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# TAX ALERT

## TRANSFER PRICING: THE T106 FORM AND RELATED PENALTIES

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### The T106 Form

The T106 Summary and corresponding Slips (collectively, the T106 Form) represent the annual information return used to report non-arm's length transactions between reporting persons or partnerships and non-residents, in accordance with section 233.1 of the *Income Tax Act*.

The T106 Form filing is in addition to the required "contemporaneous transfer pricing documentation" that taxpayers are to have in place, as must be confirmed by the taxpayer on each of the individual T106 Slips filed. (Refer to section 247 of the *Income Tax Act* and Information Circular IC 87-2R for more information on contemporaneous transfer pricing documentation requirements.)

### Who must file?

Generally, a person (corporation, trust or individual) who is resident in Canada, or is non-resident but carries on business in Canada, is required to file the T106 Form. Further, a partnership in which a member is resident in Canada, or that carries on business in Canada, also must file the T106 Form.

### What must be reported?

Any transaction that relates to a business carried on by a person (corporation, trust or individual) or a partnership must be reported on the T106 Form. Generally, the T106 Form must be filed if the amount of the total reportable transactions for all the non-residents combined is more than \$1 million.

There is a danger here that may easily be overlooked. If a taxpayer has *not* gone through the detailed exercise of analyzing their intercompany cross-border transactions, and their reportable transactions are less than \$1 million, the taxpayer may mistakenly believe that the T106 Form filing is not required. However, one of the most common errors identified when assessing a taxpayer's intercompany cross-border transactions is the identification of transactions that should have been recorded and reported, but were overlooked. For example, often a parent company allows its marketing

and trade intangibles to be used by a subsidiary company without a charge, where it was actually appropriate to charge an arm's-length royalty. If this transaction had been recorded and reported, it might have put the taxpayer over the \$1 million threshold.

### When must the return be filed?

The T106 Form must be filed by the deadline for the regular tax return or information return, as applicable. The required contemporaneous transfer pricing documentation need not be filed with the T106 Form. However, taxpayers must have the documentation in place at the time of filing the T106 Form, and must confirm such on each of the individual T106 Slips filed. The documentation must then be made available within three months of a written request by the Canada Revenue Agency (CRA).

### What happens if the return is not filed, or is not filed correctly?

It is commonly understood that there is a potential transfer pricing penalty pursuant to subsection 247(3) for failing to have supporting contemporaneous transfer pricing documentation in place. This penalty may arise where the CRA reassesses and makes an income adjustment to the transfer prices that exceeds certain thresholds. In such cases, the penalty is equal to 10% of the income adjustment.

However, it is not as well known that there are many other penalties that may apply for not filing a return, or not filing a return properly. These penalties are summarized below.

Subsection 238(1) (Offences and Punishment) provides for general penalties up to \$25,000 for failing to file a return, and possible imprisonment up to 12 months. Section 239 (Other Offences and Punishment) provides for additional general penalties up to 200% of the amount of tax evaded, and possible imprisonment up to 24 months.

However, there are three specific penalties that may apply with respect to the T106 Summary and Slips that are often overlooked:

- Subsection 162(7) (Failure to Comply) provides for a late-filing penalty up to \$2,500 per late-filed T106 Slip.
- Subsection 162(10) (Failure to Furnish Foreign-based Information) provides for a non-filing penalty up to \$12,000 per non-filed T106 Form where the person/partnership knowingly or through negligence failed to file the T106 Form. The penalty can rise as high as \$24,000 if the failure to file persists after a formal demand by the CRA.
- Subsection 163(2.4) (False Statement or Omission [re: Foreign Asset Reporting]) provides for an incorrect-filing penalty up to \$24,000 where the T106 Summary or Slip is incomplete or incorrect.

Finally, under section 163.2 (Third Party Civil Penalties), where the information reported on a T106 Form constitutes a false statement or omission, and a professional advisor was directly or indirectly involved (knowingly or through negligence) with making the false statement, a civil penalty may be applied against the professional advisor. The penalty may be up to the sum of the professional fees charged plus \$100,000. Therefore, a taxpayer's professional advisor has a personal interest, in addition to a professional interest, in assisting the taxpayer in getting the contemporaneous transfer pricing documentation and T106 Form filings completed accurately and on a timely basis.

Your Collins Barrow advisor can help you to understand your T106 Form filing obligations, and ensure that you do not fall prey to the many penalty pitfalls. §

Collins Barrow periodically publishes a *Tax Alert* for its clients and associates. It is designed to highlight and summarize the continually changing tax and business scene across Canada. While *Tax Alert* suggests general planning ideas, we recommend professional advice always be sought before taking specific planning steps.

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