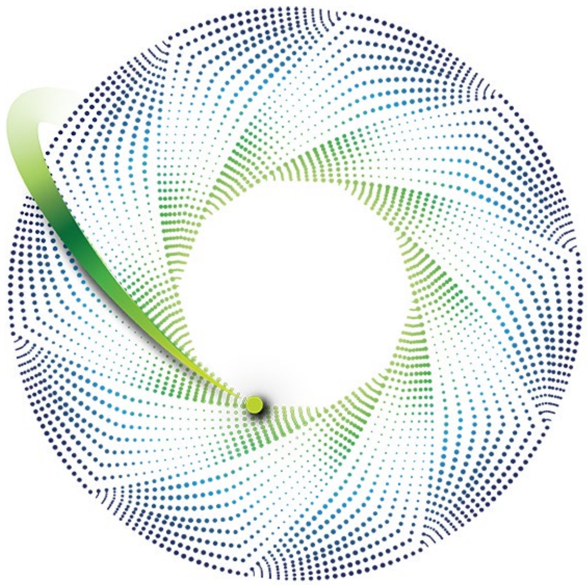
Deloitte.



Canadian Tax & Legal Alert

New Canadian Transfer Pricing Rules: Key changes and implications

November 25, 2025

Executive summary

On November 4, 2025, the Federal Budget was released and included the long-awaited update to Canada's transfer pricing rules. This is the most significant legislative change to the transfer pricing rules in over two decades, bringing Canadian rules into closer alignment with the latest guidance set out in the Organisation for Economic Co-operation and Development (OECD) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Transfer Pricing Guidelines).

The changes to the Canadian transfer pricing rules, effective for taxation years beginning after November 4, 2025, represent a fundamental shift in the way multinational enterprises (MNEs) will be required to manage and document cross-border intercompany transactions.

Key highlights include:

- **New framework of analysis:** Transactions (and series of transactions) must be analyzed based on their "economically relevant characteristics," with a broad definition that generally aligns with the Transfer Pricing Guidelines, while expanding on the traditional comparability factors.

- **Substance over form:** The actual conduct and functions of the parties now take precedence over contractual terms, with transfer pricing outcomes driven by economic substance rather than legal form.
- **New adjustment and recharacterization rule:** The Canada Revenue Agency (CRA) can adjust pricing, adjust other conditions (broadly defined) in order to adjust pricing, or replace transactions (or series of transactions) altogether if actual conditions differ from what would have occurred at arm's length between the participants, with the new rules embedding these powers directly in the definition of "arm's length conditions."
- **Analysis of related transactions:** The rules require consideration of not just the transaction under review, but also any other relevant transactions or series involving group members, potentially expanding the scope of analysis and documentation.
- **Incorporation by reference of the Transfer Pricing Guidelines:** While the rules now explicitly require consistency with the Transfer Pricing Guidelines, they also introduce broader requirements and definitions, particularly regarding the scope of analysis and documentation.
- **Enhanced documentation requirements:** With new documentation rules that do not explicitly adopt the OECD Master File/Local File framework, taxpayers must document not only the terms of the transaction, but also the relationships between the terms of all relevant related-party transactions or series, with more detailed factual and functional analysis required.
- **Record-keeping and evidentiary burden:** Taxpayers will need to perform detailed fact gathering and record-keeping, including, in addition to functional interviews and other typical procedures, compiling documentary evidence of actual conduct.
- **Shortened response timeline:** Contemporaneous documentation must now be provided to the CRA within 30 days of a request (down from three months), increasing the pressure for timely and robust compliance.

This alert explores the key changes to the Canadian transfer pricing rules and outlines the implications for Canadian businesses.

Why now?

The Canadian government's overhaul of the country's transfer pricing rules, several years in the making, is a response to mounting pressures in connection with the existing framework under section 247 of the Income Tax Act (ITA) and a perceived risk to the Canadian tax base.

Historical context and legislative lag

Canada's transfer pricing legislation, introduced in 1997, was initially intended to provide clarity and a standard for intercompany pricing. However, the legislation has seen little substantive update in nearly three decades, despite the dramatic evolution of global business models and international guidance. This has left both taxpayers and the CRA to apply these historical rules to ever-evolving sets of facts, with disputes arising from inconsistencies between legislation and administrative practice. Asserting a need for modernization, the Department of Finance (Finance) released a Consultation Paper in June 2023, which sought input from stakeholders on proposed rules meant to provide clarity on the application of the arm's length principle and incorporate by reference certain guidance set out in the OECD Transfer Pricing Guidelines.

Contacts:

Rob Jeffery
National Tax Policy Leader
Tel.: 902-721-5593

Christine Ramsay
Partner, Transfer Pricing Leader
Tel.: 416-601-6485

Bruno De Camargo
Partner, Transfer Pricing
Tel.: 514-393-7368

Rob Stewart
Partner, Transfer Pricing
Tel.: 604-640-3325

Jakub Uziak
Partner, Transfer Pricing
Tel.: 416-643-8407

Samer Wani
Partner, Transfer Pricing
Tel.: 416-775-7496

Related links:

Deloitte Tax Services

Transfer pricing

A reaction to legal setbacks

The Supreme Court of Canada's dismissal of the government's appeal of a Federal Court of Appeal decision in a landmark Canadian transfer pricing case highlighted the limited instances in which the CRA can apply current paragraphs 247(2)(b) and (d) of the ITA. Finance stated in the Consultation Paper that the current version of section 247 "has led to an overemphasis on intra-group contracts, rather than on the factual substance of the transactions," and that this has resulted in a misallocation of profits. The government's transfer pricing reform is in large part a direct reaction to these legal challenges.

International context

Canada's decision to update its transfer pricing rules also reflects the ongoing influence of coordinated, multilateral efforts to address perceived international tax avoidance, particularly the OECD's Base Erosion and Profit Shifting (BEPS) initiative and the jurisdiction-level developments it inspired. In purported coordination with global practices on the interpretation of the arm's length principle, Canada's new rules strengthen the CRA's hand in combating perceived erosion to the Canadian tax base.

What changed from proposed to final rules?

The final rules largely resemble the proposed rules released in the Consultation Paper as it pertains to the main changes to subsection 247(2), but with further refinements of the language in certain subsections. For example, the terms "commercially rational" and "options realistically available" are notably absent from the delineation provision (a welcome effort at simplification). The concepts of "non-recognition" and "replacement" have also been streamlined and are now embedded in the definition of "arm's length conditions." The incorporation by reference of the Transfer Pricing Guidelines has arguably been strengthened with the addition of the word "best" before "achieve consistency."

Possibly the most consequential shift from the proposed rules to the final rules is the move away from explicit adoption of the OECD Master File/Local File documentation model (the proposal would have introduced the Master File in Canada), in favour of an expanded set of minimum transfer pricing documentation requirements meant to more closely align with the new definitions and concepts included in the clauses that replaced subsection 247(2). Notably, the new subsection 247(4) extends the familiar concept of "series of transactions" to the documentation provision.

In terms of administrative measures, helpfully for larger taxpayers, the proposed increase in the threshold for application of transfer pricing penalties (from a transfer pricing adjustment of $5 million to $10 million) was maintained, as was the introduction of simplified documentation requirements under prescribed circumstances (to be defined through future regulation) presumed to benefit smaller taxpayers or those with routine transactions. Other proposed measures relating to the introduction of specific facilitations or limitations, namely pertaining to low-value-adding intra-group services, standardized profit margins for routine distribution activities, and limiting acceptable intra-group loan conditions, did not survive the consultation and redrafting process.

The rules: A new era of substance over form

Finance's concern that reliance on contracts over the factual substance of the transactions has led to misallocation of profits between jurisdictions has been thoroughly addressed in the final legislation, which places substance squarely over form in transfer pricing analyses.

Current transfer pricing rules

The current transfer pricing legislation in section 247 of the ITA relies on a general definition of the arm's length principle and otherwise contains sparse detail on its application. The adjustment rule focuses on whether the terms and conditions of an intercompany transaction differ from those that would have been made between persons dealing at arm's length and, if so, the amounts are adjusted accordingly. There is also a recharacterization provision whereby a transaction may be notionally replaced by the transaction that would have been entered into by parties dealing at arm's length, but only if strict conditions are met: a primary tax purpose test and a requirement to show that arm's length parties would not have entered into the transaction.

The transfer pricing analysis under the current rules is heavily driven by the legal form of the transaction, as reflected in the contracts and documentation between the parties. While the CRA and courts have sometimes looked beyond legal form to the actual conduct of the parties, the legislation itself does not explicitly require a detailed analysis of the substance of the transaction and imposes a high bar for recharacterization.

New transfer pricing rules

The new transfer pricing legislation provides more detail on the interpretation of the arm's length principle in Canada. First, subsection 247(1.1) introduces a delineation requirement that transactions or series be analyzed and determined with reference to their "economically relevant characteristics," a new term in the legislation that is granted an expansive definition.[1] The analysis still posits the contractual terms as a relevant economic characteristic, but only to the extent not inconsistent with the actual conduct of the parties to a transaction or series. Second, a new transfer pricing adjustment rule in subsection 247(2.02) applies if the transaction or series (once it has been analyzed and determined pursuant to 1.1) includes actual conditions that differ from "arm's length conditions."

A deeming rule in subsection 247(2.01) clarifies that an adjustment may apply to a condition that does not exist in respect of the transaction or series, but would have existed had the participants been dealing at arm's length in comparable circumstances. The recharacterization provision is embedded in the new definition of "arm's length conditions," which tests whether the parties would have entered into a different transaction or series (or none at all) had they been dealing at arm's length.

Importantly, "arm's length conditions" refers to the actual participants to the transaction or series, as opposed to hypothetical third parties, and the conditions that these participants would have agreed to had they been dealing at arm's length. Furthermore, the legislation is careful to extend the newly introduced concepts and provisions to any in-scope series of transactions, imposing the obligation to analyze a broad set of "economically relevant characteristics" applying to all transactions within the series as well as other "relevant" transactions or series involving any member of the MNE group.

Finally, the new interpretation rule in subsection 247(2.03), along with the most appropriate method requirement in subsection 247(2.04), incorporate the Transfer Pricing Guidelines into Canada's interpretation of the arm's length principle.

---

[1] ***economically relevant characteristics***, in respect of a transaction or series of transactions, includes
(a) to the extent that the following contractual terms are not inconsistent with the actual conduct of the participants in the transaction or series, (i) the contractual terms of the transaction or series, and (ii) 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;
(b) the actual conduct of the participants in the transaction or series, and in particular the functions performed by those participants, taking into account (i) assets used and risks assumed, (ii) how those functions relate to the wider generation of value by the multinational enterprise group to which the participants belong, (iii) circumstances surrounding the transaction or series, and (iv) industry practices;
(c) the characteristics of any property transferred or service provided;
(d) the economic circumstances of the participants and of the market in which the participants operate; and
(e) the business strategies pursued by the participants.

Consistency with the Transfer Pricing Guidelines

The intention to align the Canadian regime with the analytical framework in the Transfer Pricing Guidelines for interpreting the arm's length principle has been stated repeatedly in published comments by Finance, and has now been codified in the subsection 247(2.03) interpretation rule which requires the new subsection 247(1.1), paragraph 247(2)(b), and subsection 247(2.02) to be applied so as "to best achieve consistency with the Transfer Pricing Guidelines." Further, subsection 247(2.04) introduces another bridging provision which imposes "an analysis where the most appropriate method is selected and applied in accordance with the Transfer Pricing Guidelines."

In general, we expect the expansion of the statutory framework in the final proposals reflects Finance's attempt to enable and operationalize the principle of consistency with the Transfer Pricing Guidelines. That said, there are some notable differences between the final proposals and the Transfer Pricing Guidelines. For example, instead of directly aligning terminology or simply referencing the Transfer Pricing Guidelines, the legislation introduces a broader definition of the key comparability factors in a transfer pricing analysis within "economically relevant characteristics" as compared to the five factors in the Transfer Pricing Guidelines (i.e., the contractual terms of the transaction; the functions performed, assets used, and risks assumed by each party; the characteristics of the property or services; the economic and market context; and the business strategies of the parties). Thus, in situations where the actual conduct is inconsistent with the legal contract, the Transfer Pricing Guidelines state that more emphasis should be placed on the other factors (a rather ambiguous proposition), whereas the new rules introduce greater force in defining "economically relevant characteristics" to exclude legal contracts from the analysis altogether where conduct is inconsistent.

Furthermore, a more substantive distinction may be drawn with respect to the scope of analysis imposed on taxpayers. The Transfer Pricing Guidelines do not, in general, require the transfer pricing analysis to extend to all other transactions or series involving any member of the MNE group, except to the extent that they are so closely linked to the in-scope transaction as to require combined analysis (e.g., package deals, long-term contracts, portfolio approaches, or where the terms of one transaction directly affect another). In contrast, the new Canadian rule appears to require consideration of any other transaction or series involving at least one of the participants or any other MNE group member, provided it is "relevant" to the transaction or series under review, and not inconsistent with actual conduct. This could potentially include a wider set of transactions (or series) than the Transfer Pricing Guidelines would typically require to be considered.

Although the messaging from Finance conveys a clear desire for convergence, it remains to be seen whether the differences highlighted above will lead to significantly different outcomes with respect to positions and compliance. Taxpayers (and presumably Finance) will hope not.

Finally, the published commentary in the 2025 Federal Budget's "Tax measures: Supplementary information" annex references the Transfer Pricing Guidelines to state that the recharacterization/replacement of an in-scope transaction or series (accurately analyzed and determined) should only occur in "exceptional circumstances." Considering the extensive powers conferred by the provision in question, it seems reasonable to ask: is it sufficient as a limiting principle? The absence of safeguards in the legislation to limit recharacterization/replacement powers, other than the interpretation rule in subsection 247(2.03), raises eyebrows, particularly when considered in conjunction with a $500 million target to raise tax revenues. Taxpayers will be keen to see those limits clarified through Explanatory Notes, administrative guidance, and the courts.

The rules: A new era for compliance

The new transfer pricing legislation significantly expands contemporaneous documentation requirements in subsection 247(4) compared to both the current rules and the Transfer Pricing Guidelines.

Expanded requirements

The new legislation requires documentation not only of the contractual terms of the transaction or series, but also of 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 MNE group. This expanded scope potentially requires documenting the contractual terms of a much broader set of related-party (and third-party) transactions, emphasizing the need to consider the context of the entire MNE group and the interrelation between contracts across the group.

Furthermore, the same comparability factors included in the definition of "economically relevant characteristics" make their way into the list of required documentation content. Given the emphasis on the actual conduct of the parties, this entails a detailed description of the factual/functional substance of the transactions or series in the context of the other defined characteristics.

Finally, the contemporaneous documentation must now be submitted to the CRA within 30 days of a formal request, as opposed to three months under the current rules, which implies stronger enforcement of the contemporaneous preparation obligation.

Comparison with the Transfer Pricing Guidelines

The new Canadian documentation requirement is more granular than the OECD Local File in that it explicitly requires documentation of the relationship between the contractual terms of the transaction at issue and those of other relevant transactions or series involving any group member. While the OECD Local File requires copies of material intercompany agreements and a description of the transactions, it does not explicitly require mapping the interrelations of contractual terms across the group.

The Canadian requirement thus goes beyond the OECD standard by mandating a more comprehensive analysis of how the terms of one transaction may be influenced by, or be related to, the terms of other transactions within the group. Although (perhaps surprisingly) the new rules did not mandate the OECD Master File, the documentation requirement does contain elements typically found in the Master File such as a description of the MNE's value chain.

Implications for Canadian businesses

The recent overhaul of Canada's transfer pricing rules introduces a host of new challenges for Canadian businesses, fundamentally altering how intercompany transactions need to be evaluated and documented.

New areas of analysis and documentation

In its updated form, section 247 of the ITA now opens up new dimensions of required transfer pricing analysis for taxpayers, which will need to be thoroughly documented.

Taxpayers will need to identify and analyze not only the direct transaction but also all other relevant transactions or series involving any group member that may affect the transaction. This could be particularly challenging for large companies with complex webs of intercompany arrangements (in particular where some of these may be relatively immaterial to the group, but could be seen as giving rise to material tax adjustments by the CRA).

Collecting and maintaining up-to-date documentation on all relevant contracts and their interrelationships across the group may require significant resources and coordination across jurisdictions and business units. Furthermore, determining which other transactions or series are "relevant" to the transaction at issue will almost assuredly lead to disputes.

Taxpayers will need to perform detailed fact gathering and record-keeping to establish and document the actual conduct of the parties to the transaction or series (and any other relevant transactions or series), as well as the other economically relevant characteristics thereof. Where differences exist between the legal form and the factual substance, more extensive analysis will be required to address the misalignment. Beyond establishing the factual position through functional interviews and other typical procedures, it may be necessary for taxpayers to compile documentary evidence, in relation to key personnel, of roles and responsibilities, appropriate qualifications, reporting lines, internal process flows, how key decisions are made within the organization including delegation of authority, etc.

The expanded scope of the contemporaneous documentation requirement, along with the shortened period for provision of such documentation to the CRA (30 days), necessitates greater diligence and timeliness in transfer pricing compliance by taxpayers. A regular cadence of compliance activity is likely to be indispensable in meeting annual documentation obligations.

More transfer pricing controversy anticipated

As a result of the changes discussed herein, Canadian business should expect heightened levels of transfer pricing controversy going forward.

The series of transactions scoping will allow the CRA to ask for information which may only bear a remote connection to the transaction at hand. The expansive definition of "economically relevant characteristics" and need for accurate delineation between contractual terms and "actual conduct," a highly factual exercise, is likely to result in detailed questions during transfer pricing audits. This will surely put to use the CRA's extensive authority to compel functional interviews, as enhanced by new audit powers in draft legislation published in August 2025.

It remains to be seen whether the new recharacterization rule will only be used in exceptional circumstances by the CRA, as the Transfer Pricing Guidelines and administrative commentary from Finance suggest. Otherwise, this suggestion should remain of important interpretive value for the courts. Short of full recharacterization, taxpayers will surely anticipate that the ability for the CRA to adjust pricing through the adjustment of other conditions of a transaction or series (perhaps suitably described as "partial recharacterization") will not be exercised sparingly. In any event, an increase in the proportion of assessments containing some form of recharacterization, whether full or partial, is likely to occur until further guidance is given by the courts.

By expanding the minimum documentation requirements beyond the OECD Local File contents, taxpayers may be subject to penalties and additional questions if a generic OECD Local File format is used for Canadian purposes. The question of "reasonable efforts" under subsection 247(3) will be put to the test in this type of situation, as well as in other circumstances that push the limit of what constitutes a reasonable level of administrative burden for taxpayers to bear to comply with the rules considering the significantly expanded factual analysis involved.

Other potential areas of controversy may arise. While the new rules apply prospectively, it remains to be seen whether similar concepts will creep into transfer pricing audits or disputes for earlier time periods. In a financial statement audit or M&A tax due diligence context, advisors may begin taking extreme positions in an attempt to mirror the posture anticipated from the CRA or deal with uncertainty of enforcement action pursuant to the CRA's enhanced powers. Finally, changes in delineation of transactions/conditions other than price (i.e., partial recharacterization) under section 247 raise the question of how other provisions of the ITA (e.g., provisions imposing Part XIII withholding tax) should apply to the re-delineated transaction.

Impact on MAPs and APAs

Beyond audits, it is important to consider the potential impact of the new rules on Mutual Agreement Procedures (MAPs) and Advance Pricing Arrangements (APAs). In practice, both the CRA and its treaty partners often use the Transfer Pricing Guidelines as a reference point during MAP/APA negotiations. As established earlier in this alert, the new Canadian rules incorporate the Transfer Pricing Guidelines by reference (with differences), while also increasing the likelihood that a greater number of cases involving at least partial recharacterization will be taken to MAP.

This raises interesting questions as to how the CRA's approach to acceptance and settlement of MAP cases may shift in the future. For instance, will the CRA accept recharacterization cases into MAP (a departure from current policy)? If so, how will competent authorities starting with a different interpretation of the character of the transaction settle the MAP? This is relevant even where only select conditions were re-delineated by the CRA. It seems likely that the MAP process will be more involved and lengthier.

Given the higher potential for controversy, APAs may become more popular. However, it remains to be seen whether the CRA will amend its posture on the types of transactions it accepts for APAs, a development that many taxpayers would surely welcome.

What should businesses do now?

In light of the new transfer pricing rules, Canadian businesses should take immediate steps to ensure compliance:

- **Conduct a gap analysis:** Businesses should review their transfer pricing policies, intercompany agreements, economic substance, and contemporaneous documentation to identify areas of non-compliance with the new rules, and prepare a remediation plan, if required. This plan may include adjusting at-risk transfer pricing policies/operating models, amending or drafting new intercompany agreements, and revisiting the contemporaneous documentation strategy and format.
- **Prepare for the transition:** For many businesses, the first fiscal year to which the new rules apply begins on January 1, 2026, so time is of the essence for the initial mobilization.
- **Assess historical positions:** Businesses should also consider what the rule change could mean for historical transfer pricing positions. Although the application of the rules is prospective, financial statement auditors and M&A advisors performing due diligence may raise questions in the short term. Stakeholder interest could ultimately require a broad-based education effort.
- **Review value chains and internal controls:** Beyond the early actions, businesses should perform a comprehensive review of value chains mapped against transfer pricing policies, consider any more significant changes to align substance with form in a sustainable manner, review and update documentation of internal procedures and controls to evidence conduct, and timely prepare an audit-ready documentation file in anticipation of increased scrutiny from the CRA.
- **Leverage technology:** Given the expanded fact gathering and documentation requirements, businesses may have no choice but to accelerate adoption of productivity-enhancing technologies such as Generative AI to manage administrative demands and compliance costs.

How can Deloitte help you?

Deloitte’s professionals can help you understand how these new Canadian transfer pricing rules may impact your business.

If you have any questions on any of the above or want to learn more about the new Canadian transfer pricing rules, please reach out to your Deloitte advisor or any of the Deloitte transfer pricing advisors noted on this alert.

Deloitte LLP
Bay Adelaide Centre, East Tower
8 Adelaide Street West, Suite 200
Toronto ON M5H 0A9
Canada