

Budget 2025: Modernization of Canada's Transfer Pricing Rules

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Summary

In the Federal Budget 2025 released on November 4, 2025, the Government of Canada announced significant amendments to the nation's transfer pricing (TP) framework. The objective is to modernize Section 247 of the Income Tax Act (ITA), which sets out Canada's transfer pricing rules, and to bring the regime into closer alignment with the OECD Transfer Pricing Guidelines (2022) and the global practices relating to application of the arm's length principle.

These measures build on the June 2023 consultation paper released by the Department of Finance, which sought public feedback following an announcement in Budget 2021 that amendments to Canada's TP rules were under consideration, particularly in light of the Tax Court of Canada's judgment in *Cameco Corporation v. The Queen (2018 TCC 195, affirmed by the Federal Court of Appeal in 2020 FCA 112)*. The new proposals are expected to apply to taxation years beginning after Budget Day, i.e., November 4, 2025.

The proposed measures represent a comprehensive modernization of section 247, expanding the scope of Canada's TP regime to focus on the economic reality of intercompany transactions, while tightening compliance timelines and introducing administrative changes.



Policy Objective

Canada's existing TP rules seek to ensure that cross-border transactions between non-arm's length parties - typically members of a multinational enterprise (MNE), reflect pricing arrangements that would have been agreed to between independent entities. The Canada Revenue Agency (CRA) has expressed concerns over the narrow judicial interpretations of section 247, limiting its ability to adjust transactions that diverge from arm's length outcomes. As per the 2023 consultation paper, the government was of the view that the existing transfer pricing rules permit the shifting of excessive amounts of income out of Canada, which adversely affects the Canadian tax base.

The 2025 proposals respond to these concerns by establishing a broader TP framework focused on economic substance, consistent with the OECD Guidelines, along with enhanced administrative compliance. Budget documents project that the modernization of the TP regime, along with other international tax measures, could yield over CAD 500 million in additional revenue over five years.

Beyond revenue considerations, the reform also reflects Canada's broader policy goal of aligning domestic tax administration with evolving global norms under the OECD's Base Erosion and Profit Shifting (BEPS) framework. By embedding OECD-consistent principles directly into the ITA, the government aims to

increase certainty for taxpayers while equipping the CRA with greater flexibility to address complex intercompany arrangements.



Key Amendments

1. Substance over form

Budget 2025 specifies that an analysis of transactions between a Canadian taxpayer and a non-resident non-arm's length party must involve evaluation of whether the transaction includes actual conditions different from arm's length conditions. The actual conditions are determined not only by contractual terms but also by considering 'economically relevant characteristics' which include the actual conduct of the party.

These economically relevant characteristics include the following five comparability factors, which are aligned with the OECD guidelines:

- ✓ Contractual terms;
- ✓ Functions performed, assets used, and risks assumed;
- ✓ Characteristics of the property or service;
- ✓ Economic and market context; and
- ✓ Business strategies.

The framework emphasizes substance over form, requiring that the controlled transaction be assessed in light of the participants' actual conduct and the full set of economically relevant characteristics, ensuring that transfer pricing analyses reflect economic reality rather than just legal documentation.

2. Consistency with OECD Guidelines

A new interpretive rule would require that the identification of arm's length conditions and any resulting adjustments be made to best achieve consistency with the OECD Transfer Pricing Guidelines (as published on January 7, 2022), unless otherwise prescribed by regulation.

This ensures alignment with existing international standards while preserving flexibility for the government to prescribe other aspects through regulation.

3. Applying the Most Appropriate Method

The proposals introduce an explicit requirement that while determining whether the conditions of a controlled transaction are consistent with the arm's length principle, one must apply the most appropriate transfer pricing method in accordance with the Transfer Pricing Guidelines (i.e. the OECD Guidelines or any text, as prescribed by the government). Although this reflects existing administrative practice, it would now become a legal requirement.

4. Transfer Pricing Adjustment rule

Under existing transfer pricing rules, when certain conditions are satisfied, an in-scope transaction may be replaced with the transaction that independent parties would have entered into at arm's length under comparable terms and conditions.

As per the Budget 2025, where actual conditions differ from arm's length conditions (the conditions that would have existed had the parties been dealing independently), the CRA may adjust amounts to reflect the appropriate arm's length outcome. In exceptional cases, this could justify replacing or disregarding a transaction entirely, ensuring consistency with OECD guidance.

Under the new framework, the authority to disregard or substitute transactions would be incorporated directly into the broader definition of "arm's length conditions". While Budget 2025 emphasizes that this recharacterization should apply only in "exceptional circumstances," consistent with the OECD Transfer Pricing Guidelines and the interpretive rule, the revised approach still marks a clear expansion of the CRA's authority compared to the current rules.

5. Key Administrative changes

Budget 2025 has introduced certain administrative changes to ensure efficient transfer pricing audits by the CRA as well as reduce compliance burden on taxpayers:

- ✓ **Higher Penalty Threshold:** The threshold for applicability of transfer pricing penalty has been increased from a transfer pricing adjustment of CAD 5 million to CAD 10 million, providing some relief for smaller taxpayers/adjustments.
- ✓ **Faster Documentation submission:** Taxpayers must provide transfer pricing documentation within 30 days of a CRA request, replacing the existing 3-month period, emphasizing the need for contemporaneous documentation. However, there is no change in the requirement to actually maintain the documentation by the tax return filing date for the respective year.
- ✓ **Simplified Documentation Regime:** Simplified documentation requirements will be applicable for eligible taxpayers, thereby reducing their administrative burden. The conditions for eligibility are yet to be prescribed.
- ✓ **Aligning documentation requirements with the new changes:** Clarifying transfer pricing documentation requirements and aligning them with updated definitions (including analysis of economically relevant characteristics, actual conduct of the parties and the requirement for selection of the most appropriate method). This would expand the existing documentation requirements to a great extent.



Conclusion

Budget 2025 marks a significant modernization of Canada's transfer pricing framework, embedding OECD-aligned principles such as economic substance, comparability factors, and exceptional-case non-recognition directly into domestic law. While the arm's length principle remains central, the proposals expand the CRA's analytical scope, emphasize substance over form, and introduce stricter compliance requirements, including shortened documentation timelines; which may result in intensified audit scrutiny.

Multinational enterprises with Canadian operations should use the transition period before these rules take effect, for taxation years beginning after November 4, 2025, to review intercompany arrangements, update documentation processes, and ensure that pricing structures and functional analyses align with the updated OECD-consistent framework. Proactive preparation will be essential to navigate a more rigorous, substance-driven transfer pricing environment and to minimize exposure to adjustments or penalties.

Sources:

- Canada Strong Budget 2025 [<https://budget.canada.ca/2025/home-accueil-en.html>]
- Tax Measures: Supplementary Information [<https://budget.canada.ca/2025/report-rapport/tm-mf-en.html>]
- Consultation on Reforming and Modernizing Canada's Transfer Pricing Rules [<https://www.canada.ca/en/department-finance/programs/consultations/2023/transfer-pricing-consultation/consultation-on-reforming-and-modernizing-canadas-transfer-pricing-rules.html>]

About us



VSTN Consultancy is a Global Transfer Pricing firm with extensive expertise in the field of international taxation and transfer pricing. VSTN Consultancy has been awarded by International Tax Review (ITR) as Best Newcomer in Asia Pacific – 2024 and is ranked as one of the recommended transfer pricing firms. VSTN has also been nominated in 9 Categories under APAC, EMEA and Middle East Region ITR awards 2025. VSTN has its offices in India and Dubai.

Nithya Srinivasan, Founder of VSTN Consultancy, was named Middle East Transfer Pricing Practice Leader of the Year, recognizing her outstanding leadership and contribution to the profession. VSTN also received the Best Newcomer in the Middle East award from International Tax Review, showcasing its rapid growth and excellence in global transfer pricing advisory.

VSTN Consultancy has been honored with the Best Global Transfer Pricing Consultancy 2025 – India award at the prestigious Wealth & Finance Management Consulting Awards 2025.

Our offering spans the end-to-end Transfer Pricing value chain, including design of intercompany policy and drafting of Interco agreement, ensuring effective implementation of the Transfer Pricing policy, year-end documentation and certification, BEPS related compliances (including advisory, Masterfile, Country by Country report), safe harbour filing, audit defense before all forums and dispute prevention mechanisms such as Advance Pricing agreement. VSTNs senior partners have been ranked in ITR in the list of recognized Practitioners.



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