into pre-acceptance withdrawals and post-acceptance withdrawals. A pre-acceptance withdrawal occurs when a taxpayer formally engages the CRA in an APA pre-file meeting, but either chooses on its own accord not to pursue an APA, or is informed by the CRA that the proposed covered transaction is not well suited to the APA program. A post-



acceptance withdrawal occurs where a taxpayer has formally requested and been accepted into the program, but is subsequently unable to continue on in the APA process.

In 2009-10, there were a total of 13 withdrawals from the APA process, 11 of which were pre-acceptance withdrawals with the balance being post-acceptance withdrawals.

Although the withdrawal of 11 taxpayers from the APA process during the pre-acceptance stage may appear alarming, in reality, it speaks more to the evolution of the APA pre-file meeting. In recent years, in an effort to increase transparency in the program and to ensure applicants are able to meet the demands of an APA, the CRA has been increasingly proactive in ensuring that taxpayers are well-equipped with the necessary feedback on their proposed transfer pricing methodologies and covered transactions. Consequently, based on this feedback, in some instances taxpayers opt not to pursue an APA, while in a few other instances, the CRA may conclude that it would not be appropriate to accept or pursue an APA with a taxpayer. If the CRA declines an APA request, or chooses not to pursue an APA, taxpayers are provided with an explanation for the CRA's decision. As an example, the CRA may decline an APA request when the central issue involves a matter that is before the courts. In most cases however, taxpayers are given an opportunity to make further representations on any outstanding issues that are precluding their acceptance into the program.

Of course, financial constraints, significant changes in operations such as business restructurings, and change in personnel are other reasons why a taxpayer may choose not to pursue an APA. In any case, a taxpayer's withdrawal from the process during the pre-acceptance stage reduces the likelihood of a withdrawal at a subsequent point in time after being formally accepted into the program. It is worth noting that in some cases, taxpayers who choose not to proceed with an APA at this early stage will simply not make a formal request for an APA. As such, information pertaining to the taxpayer's decision not to proceed in the process is not always available to the CRA.

A point of interest, since 2003-04 there have been 27 incidents of pre-acceptance withdrawals from the APA process and only 4 incidents of a post-acceptance withdrawals. From an efficiency standpoint, the withdrawal of a taxpayer during the pre-acceptance instead of the post-acceptance stage of the APA process represents a significant savings of resources for both taxpayers and tax administrations.

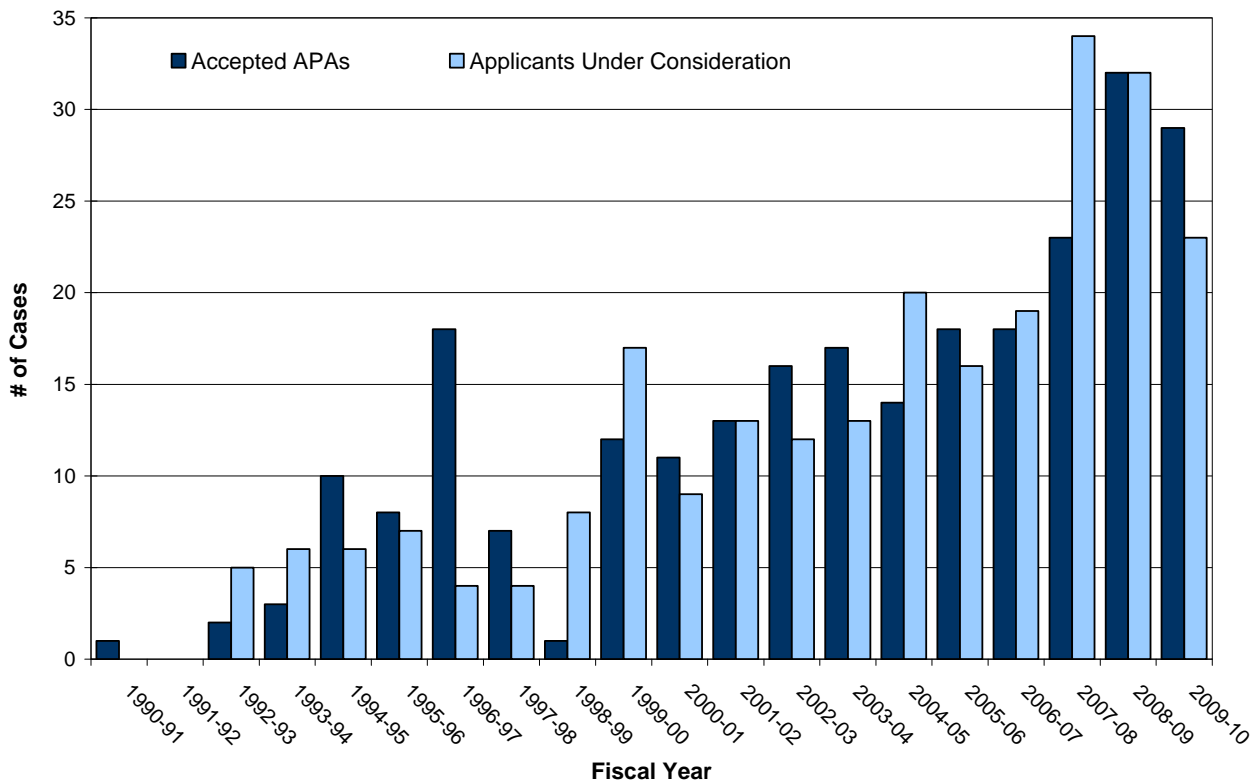


Program Inventory and Annual Production

Although down from last year's historical high of 32 new APA acceptances, the APA program continued to experience strong growth over the course of the 2009-10 fiscal year with the acceptance of 29 new cases. These 29 new cases are in addition to those cases already in inventory from acceptances in years past.

The chart below provides a visual depiction of the number of cases accepted into the program during a given fiscal year, and the number of applications still under consideration at the end of that fiscal year. At the end of the 2009-10 fiscal year, there were still 23 applications under consideration for the APA program (i.e. those instances where a pre-file meeting has occurred between the CRA and a taxpayer, but a taxpayer's acceptance into the program had yet to be determined at the close of the fiscal year). This figure alone, without any consideration to pre-file meetings that may take place in the coming year, suggests that there could be as many as 23 new cases accepted into the program in 2010-11.¹

Current / Potential APA Program Growth



¹ The number of cases where applications are still under consideration was computed in two stages. First, the cumulative number of APA pre-file meetings undertaken from the program's inception up the end of a given fiscal year was quantified. Second, the cumulative number of cases accepted into the program and the cumulative number of pre-acceptance withdrawals were subtracted from the cumulative pre-file count, over time, for each fiscal year.

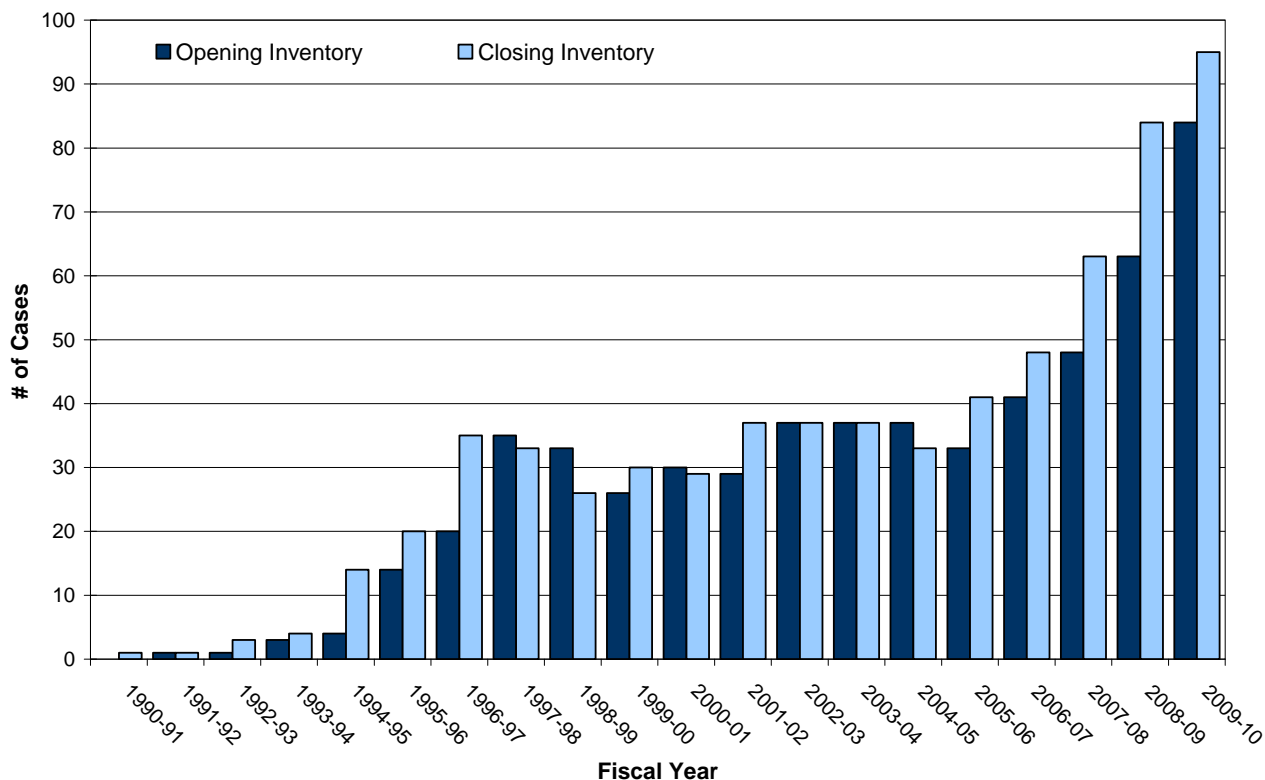


Heading into the 2009-10 fiscal year, the CRA's APA program had an opening case inventory of 84 APAs in progress – a historical high in terms of APA inventory. Outgoing inventory, which is composed of APAs completed, any unresolved APAs, and post-acceptance withdrawals from the APA program, totalled 18 cases in 2009-10. APAs completed, or those cases that successfully resulted with an APA agreement, represented 16 of the 18 cases.

This year there were two post acceptance withdrawals where taxpayers were unable to proceed in the APA process after already receiving formal acceptance into the program. Since APAs are predicated on the basis that the facts and circumstances underlying the covered transaction will not change over the course of the APA term, any event which brings into question the continuity of the transaction could potentially result in a taxpayer's withdrawal from the APA program on a premature basis (i.e. prior to the completion of an APA). Due to the confidentially provisions of the ITA, the CRA is unable to provide specific details pertaining to the two instances of post-acceptance withdrawals.

With the addition of 29 new cases to the APA program, and the closure of 18 APAs, 2009-10 closed with a total inventory of 95 cases.

APA Program Inventory



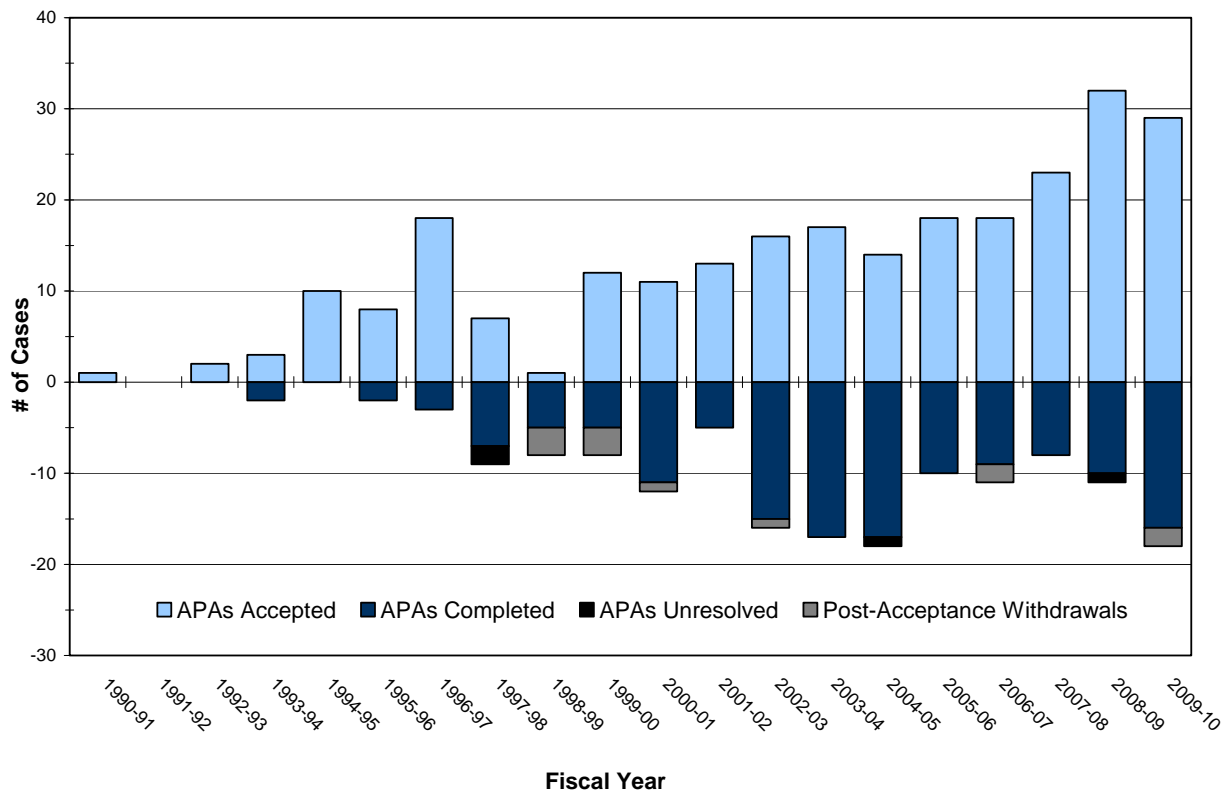


Presented in the chart below is a visual overview of incoming and outgoing inventory in the CRA's APA program. The upper portion of the chart represents incoming inventory or new cases entering the APA program – i.e. accepted APAs, by fiscal year. The bottom portion of the chart represents outgoing inventory as a result of completed, unresolved and post-acceptance withdrawn APAs. As the chart depicts, in recent years, incoming inventory has generally outpaced the number of APAs closed.

Considering the history of the APA program, it is a very rare occurrence that an APA is closed without reaching resolution. In total, since the inception of the APA program, there have been 4 instances in which the CRA has been unable to conclude an agreement with a taxpayer and/or foreign tax administration. These few numbers, reflect the gravity with which the CRA considers closing an APA without resolution.

Similarly, in only 12 cases have taxpayers elected to exit the APA process after having received formal acceptance into the program. Again, it is worth noting that in many instances a taxpayer's decision to withdraw from the APA process after receiving acceptance follows a material changes in the facts and circumstances underlying the proposed covered transaction. In such circumstances, a taxpayer will simply conclude that an APA is no longer warranted.

APA Inventory Turnover





At the close of the fiscal year 2009-10, the CRA has now successfully concluded 142 APAs since the program began in the early 1990s. Of these, the vast majority were bilateral. Including multilateral APAs, of the 142 successfully concluded cases, approximately 80% (or 113 of the cases) involved at least one other foreign tax administration. Of the APAs still in progress, 85 of the 95 cases or approximately 89% are bilateral or multilateral. As in previous years, it can reasonably be concluded that the CRA and applicants to the APA program continue to be focused on bilateral (or multilateral) arrangements in order to obtain double-tax relief and enjoy the highest degree of tax certainty.

APAs - Intergovernmental Status								
Type	Unilateral		Bilateral		Multilateral		Total	
	#	% of total	#	% of total	#	% of total	#	% of total
Completed To Date	29	20%	110	77%	3	2%	142	100%
In Progress	10	11%	83	87%	2	2%	95	100%
Combined	39	16%	193	81%	5	2%	237	100%

* Totals may not sum due to rounding.

It is the scope and complexity of a case and not the size of the covered transaction or companies involved, along with other factors such as a taxpayer's cooperation and the availability of quality information, that determine the length of time required to complete an APA. In some instances, cases require a substantially greater investment in the CRA's time and resources because they cover a particularly complex transaction or because the necessary information needed to complete a transfer pricing analysis is limited. In this respect, readers should be aware that given the small number of cases used in the computation of the CRA's APA completion time statistics, the figures presented in the following section may be susceptible to biases resulting from the presence of extreme outliers.

Completing an APA, from the time it is accepted into the program to agreement and signing of a formal arrangement by all of the parties involved, requires a substantial investment in time and resources. Bringing an APA from start to finish can generally be broken down into three distinct stages. These stages can be described as the due diligence, negotiations, and post-negotiations stages.

The due diligence stage begins with the acceptance of a candidate into the program and finishes with the completion of a formal position paper outlining the CRA's views on the covered transactions. Due diligence includes reviewing materials presented by the taxpayer, undertaking site-visits, issuing additional queries and/or information requests as needed in order for the CRA to undertake a thorough financial and transfer pricing analysis, and finally, formalizing a transfer pricing position with respect to the covered transactions.



The second stage (at least with respect to bilateral and multilateral APAs) is the government-to-government negotiations in which the CRA and foreign tax administration(s) discuss their views and reach a common agreed-upon transfer pricing methodology. Although a transfer pricing analysis and positions are developed prior to meeting with the foreign tax administration, the discussions can often require additional analysis, research, and fact-finding in order to help resolve differences between the CRA's and a foreign tax administration's transfer pricing positions. Depending on the case, this often requires a substantial investment in additional time and resources.

And finally, the third stage pertains to the documentation and signing of a bilateral/ multilateral understanding between the CRA and a foreign tax administration, and similarly the signing of a corresponding domestic APA between the CRA and the Canadian taxpayer. Depending on the complexity of the transfer pricing methodology agreed upon, the time required to finalize an APA can vary. Historically, this stage of the APA process has far exceeded planned or expected timelines.

Focusing on the 11 bilateral APAs closed in 2009-10, the CRA required on average 17 months to gather the necessary information and develop a position with respect to the covered transactions in question. Once position papers were exchanged between the CRA and a foreign tax administration, it took on average an additional 10 months to reach an agreement on a transfer pricing methodology and to establish an arm's length intercompany price for any elapsed years pertaining to the covered transactions. And finally, once negotiations were complete, approximately 13 months were needed to draft and finalize the APA. In all, for bilateral APAs closed in 2009-10, 49 months on average elapsed from the time an applicant was accepted into the program to the time a formal arrangement was signed by all parties involved.

In 2009-10, unilateral APAs required on average 10 months in order for the CRA to undertake its due diligence and to develop a transfer pricing position paper. As unilateral APAs do not entail negotiations with a foreign tax administration, the second stage does not apply to these cases. The time required to finalize a unilateral APA between the CRA and a taxpayer averaged 9 months in 2009-10. In total, unilateral APAs that closed in 2009-10 required 19 months on average to progress from acceptance to completion.



APA Stages - Completion Time Statistics							
Fiscal Year	Type	Cases	Due Diligence	Negotiations	Post-Negotiations *	Total - Acceptance to Completion **	
		#	Months (Average)			Average	Median
2009 - 10	BAPA/MAPA	11	17.4	9.7	13.2	48.8	45.8
	APA (Unilateral)	5	9.8	NA	8.7	18.5	16.6
2008 - 09	BAPA/MAPA	9	15.1	9.2	11.6	42.2	35.6
	APA (Unilateral)	2	26.7	NA	13.6	40.3	40.3
2007 - 08	BAPA/MAPA	7	16.5	4.0	10.5	32.8	25.9
	APA (Unilateral)	1	6.1	NA	6.2	12.3	12.3
2006 - 07	BAPA/MAPA	6	11.4	8.2	11.4	39.9	35.0
	APA (Unilateral)	3	16.7	NA	7.0	23.7	22.1
2005 - 06	BAPA/MAPA	9	21.6	12.3	7.8	44.1	42.7
	APA (Unilateral)	1	10.3	NA	1.0	11.3	11.3
Five-Year Average (Weighted)	BAPA/MAPA	42	16.8	9.0	11.0	42.4	38.1
	APA (Unilateral)	12	14.1	NA	8.2	22.3	21.1

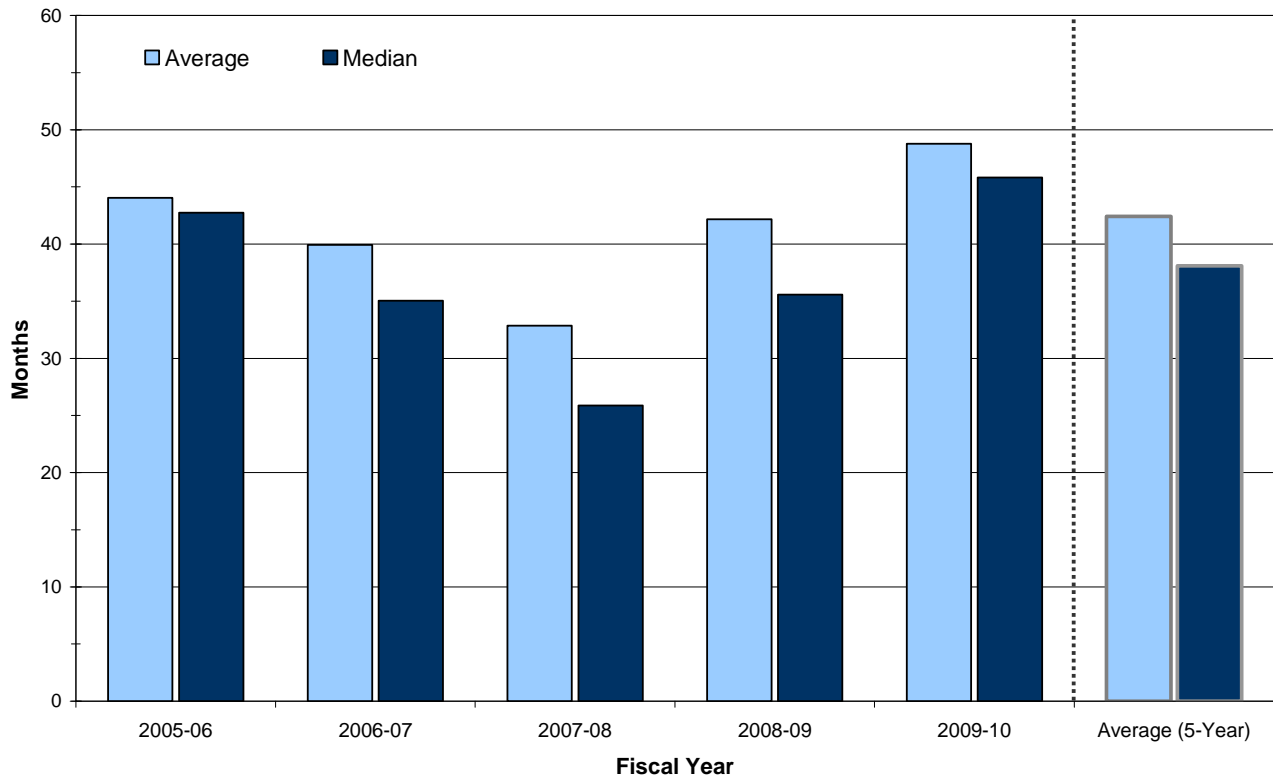
* For unilateral APAs, this column represents the time required to finalize an APA once a CRA transfer pricing position has been established.

** Total Time to complete an APA from acceptance into the program does not necessarily equate to the sum of due diligence, negotiations, and post-negotiations stages. Cases have been put into suspense on occasion pending the receipt of additional information. Additionally, due to the fact that APA program requires a simultaneous exchange of position papers between tax administrations, additional delays can occur.

Comparing total APA completion times on an annual median basis to that of the annual average, we see that in each of the past five years the median APA completion time has been lower than average APA completion time. This would indicate that a disproportionate number of outlier cases are taking considerably longer periods to conclude, and thus, are skewing the average completion time statistics in each year. For instance, we see that in 2009-10, the median time required to complete a bilateral/multilateral APA was approximately 46 months versus that of the average time of 49 months. Overall, the average median time required to complete an APA over the past five years was 38 months. The average completion time over the same period was approximately 42 months.



Total APA Completion Times - Bilateral and Multilateral APAs



Readers should be aware that the total time to complete an APA from acceptance into the program does not necessarily equate to the sum of the due diligence, negotiations, and post-negotiations stages. In some instances, cases have been put into suspense while the CRA awaits additional information from a taxpayer. Instances of this nature generally occur when a taxpayer is reconsidering their suitability for the APA program or is unable to provide the necessary information needed for the CRA to undertake a thorough financial and transfer pricing analysis. In other instances, delays are due to the fact that the APA program requires the simultaneous exchange of position papers between tax administrations prior to commencing negotiations.

Tracking the amount of time to complete an APA might best be measured with reference to the year in which it was accepted into the program. Completion is typically measured from the date in which a case is formally accepted into the APA program and all APA documentation between the CRA, foreign tax administrations, and the taxpayers are finalized. Provided in the table below are the average time statistics associated with the completion of APAs accepted into the program in a given fiscal year.



APAs - Completion Time Report								
Fiscal Year	Average Completion Time -- Months	APAs Accepted*	APAs Completed	% Completed	APAs Unresolved	% Unresolved	APAs In Progress	% In Progress
2009-10	0.0	29	0	0%	0	0	29	100%
2008-09	13.2	30	3	10%	0	0%	27	90%
2007-08	21.6	23	3	13%	0	0	20	87%
2006-07	24.0	18	7	39%	0	0%	11	61%
2005-06	32.4	16	13	81%	0	0	3	19%
2004-05	30.0	14	11	79%	0	0%	3	21%
2003-04	31.2	17	16	94%	0	0%	1	6%
2002-03	31.2	15	14	93%	1	7%	0	0%
2001-02	39.6	13	11	85%	1	8%	1	8%
2000-01	36.0	11	11	100%	0	0%	0	0%
1999-00	33.6	10	10	100%	0	0%	0	0%
1998-99	44.4	1	1	100%	0	0%	0	0%
1997-98	49.2	6	6	100%	0	0%	0	0%
1996-97	43.2	17	17	100%	0	0%	0	0%
1995-96	51.6	7	7	100%	0	0%	0	0%
1994-95	38.4	8	7	88%	1	13%	0	0%
1993-94	37.2	3	3	100%	0	0%	0	0%
1992-93	9.6	2	1	50%	1	50%	0	0%
1991-92	0.0	0	0	NA	0	NA	0	NA
1990-91	42.0	1	1	100%	0	0%	0	0%
Average	30.0	241	142	59%	4	2%	95	39%

* For the purpose of computing completion time statistics, excluded from "APAs Accepted" are those instances where a taxpayer withdrew from the program subsequent to receiving formal acceptance to the program -- i.e. post-acceptance withdrawals.

As an example, referring to fiscal year 2001-02, 13 APAs were accepted into the program during the course of that fiscal year. Of these, 11 of the thirteen have now been completed with one case being closed on the basis that an agreement could not be reached with a foreign tax administration and/or taxpayer. In all, one case continues to be active. As it relates to the 11 completed cases that were accepted into the program in fiscal year 2001-02, it has taken approximately 40 months on average to take a case from acceptance to completion.

It is important to note that outliers can greatly skew the information presented in the table above. For instance, there are incidences when APAs are accepted for renewal and the facts and circumstances of the



intercompany transaction have not changed substantially from the previous cycle; consequently, an agreement with a foreign tax administration and/or taxpayer is reached in very short order.

On the other hand, some cases do take substantially greater time to reach an agreement with a foreign tax administration and/or taxpayer. As a result, as these cases close, the average time statistics for a given fiscal year are materially skewed. The phenomenon is that much more amplified in those fiscal years where very few cases are (were) accepted into the program and a number of cases remain (remained) in progress over several years.

Common Transfer Pricing Issues

Intercompany transactions can broadly be classified into four categories of transfer pricing issues. These are: the physical transfers of tangible property; the transfer of rights associated with intangible property; intra-group services; financing.

Although less than the historical norm (as measured by cases completed to date), the majority of APAs continue to relate to the cross-border transfer of physical property. At the close of 2009-10, 49% of the total number of APAs still in progress related to the transfer of tangible property. Cases involving intangible property were the second most common transfer pricing issue in the APA program, representing 29% of all cases in progress. Transactions relating to intra-group services represented the remaining 21% of cases. There are currently no APAs involving financial products.

APAs - Transactional Issue										
	Tangible Property		Intangible Property		Intra-Group Services		Financing		Total	
	#	% of total	#	% of total	#	% of total	#	% of total	#	% of total
Completed To Date	77	54%	29	20%	30	21%	6	4%	142	100%
In Progress	47	49%	28	29%	20	21%	0	0%	95	100%
Combined	124	52%	57	24%	50	21%	6	3%	237	100%

* Totals may not sum due to rounding.



Selection of Transfer Pricing Methodologies

The transactional net margin method (TNMM) continues to be the predominant methodology employed in APAs – both completed (39% of all cases completed) and in progress (53% of cases in progress). At the end of fiscal year 2009-10, the TNMM in conjunction with an operating margin profit level indicator (PLI) represented 37% of all cases currently in progress in the APA program. The total cost plus, Berry ratio, and return on assets profitability indicators represented in 8%, 4% and 3%, respectively, of all in-progress APA inventory.

APAs - Transfer Pricing Methodology						
Methodology	Completed	% of total	In Progress	% of total	Combined	% of total
Comparable Uncontrolled Price / Transaction	22	15%	9	9%	31	13%
Cost Plus	19	13%	15	16%	34	14%
Resale Price	11	8%	3	3%	14	6%
Transactional Net Margin Method (TNMM) - Total *	56	39%	50	53%	106	45%
<i>PLI - Berry Ratio</i>	4	3%	4	4%	8	3%
<i>PLI - Operating Margin</i>	30	21%	35	37%	65	27%
<i>PLI - Return on Assets</i>	4	3%	3	3%	7	3%
<i>PLI - Total Cost Plus</i>	18	13%	8	8%	26	11%
Profit Split	34	24%	18	19%	52	22%
Total *	142	100%	95	100%	237	100%

* Totals may not sum due to rounding.

Profit split methodologies, which are commonly utilized when intangible assets factor into the transfer pricing equation, continue to be the second most common transfer pricing methodology used with respect to cases in the CRA's APA program. The profit split methodology is currently used in 19% of the cases that are still in progress. The use of the profit split methodology in a significant number of cases reflects the CRA's perspective that where both parties to the transaction are contributing to residual profits, a profit split will often provide a result that is more in keeping with the arm's length principle. The profit split methodology is also often used when the operational characteristics of two non-arm's length parties are highly integrated, making it difficult to clearly identify functions, risks, and assets undertaken by each respective party. Additionally, where it is appropriate and possible, all covered transactions involving a royalty payment in one form or another, are initially analysed utilizing the profit split methodology to evaluate the proposed royalty rate.

The cost plus, comparable uncontrolled price / transaction, and resale methodologies were represented in 16%, 9%, and 3%, respectively, of all in-progress APAs at the close of fiscal year 2009-10.

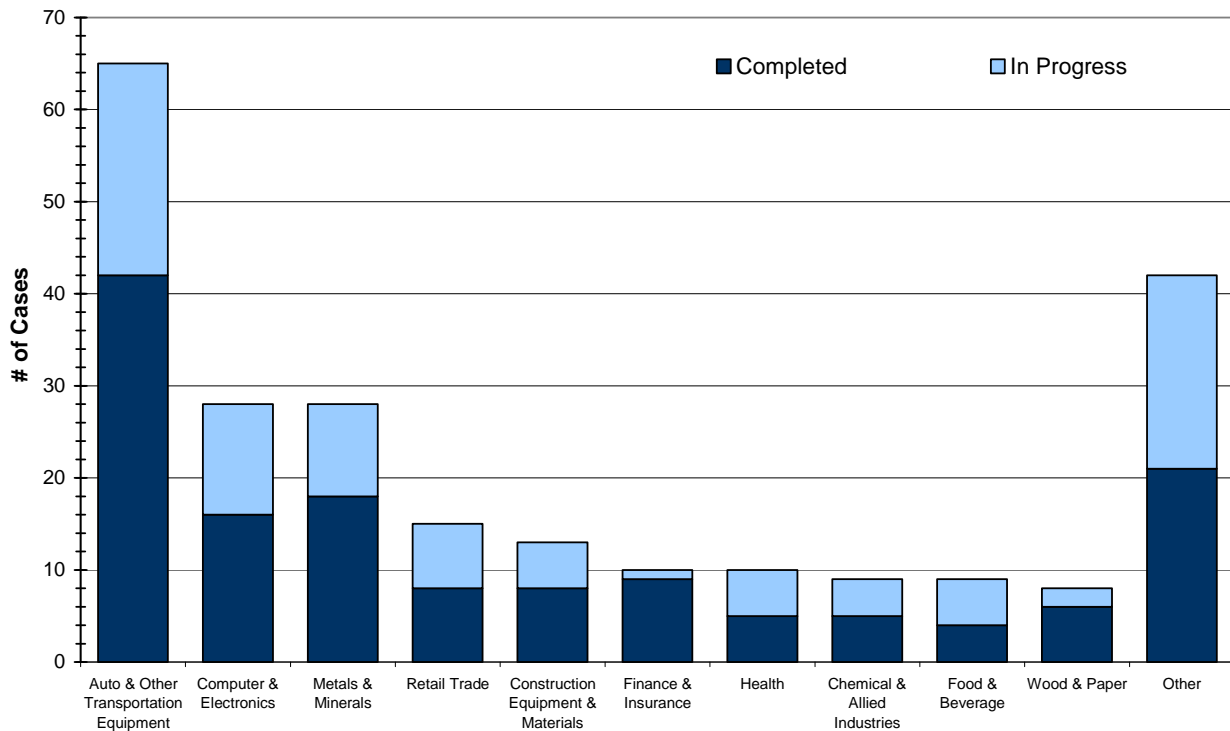


It should be noted, that where an APA is still in progress and the CRA has yet to finalize its position paper, the methodology reported is normally that which is proposed by the taxpayer. Following the development of the CRA's position, where an alternative methodology has been selected by the CRA, the alternative approach may be that which is reflected in the statistics. Additionally, statistics reported for the cost plus method include services transactions, as well as cost sharing arrangements.

Participation in the APA Program by Industrial Sector

Participation in the APA program by industrial sector generally reflects the pattern of Canadian trade. Cases involving taxpayers with operations falling in the realm of the auto and other transportation equipment, computers and electronics, and metals and minerals sectors continued to represent almost one half of all in-progress cases in the CRA's APA program.

APAs by Industrial Sector - Ranked



Since the inception of the APA program, there have been 65 cases related to the auto and other transportation equipment sector, of which 23 are currently still in progress. Cases with taxpayers operating in



the realm of the computer and electronics sector have represented 28 cases into total, 12 of which are still in progress. There have also been 28 cases involving taxpayers in the metals and minerals sector, of which 10 are currently in progress. Rounding out the top five most-represented industrial sectors in the APA program are retail trade, followed by construction equipment and materials.

APAs - Industrial Sector						
Industrial Sector	Completed	% of total	In Progress	% of total	Combined	% of total
Agricultural	2	1%	5	5%	7	3%
Arts & Entertainment	1	1%	1	1%	2	1%
Auto & Other Transportation Equipment	42	30%	23	24%	65	27%
Chemical & Allied Industries	5	4%	4	4%	9	4%
Clothing & Textile	3	2%	2	2%	5	2%
Computer & Electronics	16	11%	12	13%	28	12%
Construction Equipment & Materials	8	6%	5	5%	13	5%
E-Commerce	1	1%	1	1%	2	1%
Finance & Insurance	9	6%	1	1%	10	4%
Food & Beverage	4	3%	5	5%	9	4%
Health	5	4%	5	5%	10	4%
Information & Publishing Services	1	1%	0	0%	1	0%
Machinery	6	4%	1	1%	7	3%
Management, Administrative Services	0	0%	1	1%	1	0%
Metals & Minerals	18	13%	10	11%	28	12%
Petroleum	3	2%	4	4%	7	3%
Real Estate, Rental & Leasing	0	0%	1	1%	1	0%
Retail Trade	8	6%	7	7%	15	6%
Technical, Scientific & Professional Services	0	0%	1	1%	1	0%
Transportation & Warehousing Services	2	1%	2	2%	4	2%
Wholesale Trade	2	1%	2	2%	4	2%
Wood & Paper	6	4%	2	2%	8	3%
Total	142	100%	95	100%	237	100%

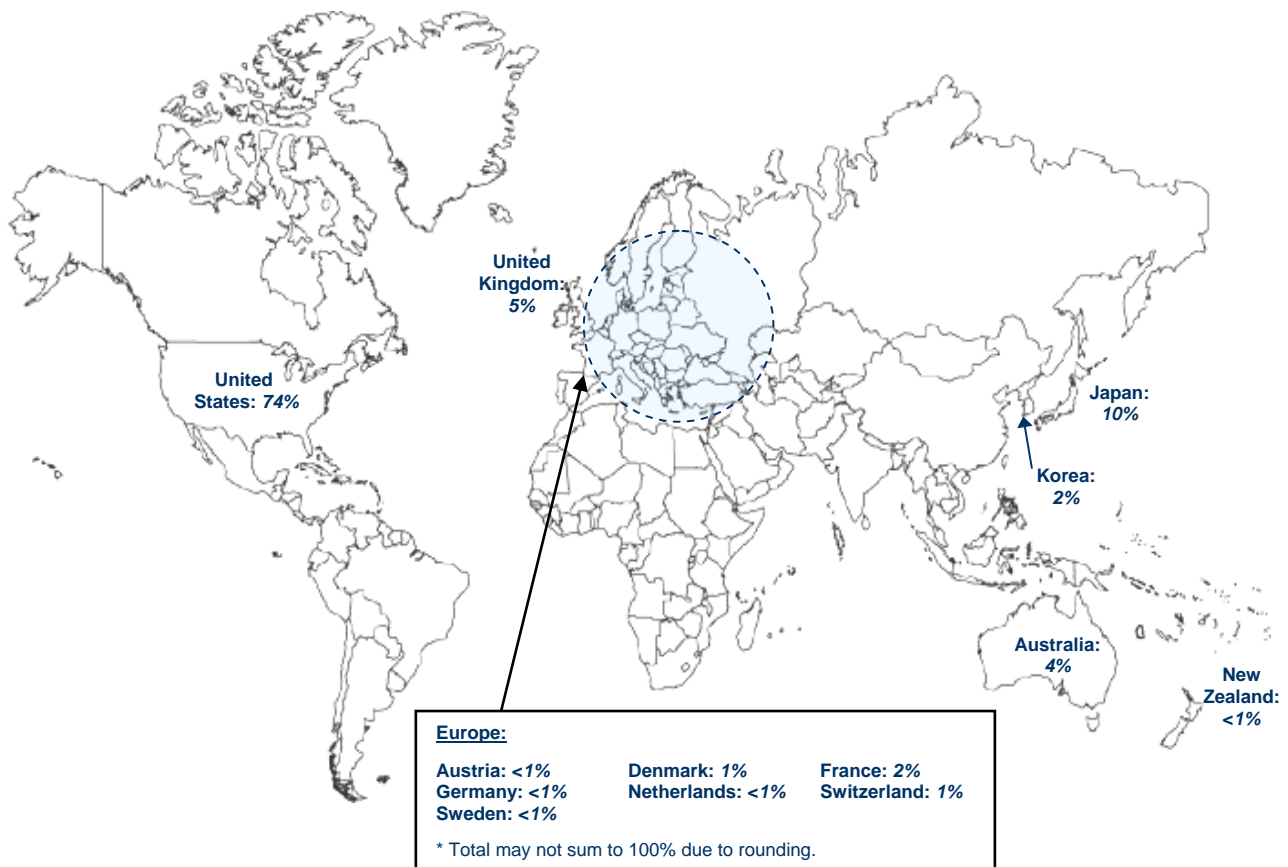
* Totals may not sum due to rounding.



Bilateral and Multilateral APAs by Foreign Jurisdiction

The breakdown of bilateral and multilateral APAs by foreign jurisdiction continues to reflect the significant flow of goods and services exchanged between Canada and the United States. Since the program's inception, the CRA has completed 87 APAs which involved the United States on a bilateral process. At the close of fiscal year 2009-10, 60 cases involving the United States were still in progress. Combined, both completed and in-progress APAs, cases involving trade between the United States and Canada represent approximately 74% of all cases in the APA program.

Bilateral and Multilateral APAs by Country Percentage of Total APAs Completed and In Progress *



At the end of 2009-10, the CRA was actively engaged in bilateral or multilateral APA processes involving taxpayers from ten different countries. After the United States, these other countries include Japan, France, United Kingdom, Korea, Switzerland, Austria, Denmark, Netherlands, and Sweden.



Bilateral and Multilateral APAs - Foreign Jurisdiction						
Country	Completed	% of total	In Progress	% of total	Combined	% of total
Australia	7	6%	0	0%	7	4%
Austria	0	0%	1	1%	1	< 1%
Denmark	1	1%	1	1%	2	1%
France	0	0%	4	5%	4	2%
Germany	1	1%	0	0%	1	< 1%
Japan	10	9%	9	11%	19	10%
Korea	0	0%	3	4%	3	2%
Netherlands	0	0%	1	1%	1	< 1%
New Zealand	1	1%	0	0%	1	< 1%
Sweden	0	0%	1	1%	1	< 1%
Switzerland	0	0%	2	2%	2	1%
United Kingdom	6	5%	3	4%	9	5%
United States	87	77%	60	71%	147	74%
Total	113	100%	85	100%	198	100%

* Totals may not sum due to rounding.

Geographic Breakdown of the APA Program by Canadian Province

The distribution of APAs amongst Canadian provinces continues to reflect the general allocation of Canadian corporate headquarters within the country. As in past years, taxpayers located in Ontario continue to represent just over one half of all APAs currently in progress with 55 cases or 58% of in-progress APAs. There are currently 19 cases involving taxpayers headquartered in the Province of Quebec or 20% of in-progress APAs. Representation from Western Canada (the Provinces of B.C., Alberta, Saskatchewan and Manitoba) totalled 17 in-progress APAs or 17%. And finally, there are currently 4 APAs or approximately 4% of all in-progress APAs involving taxpayers located in the Atlantic Provinces.



APAs - Canadian Province						
Province	Completed	% of Total	In Progress	% of Total	Combined	% of Total
Alberta	4	3%	7	7%	11	5%
British Columbia	15	11%	5	5%	20	8%
Manitoba	2	1%	2	2%	4	2%
New Brunswick	0	0%	1	1%	1	< 1%
Newfoundland and Labrador	1	1%	0	0%	1	< 1%
Nova Scotia	6	4%	3	3%	9	4%
Ontario	83	58%	55	58%	138	58%
Quebec	27	19%	19	20%	46	19%
Saskatchewan	4	3%	3	3%	7	3%
Total	142	100%	95	100%	237	100%

* Totals may not sum due to rounding.



Outlook for the Upcoming Year

The CRA anticipates that taxpayers' interest in the APA program will continue to be strong in coming years. In order to accommodate taxpayers and their requests to obtain transfer pricing certainty on a prospective basis through the APA program, the CRA will continue to closely monitor APA inventory turnover to ensure that the Agency is meeting its pre-established APA timelines.

In follow-up to last year's publication, the CRA would like to comment on the five initiatives outlined at the end of that report pertaining to the optimization of operational efficiencies to help facilitate the closure of cases.

Beginning first with the utilization of technology to minimize time spent away from the office, the CRA has been increasing its use of video and teleconference correspondence with other foreign tax administrations in lead up to intergovernmental negotiations. The use of these technologies has been particularly useful when the underlying facts or circumstances of a particular case are in question and further clarification is needed. Through the facilitation of pre-negotiation meetings, the CRA aims to increase the overall effectiveness of time spent in APA negotiations.

The CRA still holds to its objective of possibly reducing or eliminating site visits on renewal APA applications where it can be reasonably ascertained that there has not been a material change to the functions, assets, and risks of the parties to the transaction. The degree to which this is possible is a function of the complexity of the transaction and the evolution of the taxpayer's business and industry in which it operates. That being said, on a limited number of renewal APAs, the time allotted for site visits has been greatly reduced or entirely eliminated.

Where possible, the CRA will continue to entertain the extension of APA terms (prior to the conclusion of negotiations) in order to provide taxpayers with expanded prospective certainty. It should be noted however, that extending the term of an APA requires concurrence from the other foreign tax administration. Additionally, the CRA would like to make clear that it will not extend the term of an APA when there is a high probability that the facts and circumstances underlying the covered transaction could materially change during the extended period of coverage.

As evidenced by the number of pre-acceptance withdrawals in recent years, the CRA has been increasingly proactive in ensuring that taxpayers are well-equipped with the necessary feedback on their proposed transfer pricing methodologies and covered transactions prior to accepting them into the APA program. The underlying objectives of this initiative are to better assess the suitability of candidates and to reduce the time needed to gather information during the APA process. Consequently, in some instances taxpayers opt not to



pursue an APA, and in a few other instances, the CRA has concluded that it would not be appropriate to accept or pursue an APA with a taxpayer. The CRA will continue to monitor this initiative to ensure that it is being applied fairly and consistently amongst all taxpayers.

And finally, concerning the utilization of specialized expertise to expedite the resolution of APAs and to ensure consistency in the treatment of issues and cases, progress on this initiative has been limited given current caseload levels and available resources at the CASD. However, to the extent possible, the CASD endeavours to utilize available resources in the most efficient manner possible to help facilitate the closure of APAs in an efficient and timely manner.

Although progress with respect to each of the five initiatives presented in last year's APA report has been varied, the CASD will continue to pursue the implementation of these initiatives over the coming year with aim of increasing productivity and case turnover in the APA program.

The CRA also wishes to inform readers that the development of a new inventory tracking system that will permit the Agency to more accurately monitor the progress of APA case work is near completion. Compared to the system currently employed by the CASD, the enhanced functionality of the new system will allow for more in-depth analysis of APA cases, including: taxpayer response times to CRA queries; greater detail with respect to APA completion times and corresponding stages; and point-in-time inventory snapshots and analysis. It is anticipated that this new system will be fully implemented by the summer of 2010.



Appendix A – Methodological Changes Introduced in 2008-09

In the 2008-09 publication, the CRA modified the methodology used to compile its production report statistics. An explanation of these changes and an accompanying rationale are provided below.

Historically, when computing inventory counts, taxpayers that withdrew from the APA program after receiving formal acceptance were removed from the computation of opening and closing inventory balances, and in the number of APAs accepted. Consequently, in past reports, when a taxpayer withdrew from the APA process, the case was reclassified as a “withdrawal” and was no longer reflected in production report statistics. In the circumstance where a withdrawal took place in a year other than the year in which the case was accepted into the APA program, the withdrawal resulted in inconsistent inventory counts from one annual report to another.

To improve the consistency of APA reporting and to better track and account for APA inventory and case turnover on a year-to-year basis, the CRA has modified the treatment of APA withdrawals.

First, APA withdrawals have now been segmented into two types of APA withdrawals. The first type is a pre-acceptance withdrawal. These are cases whereby a taxpayer has undergone a pre-file meeting but was subsequently unable to proceed with the APA process. It is important to note that in previous annual reports, APA production statistics presented in the annual production report table did not account for pre-acceptance withdrawals since an official acceptance had not been issued, and thus, these cases were not formally considered to be a part of the APA workload. The second category of withdrawals, post-acceptance withdrawals, measures the number of cases where a taxpayer is unable to proceed in the APA process after already being formally accepted into the program. Post-acceptance withdrawals were accounted for in opening, closing, and accepted (i.e. incoming inventory) case inventory statistics, but only for that period leading up to the point in time in which the CRA was notified of the taxpayer’s withdrawal from the program.

With respect to this annual report, post-acceptance withdrawals will be reflected in outgoing inventory levels under the heading of “post-acceptance withdrawals”.

Second, as a consequence of the changes outlined above pertaining to the treatment of APA withdrawals, closing inventory counts are now computed in the following manner:



Closing Inventory Year t

Equal to:

Opening Inventory Year t

Plus

Incoming Inventory: Accepted APAs Year t

Less

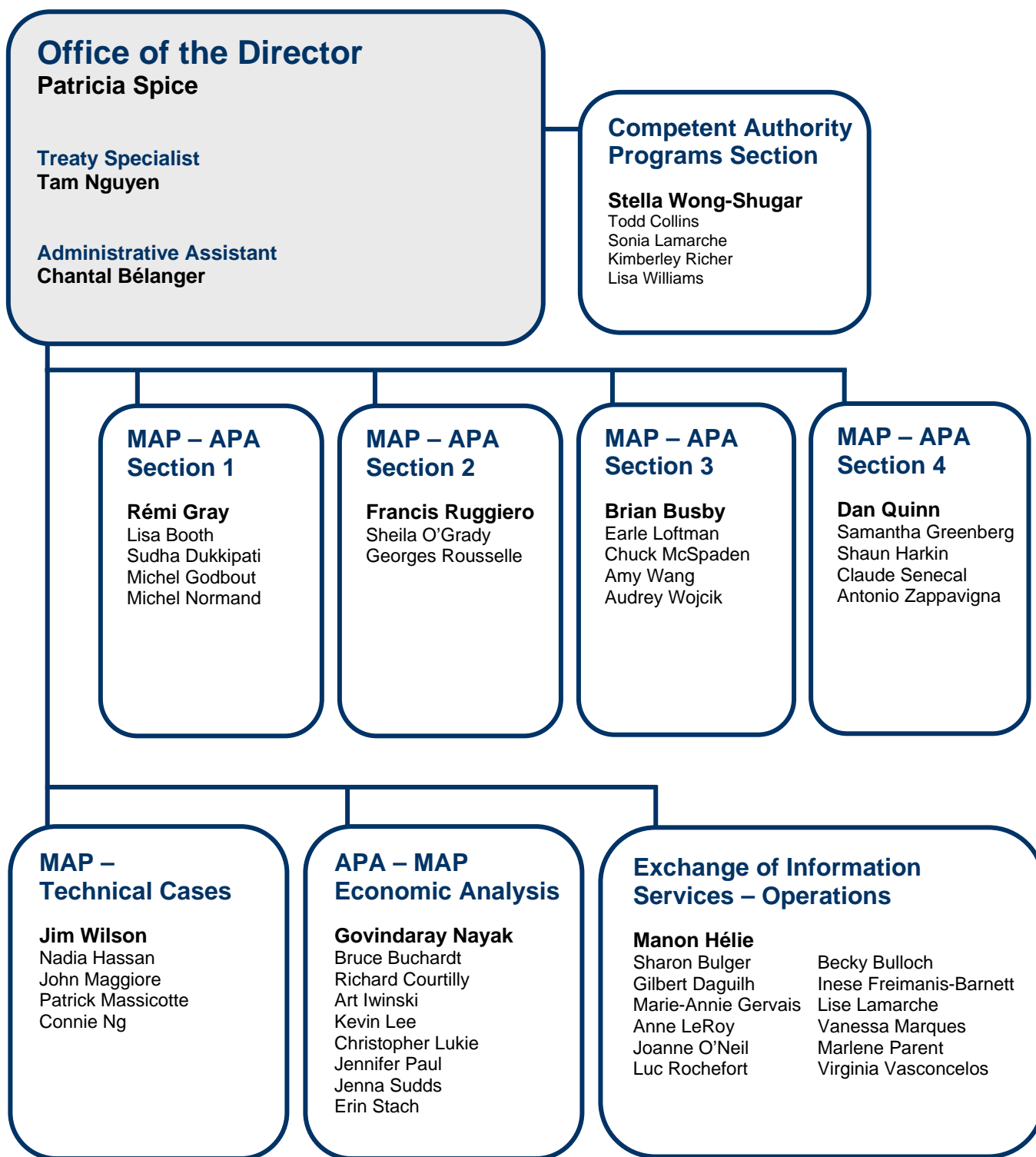
Total Outgoing Inventory Year t ²

The computation of opening inventory for a given fiscal year has not been altered, but it is by definition impacted by the manner in which closing inventory levels are now computed. Opening inventory levels will continue to be based on the closing inventory count from the previous fiscal year.

² Where, "Total Outgoing Inventory" is the sum of "APAs Completed", "APAs Unresolved", and "Post-Acceptance Withdrawals".



Appendix B – Competent Authority Services Division: 2009-10





How to Contact Us

If you have any comments or questions about this report or the services offered by the Competent Authority Services Division, contact us by telephone at (613) 941-2768, send us a facsimile at (613) 990-7370, email us at CP-PO_MAP-APA_PAA-APP@cra-arc.gc.ca, or write to us at the following addresses:

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International and Large Business Directorate
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