



Preliminary Findings on International Taxation



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The Parliamentary Budget Officer (PBO) supports Parliament by providing economic and financial analysis for the purposes of raising the quality of parliamentary debate and promoting greater budget transparency and accountability.

This report presents PBO findings on international taxation, in response to Senator Percy E. Downe's request to the Parliamentary Budget Officer in 2012.

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Executive Summary

In 2012, Senator Percy E. Downe requested the Parliamentary Budget Officer (PBO) to “estimate the financial cost to the Government of Canada in loss of tax revenues by failing to reduce overseas tax evasion.” This initial request has evolved into an ongoing attempt by PBO to estimate the tax gap.

The tax gap is the difference between the amount of tax “that would be paid if all obligations were fully met in all instances” (the total theoretical tax liability) and the amount of tax that is actually collected by the tax administration authority (TAA).¹

Part of the tax gap can be attributed to tax evasion, which includes illegal means to reduce the amount of taxes paid, and the other to tax avoidance, which includes actions that reduce the amount of taxes paid through legal means, but contravene the “object and spirit of the law”.² Various countries, including Canada, have attempted to measure the tax gap. However, few countries measure the avoidance component.

Tax avoidance by multinational corporations through transactions between affiliates that effectively transfer income and expenses are difficult to measure and prevent by one country alone. These transactions also follow the letter of the law, which makes it difficult for tax administrations to prosecute the corporations that use such techniques. Furthermore, as it involves transactions with parties in other tax jurisdictions with which there may be tax treaties, a global overhaul of international tax systems is required to eliminate such practices. As a consequence, the Organization for Economic Co-operation and Development (OECD) developed the *Base Erosion and Profit Shifting* (BEPS) initiative.

In this report, PBO presents preliminary findings on international taxation, including:

- financial flows between other countries and Canada using Electronic Funds Transfers (EFTs); and
- financial flows between Canadian resident firms and non-residents through non-arms-length transactions (i.e. transactions between firms in Canada and related firms outside Canada that are not dealing independently).

PBO finds that financial flows between Canada and certain jurisdictions are disproportionately large compared to their GDP, net cross border position and net trade flows. Some of these jurisdictions have been recognized as tax havens.

1. Introduction

In a letter dated 18 October 2012, Senator Percy E. Downe (Prince Edward Island, LPC) requested the Parliamentary Budget Officer (PBO) to “estimate the financial cost to the Government of Canada in loss of tax revenues by failing to reduce overseas tax evasion.” This initial request has evolved into an ongoing attempt by PBO to estimate the tax gap.

The tax gap is the difference between the amount of tax “that would be paid if all obligations were fully met in all instances” (the total theoretical tax liability) and the amount of tax that is actually collected by the tax administration authority (TAA).³

Part of the tax gap can be attributed to unintentional actions, such as errors, ignorance of relevant tax rules or inability to comply. Intentional actions that widen the tax gap can be categorized into two broad classes:

- Tax evasion, wherein specific sections of the tax code are ignored or contravened. These actions would typically be classified as ‘illegal’. For example, under-reporting income that would be considered taxable is considered tax evasion.
- Tax avoidance, which involves tax minimization, aggressive tax planning and other similar actions which, though they follow the letter of the law, contravene the “object and spirit of the law”.⁴

Lastly, there is also the payment gap component, where income can be properly reported, and taxes assessed, but not collected (due for example to bankruptcy).

Internationally, most measures of the tax gap are calculated by the relevant TAA.⁵ Since 2012, PBO has attempted to estimate the tax gap through information requests pursuant to the *Parliament of Canada Act* that were sent to the Canada Revenue Agency (CRA).

Initially in 2012, the CRA cited that it did not measure the tax gap, similarly to other tax administration authorities in other countries at that time, due to concerns by these authorities and the OECD that measuring the tax gap is “difficult, costly and...imprecise.”

More recently in 2015, it has cited privacy concerns relating to individual taxpayer information to be the reason for refusing to provide the relevant tax data to the PBO, and that aggregated information was publicly available. Indeed, section 241 of the *Income Tax Act* (ITA) prohibits the Agency from disclosing any taxpayer information to persons not expressly authorized to receive such information.⁶

In 2016, CRA published two reports: a conceptual study on tax gap estimation, and an estimate of the tax gap for goods and services tax/harmonized sales tax. In 2017 and 2018, CRA published reports on domestic personal income tax compliance as well as the international personal income tax gap.⁷

In June 2019, CRA published a report on the tax gap for the corporate income tax (CIT). It estimates the gross CIT gap (before accounting for audits results) to be between \$9.4 billion and \$11.4 billion. The net tax gap after examining audits results is estimated to be between \$3.3 billion and \$5.3 billion (between 8 and 13 per cent of federal CIT revenue).⁸ CRA notes that its report does not estimate the gap resulting from 'legal' tax avoidance through profit shifting (except when the profit shifting has been identified as tax evasion during an audit). It also does not estimate the tax gap from non-resident corporations doing business in Canada.

To date, CRA has not published a comprehensive tax gap study for the entire tax system, similar to those published by Her Majesty's Revenue and Customs, (HMRC, the UK TAA), or the Australian Taxation Office. However, it is mentioned in their latest report that they intend on releasing future reports analysing additional gaps, such as the excise tax gap and the payment gap. CRA also plans to regularly update its estimates of the different the tax gaps.

A portion of the corporate income tax gap can be attributed to profit shifting activities by multinational corporations using transfer pricing, which is the price of goods and services sold and purchased by affiliates of such corporations. These activities, although legal, could be grouped under the 'tax avoidance' class of the tax gap. Some multinationals use transfer pricing as a legitimate tool to fairly price intra-company transactions, while others use it as a tool for aggressive tax planning by adjusting the price of goods and services traded within a corporate group to shift profit away from or to a certain jurisdiction. Few countries measure the avoidance component in their tax gap analysis.

Tax avoidance, especially when income and expenses are transferred across national boundaries, is difficult to tackle independently by one country. As mentioned, it usually follows the letter of the law, which makes it difficult for tax administrations to detect and prevent. Furthermore, as it involves transactions with parties in other tax jurisdictions with which there may be tax treaties, a global overhaul of tax systems is required to eliminate such practices. As a consequence, the Organization for Economic Co-operation and Development (OECD) developed the *Base Erosion and Profit Shifting* (BEPS) initiative.

Following the methodology proposed by OECD in its Action 11 Report to create a dashboard of profit shifting indicators, Statistics Canada released, in June 2019, a report titled "Indicators of profit shifting by multinational enterprises operating in Canada". It presents multiple metrics under three

main categories that could indicate profit shifting: mismatches between real and financial activities, profitability differentials within MNEs, and effective tax rate differentials between MNEs and non-MNEs. Their report indicates that “(Canadian) MNEs... may have used strategies to minimize the amount of taxes they owed globally”, though they do indicate this is not conclusive evidence, nor does it quantify the “extent of the impacts of these behaviours on taxation revenues in Canada”.

Due to the aforementioned data limitations, an appropriate bottom-up estimation of the tax gap could not be performed. Instead, PBO has primarily studied the impact of tax planning activities by multinational enterprises (MNEs), part of which include profit shifting and transfer pricing, through two main ways:

- studying the flow of Electronic Funds Transfers (ETFs) into and outside Canada, using information from CRA; and
- studying data from CRA’s T106 tax form, which is required for all companies engaging in non-arms-length transactions with non-residents of Canada having a value of over \$1 million.

1.1. What is profit shifting and transfer pricing?

Simply put, transfer pricing is the set of rules that determine the price paid for intra-company transactions involving the exchange of goods and services.⁹ Formally, the entities and subsidiaries providing goods and services to an MNE are all “related parties” and such transactions are known as a “related-party transactions.”

Profit shifting occurs when MNEs shift their income across jurisdictions through their various subsidiaries, using transfer pricing as a tool to minimize the total tax they pay and by exploiting tax rate differentials between jurisdictions. The objective is usually to record costs in high tax jurisdictions while realizing income in low tax jurisdictions.

Seminal papers by Hines and Rice (1994) and Grubert and Mutti (1991) identified important tax havens across the world and income shifting behaviour by MNEs that are consistent with changes in effective tax rates.

The OECD began its project on BEPS in 2013, culminating in a report published in 2015. Significantly, this project and the report called for 15 specific actions addressing various aspects of tax base erosion and profit shifting by multinationals, and how to address these issues.

The OECD report spurred further international action on aligning tax rules, the most significant of these being a multilateral instrument (MLI) to “update international tax rules and lessen the opportunity for tax avoidance by MNEs”.¹⁰

As of April 2019, there have been 87 signatories to the MLI.¹¹ Bill C-82, introduced by the Minister of Finance in June 2018, proposes legislation that would enact the MLI. At the time of writing, the bill has passed third reading in the Senate.

Reliable data related to the international aspect of the tax gap is often difficult to find, due to the nature of the activities and the secrecy laws of some jurisdictions that provide favourable tax treatment for foreign firms. To address this, PBO relied on two sources of information: the Electronic Funds Transfer (EFT) reporting and the T106.

Since January 2015, all financial institutions are required to report international EFTs (i.e. inbound and outbound fund transfers) valued at \$10,000 or more to the CRA.¹² Similarly, the T106 is a tax form for companies that engage in any non-arms-length transactions with non-residents of Canada. Data from EFTs and T106 forms are explored respectively in Sections 2 and 3 of this report.

Appendix A provides an estimate of the amount of revenue, earnings before taxes and the amount of taxes that could be collected in Canada from MNEs with operations in Canada if the level of earnings before tax is proportional to the GDP of Canada relative to the total GDP of countries in which the MNE operates.

2. Electronic Funds Transfers

International electronic funds transfers (EFTs) present an opportunity for individuals and businesses to channel funds that are the result of tax evasion or aggressive tax avoidance strategies. Beginning January 2015, all financial institutions were required to report international EFTs (i.e. inbound and outbound fund transfers) valued at \$10,000 or more to the CRA.

Table 2-1 Top 10 total EFT values of recipient/source country involving a corporate beneficiary in 2018 (\$ billion)

Country	Incoming	Outgoing	Total EFT value	Net EFT value
United States of America	2,910.2	5,591.7	8,501.9	-2,681.5
United Kingdom	922.0	951.4	1,873.4	-29.5
Ireland	90.7	145.0	235.7	-54.3
Germany	97.4	127.3	224.7	-29.9
Singapore	35.9	157.7	193.5	-121.8
Netherlands	96.9	80.5	177.3	16.4
Luxembourg	71.1	98.6	169.7	-27.5
Switzerland	74.3	90.7	165.1	-16.4
France	125.5	34.6	160.1	90.9
Morocco	0.8	116.8	117.6	-115.9

Sources: CRA electronic fund transfer data and PBO's calculations.

Note: Canadian dollars.

Table 2-1 presents the top 10 countries by total EFT value (total transfers into and out of Canada from and to that country for which the beneficiary was a corporation) involving a corporate beneficiary. While the United States has the largest total EFT value at over \$8.5 trillion, the list is dominated by European Union countries. This is likely a result of the establishment of a common market across all EU member countries allowing the free movement of people, goods, services and capital¹³.

Looking at the ratio of total EFT value for transfers involving a corporate beneficiary over the GDP of the beneficiary/source country, small island countries such as Tonga, Cayman Islands and Tuvalu dominate this list,

because of the small size of these jurisdictions' economies.¹⁴ Some are also recognized as offshore financial centres (OFCs), most notably, the Cayman Islands. According to CORPNET¹⁵, an OFC is "a jurisdiction (often a country) that provides corporate and financial services to non-resident companies on a scale that is incommensurate with the size of its economy. Traditionally, OFCs are assumed to be small, low-tax jurisdictions in remote location. In practice, determining which countries are in fact OFCs is nontrivial and as such a highly debated topic."¹⁶

Calculating the ratio of a country's net EFT value (net transfers into and out of Canada from and to that country) involving a corporate beneficiary and its cross-border position provides an indicator of the value of the EFTs reported in Canada and the value of all transactions that have been cleared by that country's banks.¹⁷ Mexico, the United States and Bermuda top the list of net creditor countries relative to Canada where as Singapore, Ireland and the Bahamas are the top net debtors.

Comparing countries by the ratio of net EFT value involving a corporate beneficiary and the country's net investment position relative to Canada provides an indicator of the value of financial flows into and out of the country relative to the trade flows into and out of the country.¹⁸ Denmark, Ireland and Taiwan are countries where financial flows are disproportionately larger than trade flows.

The European Union Commission maintains a black list and a gray list of non-cooperative tax jurisdictions.¹⁹ CORPNET also maintains a list of Offshore Financial Centers (OFC). Using a method based on network analysis, they identify two types of OFC:

- "Sink-OFC: a jurisdiction in which a disproportional amount of value disappears from the economic system.
- "Conduit-OFC: a jurisdiction through which a disproportional amount of value moves toward sink-OFCs."²⁰

Table 2-2 Total and net EFT values of recipient/source country involving a corporate beneficiary in non-cooperative jurisdictions and offshore financial centers in 2018 (\$ billion)

	Incoming	Outgoing	Total EFT value	Net EFT value
EU Black list	57.3	70.0	127.3	-12.6
EU Gray list	196.6	304.0	500.7	-107.4
Total Black list & Gray list	254.0	374.0	628.0	-120.0
Sink-OFC	210.8	213.5	424.4	-2.7
Conduit-OFC	1,219.7	1,425.3	2,645.0	-205.5
Total Sink-OFC & Conduit-OFC	1,430.6	1,638.8	3,069.4	-208.2

Sources: CRA electronic transfer fund data, European Commission list of non-cooperative jurisdictions, CORPNET's OFC Meter and PBO's calculations.

Note: Canadian dollars.

Table 2-2 displays the total and net EFT values of transactions by corporations in these jurisdictions.²¹ Total EFT value in EU's non-cooperative tax jurisdictions amount to almost \$630 billion in 2018. This represents about 3 per cent of total EFT values in and out of Canada. The numbers are much higher for OFCs, where the total amounts to over \$3 trillion dollars, representing about 15 per cent of total EFT values in and out of Canada.

3. T106 Form Information

Canadian taxpayers are required to provide information on non-arm's length transactions with non-residents to the CRA through the T106 Form.²² In other words, corporations doing business in Canada must report transactions they've had during the year with foreign affiliates. The form comprises of a summary portion as well as a slip for each non-resident affiliate with which the reporting person had transactions.²³

The T106 Form must be filed by the same date as the annual tax return of the reporting person.²⁴ The T106 Form is only filed if the reporting person has a total amount of reportable transactions with all non-residents above CAN \$1 million.

T106 slips require the filer to provide a detailed breakdown of transactions by type: for example, trade of tangible property, rents and royalty payments, services (management, R&D, etc.), financial (interest, dividends, etc.), derivatives (interest rate contracts, foreign exchange contracts, etc.), loans and advances. Some of these transactions represent real economic activity where a good or service is provided to or by the foreign affiliate. However, some of these transactions are undertaken to minimise total tax payable. This tax avoidance is entirely legal if done in accordance with the OECD's transfer pricing guidelines.

The PBO accessed T106 microdata for tax years 2014 to 2016 through Statistics Canada Center for Data Development and Economic Research (CDER). The CRA also provided data for tax years 2014 to 2018²⁵ for certain information reported on the Form.²⁶

Table 3-1 presents the distribution of T106 filers by the number of T106 slip filled. Recall that the reporting person must fill one slip for each foreign affiliate with which it engaged in transactions during the year. As we can see, about 6,000 filers (nearly 40 per cent of all filers) only filed one slip. Another 6,470 filed between 2 and 5 slips. Thus, close to 80 per cent of all filers deal with 5 foreign affiliates or less. This is in line with the findings in chart 8 of Statistics Canada "Multinational enterprises in Canada" which identified that 80 per cent of Canadian multinationals owning foreign affiliates operated in less than 5 countries.

Table 3-1 **Distribution of T106 filers by the number of Slips produced (2016)**

No. of T106 Slips	No. of filers	Percentage of filers
1	6,040	38
2 to 5	6,470	41
6 to 9	1,620	10
10 to 49	1,440	9
50 and more	120	1
TOTAL	15,690	100

Sources: T106 Slips and PBO's calculations.

The majority of corporations that file Slips are likely not engaging in tax avoidance activities. At the other end of the spectrum, about 120 corporations filed 50 Slips or more. These filers are more likely to engage in sophisticated tax planning through a complex network of affiliates located in multiple jurisdictions.

For 2017, the total of reportable transactions by all T106 filers was \$4,412 billion.²⁷ This amount increased from a total of \$2,684 billion in 2014. It represents an increase of nearly 65 per cent over three years, or an average annual growth of 18 per cent. The total of reportable transactions includes the sum of both revenue from non-residents as well as expenditures to non-residents.

While the total value of reportable transactions has increased significantly over three years, it's not necessarily an indication of a similar trend in tax avoidance. The total value of transactions involving the purchase and sale of goods and services, royalties, rent and lease payments, services, etc., has only increased by 28 per cent over the 2014 to 2016 period.²⁸ The increase in total reportable transactions is mostly explained by increases or decreases in loans, advances and investment in non-residents as well as by increases in the revenues and expenditures in derivatives.

T106 filers must also report their total gross revenue. As can be seen in Table 3-2, the aggregate for all filers has remained relatively steady at \$2.2 trillion, except for an outlying year 2015. Thus, it seems peculiar that the total value of reportable transactions has risen over three years, but the gross revenue of the filers has not changed. As mentioned earlier, this could arise from data quality issues. However, it could also suggest that most of the increase doesn't come from an increase in trade between affiliates, but simply an increase in the loans and advances.

While there are only roughly 15,000 T106 Summary Forms that were filed in any year, the gross revenue of all T106 filers represents slightly over half of the total revenue of all corporations filing a T2 tax return in Canada. Note that most T106 filers are corporations, but some filers are trusts. Thus, if we

add the total revenue of all T3 filers (trusts), which amounted to \$139 billion in 2014, to that of T2 filers, the T106 filers' share reduces slightly from 53.2 to 51.4 per cent $(2,192/(4,123 + 139))$.²⁹

Table 3-2 Total gross revenue of T106 filers and their share of total revenue from all T2 filers (\$ billion)

Tax Year	Gross revenue (T106 filers)	Operating revenue (All T2 filers)	T106 filers' share of op. revenue (%)	Total revenue (All T2 filers)	T106 filers' share of tot. revenue (%)
2014	2,192	3,901	56.2	4,123	53.2
2015	3,793	3,863	98.2	4,064	93.3
2016	2,132	3,936	54.2	n.a.	n.a.
2017	2,208	4,179	52.8	n.a.	n.a.

Sources: Gross revenue: Box 5 - Total Gross Revenue of the Reporting Person/Partnership from section 2 of the T106 Summary Form.

Operating revenue: Statistics Canada. Table 33-10-0006-01. Financial and taxation statistics for enterprises (AFTS).

Total revenue: Canada Revenue Agency. T2 Corporate Statistics 2018 Edition (2011-2015 tax years).

T106 filers' shares: PBO's calculations.

Table 3-3 presents the top ten countries with which Canadian reporting persons had the highest total value of reportable transactions in 2016 (based on the sum of all boxes "I" of the T106). The United States is first with half of the value of all reportable transactions. Most countries in that table were considered in 2016 as having a high financial secrecy index or being tax favourable locations. Note that the value of total transactions includes both revenue from non-residents and expenditures to non-residents. Finally, the country is the country in which the non-resident affiliate is located. However, the transaction could refer to goods or service provided in another country. Also, the ultimate destination of the funds is unknown, as the foreign affiliate could in turn transfer the payment to another affiliate in a different jurisdiction. Indeed, Switzerland, Ireland, the UK and the Netherlands are all identified as conduit-OFCs in CORPNET's study.

Table 3-3 Top 10 countries for the total reportable transaction - both to and from non-residents (Box I of the T106) (2016)

Country	Value of total transactions (\$ billion)	Percentage of total	Percentage of total (excl. USA)
United States	1,895.9	51.3	
Luxembourg	236.7	6.4	13.1
Switzerland	198.4	5.4	11.0
Ireland	172.4	4.7	9.6
United Kingdom	164.6	4.5	9.1
Netherlands	115.7	3.1	6.4
Barbados	48.2	1.3	2.7
Australia	33.0	0.9	1.8
Hungary	31.4	0.9	1.7
Bermuda	29.7	0.8	1.6
Top 10 Total	2,926.0	79.1	57.2

Sources: Total of all boxes I of the T106 slips and PBO's calculations.

The next two tables present the top ten countries in terms of net expenditure and net revenue with respect to transactions reported in Part III of the T106 slips³⁰ (box A – revenues from non-residents minus box B – expenditures to non-residents). As can be seen in Table 3-3, Netherlands is the country that received the most net payments from T106 filers, with \$14.4 billion more that were sent than what was received.

In terms of positive net receipts, Canada is a net recipient of \$17.6 billion from its biggest trade partner, the United States. While the US represents the greatest volume of transactions, it only comes second to Luxembourg in net receipts. With \$47.6 billion received versus only \$6.6 billion sent, Luxembourg takes the first place in 2016 with net receipts of \$41 billion.³¹

Table 3-4 Top 10 countries for the highest net expenditures to non-residents (2016)

Country	Revenues from non- residents (\$ billion)	Expenditures to non- residents (\$ billion)	Net revenue from non- residents (\$ billion)
Netherlands	6.8	21.2	-14.4
Germany	3.3	13.4	-10.1
Japan	3.6	11.6	-8.0
South Korea	0.6	7.0	-6.4
Switzerland	11.4	17.8	-6.4
Mexico	2.8	5.0	-2.2
Ireland	3.1	4.8	-1.6
France	3.2	4.5	-1.2
China	1.6	2.8	-1.2
Brazil	1.0	2.2	-1.2
Top 10 Total	37.6	90.4	-52.8

Sources: Total of all boxes A and B of the T106 slips and PBO's calculations.

Table 3-5 Top 10 countries for the highest net revenues from non-residents (2016)

Country	Revenues from non- residents (\$ billion)	Expenditures to non- residents (\$ billion)	Net revenue from non- residents (\$ billion)
Luxembourg	47.6	6.6	41.0
United States	612.4	594.8	17.6
Barbados	8.4	3.7	4.7
Bermuda	9.2	4.9	4.3
Australia	5.1	1.6	3.5
Singapore	6.3	2.8	3.4
Bahamas	2.2	0.4	1.9
Cayman Islands	1.8	0.2	1.6
Gibraltar	1.5	0.0	1.5
Hong Kong SAR	3.1	2.3	0.8
Top 10 Total	697.5	617.4	80.2

Sources: Total of all boxes A and B of the T106 Slips and PBO's calculations.

It is interesting to note that more money was received than sent from many countries considered as tax havens such as Barbados, Bermuda, the Bahamas, the Cayman Islands, Gibraltar or even Singapore and Hong Kong.

It is possible that foreign based multinationals set-up subsidiaries in Canada which undertake R&D activities for example, taking advantage of the country's generous federal and provincial tax credits for such activities. The Canadian subsidiary is only a cost center and the foreign parent pays for the R&D services through another subsidiary located in a tax haven in which it has channeled most of its profits to avoid taxation in its home country. The Canadian subsidiary pays little to no income tax in Canada, since its profits is limited to the margin realised on the R&D activities which can be offset by the R&D tax credits. Furthermore, even though most of the product will have been developed in Canada, the Canadian subsidiary is not necessarily the owner of the intellectual property, and thus future revenues from royalty payments will be taxed in another jurisdiction (such as Luxembourg or the Netherlands for example, which are "patent box" countries³²).

Table 3-6 provides a breakdown of the transactions that make up the totals of boxes A and B in Part III of the T106, by five categories. As can be seen, trade in tangible property accounts for the most part of the total value of transactions. Financial (interest payments, dividends, etc.) comes in second representing about 15 per cent of revenues from non-resident and 12 per cent of expenditures to non-residents.

Table 3-6 Breakdown of Part III transactions by type (2016)

Part III subsection	Revenue (\$ billion)	Expenditure (\$ billion)	% of box A total	% of box B total
Tangible Property	566.9	576.8	74.0	77.1
Rents, Royalties and Intangible Property	5.6	14.4	0.7	1.9
Services	43.0	31.4	5.6	4.2
Financial	116.5	88.5	15.2	11.8
Other	34.4	37.1	4.5	5.0
Total	766.4	748.3	100.0	100.0

Sources: Total of all boxes A and B of the T106 Slips and PBO's calculations.

Table 3-7 provides the same breakdown in terms of number of T106 filers that recorded amounts in any of these categories. We can see that most filers report transactions in tangible property as well as services. Few report rents and royalty payments and the financial category falls in the middle.

Comparing the numbers in Table 3-7 with those of Table 3-1, we can probably assume that the corporations with few foreign affiliates (5 or less) are only reporting transactions in tangible property and services. Meanwhile, corporations with a larger number of affiliates are likely the ones reporting

rents, royalty payments, intangible property and financial payments (interests, dividends, etc.).

Table 3-7 Breakdown of number of filers by Part III transaction type (2016)

Part III subsection	# filers with revenue	% of total filers	# filers with expenditure	% of total filers
Tangible Property	12,330	78.6	14,650	93.4
Rents, Royalties and Intangible Property	1,780	11.3	2,740	17.5
Services	14,570	92.9	14,840	94.6
Financial	5,570	35.5	6,200	39.5
Total number of filers	15,690		15,690	

Sources: T106 Slips and PBO's calculations.

As mentioned in Section 2, the European Union Commission maintains a black list and a gray list of non-cooperative tax jurisdictions³³ and CORPNET maintains a list of Offshore Financial Centers (OFC).³⁴

Table 3-8 displays the total value of transactions by T106 filers with their affiliates in these jurisdictions for boxes A, B and I.³⁵ Note that some countries in the lists had too few observations so their values had to be suppressed for confidentiality reasons. Thus, the numbers in Table 3-8 are slightly underestimated.

Table 3-8 Revenues, expenditures and total reportable transactions with non-residents in non-cooperative jurisdictions and offshore financial centers

	Revenues (\$ billion)	Expenditures (\$ billion)	Total reportable transactions
EU Black list	21.6	16.9	110.9
EU Gray list	19.4	22.3	260.6
Total Black list & Gray list	41.0	39.2	371.5
Sink-OFC	67.0	15.2	344.6
Conduit-OFC	41.6	61.3	651.1
Total Sink-OFC & Conduit-OFC	108.6	76.5	995.7

Sources: Total of all boxes A of the T106 slips for revenues, boxes B for expenditures and boxes I for total reportable transactions, European Commission list of cooperative jurisdictions, CORPNET's OFC Meter and PBO's calculations.

We can see in the table that reportable transactions in EU's non-cooperative tax jurisdictions amount to at least \$370 billion in 2016. This represents about

10 per cent of the value of all transactions and slightly more than 20 per cent of the value of all transactions outside the United States. The numbers are much higher for OFCs, where the total amounts to almost a trillion dollars, which represents 27 per cent of the value of all transactions and 58 per cent of the value of all transactions outside the United States.

The high volumes of transactions in suspected tax havens highlights the importance of the BEPS initiative. Furthermore, it is only through review of the T106 Forms that the extent of the problem can be determined. As well, the low penalties for omissions and false statements on the form may reduce the incentive for corporations to accurately report their related transactions.³⁶

4. Conclusion

PBO finds that financial flows between Canada and certain jurisdictions are disproportionately large compared to their GDP, net cross border position and net trade flows. Some of these jurisdictions have been recognized as tax havens. However, more work is needed to estimate the size of corporate financial flows and tax loss attributed to profit shifting.

For illustrative purposes, if we assume that 10 per cent of the \$996 billion in reportable transactions with offshore financial centers (OFCs) identified in Table 3-8 has avoided corporate income taxes in Canada, it would represent an amount of \$100 billion of taxable income that should have been taxed at the general rate of 15%. Thus, this would represent a loss in tax revenues of about \$15 billion. Looking at electronic funds transfers (EFTs) would generate an even higher estimate. Indeed, if we assume that 10 per cent of the \$1,639 billion in outgoing EFTs to OFCs identified in Table 2-2 has avoided taxes, this would represent approximately \$164 billion in taxable income and \$25 billion of tax revenues lost. These calculations are of course hypothetical and cannot be verified.

When examining transfer pricing audits by the CRA, \$12.9 billion of income was disputed by auditors in the 760 cases heard by the Appeals Branch of the CRA between 1 April 2014 and 1 March 2019.³⁷ However, only \$4.5 billion of that income was confirmed by the Appeals Branch. Such disputed income by auditors represents a small proportion of the total value of transfer pricing transactions.

In our analysis in Appendix A we determined that MNEs would have under-reported \$4.2 billion of taxable income in 2015 if their Canadian taxable income was proportional to the level of Canada's GDP to the total GDP of the countries in which the MNEs operate.

From our examination of EFT and T106 data, we are unable to determine whether Canada is a net loser from tax planning activities. Until 2018, the statutory corporate income tax rate in Canada was lower than in the US, our major trading partner. Thus, there might have been some profit shifting from US corporations towards Canada.

Globally, efforts are underway to stem the practice of profit shifting by MNEs to reduce global tax payable. Canada is among several countries that have begun the process to implement OECD's multilateral tax convention to implement BEPS, adding an anti-avoidance rule to existing bilateral tax treaties.

Some countries have gone further to address tax avoidance. For example, to address the tax challenges of the digital economy, France is proposing a domestic digital services tax that would apply to revenues from certain digital business models.

CRA efforts to increase audits on the information reported on T106 forms could reduce the magnitude of aggressive tax planning. However, it may be time for a “fundamental rethink” on international corporate taxation to ensure income is taxed where the economic activity is taking place.³⁸

Appendix A: Analysis of Financial Metrics

Using 3rd party sources party sources (Standard and Poor's Capital IQ platform) PBO was able to gather information on various financial metrics of Canadian multinationals and domestic firms that are publicly traded and that had operations in Canada.

Table A-1 compares average values for effective tax rates (ETR), revenues, cost of goods sold (COGS) and earnings before taxes (EBT) between MNEs and domestic firms across non-financial, financial and all sectors. Values for MNEs relate to the global operations of the MNE and does not isolate the Canadian proportion of such activities.³⁹

Table A-1 Averages of various financial metrics, 2015

	Effective tax rate (%)	Revenue (\$ million)	Cost of goods sold (\$ million)	Earnings before taxes (\$ million)
<u>Non-financial firms</u>				
MNE	21.3	9,210 *	6,360 *	619 *
Domestic	22.9	550 *	372 *	17 *
<u>Financial firms</u>				
MNE	38.6	11,500 *	7,740 *	1,200 *
Domestic	10.5	251 *	137 *	54 *
<u>All firms</u>				
MNE	22.6	9,380 *	6,470 *	663 *
Domestic	19.3	464 *	304 *	28 *

Sources: Standard & Poor's Capital IQ data and PBO's calculations.

Notes: Financial firms are those with two-digit Standard Industrial Classification (SIC) codes of 60, 61, 62, 63, 64 and 67.

Asterix indicates that the difference in means between MNE's and non-MNEs is statistically significant at the 99% confidence level.

In general, financial sector MNEs have higher values across all three of these metrics relative to domestic firms, which would explain why this is also the case when comparing averages across all sectors. When financial sectors are removed, non-financial sector MNEs have a lower ETR compared to domestic peers (though their COGS and EBT is still higher).

Table A-2 compares the earnings before tax and revenue for all multinational firms that are publicly traded in the Capital IQ database and as reported on the T2 tax return in Canada. To attribute the total global amount of earnings

and revenue reported by multinationals in Table A-2, we used the proportion of Canada's GDP of the total GDP of all the countries in which multinationals operate.⁴⁰ This attribution percentage is 2.23%.

Table A-2 **Comparison of the average revenue and average earnings before tax of all firms, 2015**

	Revenue (\$ million)	Earnings before taxes (\$ million)
Capital IQ	209.1	14.8
T2 Data	184.7	13.5

Sources: Standard & Poor's Capital IQ data, T2 Data from Statistics Canada and PBO's calculations.


Notes: Average earnings and revenue for data from Capital IQ is based on totals for all multinationals publicly-traded and is attributed to Canada based on the proportion of Canada's GDP to the GDP of all countries in which such multinationals operate and is 2.23%. The total count was 3,211.

The average earnings before tax for T2 data is the total reported by all multinationals resident in Canada and which are publicly-traded or controlled by a publicly-traded corporation or "other" as identified on the T2 tax return and that had a foreign affiliate, owned shares in a foreign affiliate or filed a T106. The total count was 3,890. Earnings before tax was taken from line 360 of the T2 and total revenue was taken from line 8299 on Schedule 125.

As can be seen from Table A-2, the earnings before tax and revenue as reported in the T2 Data are both lower than would be expected if such earnings and revenue was in proportion to the economic activity in Canada as measured by the GDP of Canada when compared to the total GDP of all countries in which the multinational operates.

Based on this difference, one can estimate the tax gap as a result of profit shifting and other activities by Canadian MNEs to be on average \$1.3 million of taxable income per multinational which is approximately \$4.2 billion in taxable income for the approximately 3,200 MNEs operating in Canada. Applying a 15% tax rate would result in an additional \$600 million in tax revenue for 2015 if such shifting and activities did not occur.

Appendix B: CRA T106 Form

	Canada Revenue Agency Agence du revenu du Canada	Protected B when completed Do not use this area
Information Return of Non-arm's Length Transactions with Non-residents T106 Summary Form		
<ul style="list-style-type: none"> Refer to the instruction sheet before you complete the T106 Summary and Slips. Complete a separate T106 Slip for each non-resident. Refer to the instruction sheet for information on the penalties applicable to each T106 Slip. If an election has been made to use functional currency (see instruction sheet), state the elected functional currency code: 		
If this is an amended return, tick this box: <input type="checkbox"/>		
Section 1 – Reporting person/partnership identification Tick the applicable box and complete the areas that apply.		
<input type="checkbox"/> Corporation <input type="checkbox"/> Partnership <input type="checkbox"/> Trust <input type="checkbox"/> Individual	Corporation name: Partnership name: Trust name: First name: Last name: Initial: 	Business Number (BN): Partnership identification number: Trust account number: Individual code: Social Insurance Number:
Reporting person/partnership address: No. Street City Province or territory Postal code 		
Section 2 – Summary information		
1. For what tax year/fiscal period are you filing these T106 forms? From Year Month Day To Year Month Day 		
2. Is this the first time you have filed T106 forms? <input type="checkbox"/> Yes <input type="checkbox"/> No If no, indicate the last tax year/fiscal period end for which the reporting person/partnership filed T106 forms. 		
3. Enter the total number of T106 Slips attached. 		
4. Enter the total of all box "I" amounts from the T106 Slips attached (to the nearest Canadian dollar or functional currency unit – see instructions). \$ 		
5. Enter the gross revenue of the reporting person/partnership (to the nearest Canadian dollar or functional currency unit – see instructions). \$ 		
6. State the main business activities of the reporting person/partnership by entering the appropriate NAICS code(s) – see instructions for NAICS codes. NAICS code(s): 1 2 3 4 		
7. Are any of the amounts (e.g., income, deductions, foreign tax credits) claimed by the reporting person/partnership in the current tax year/fiscal period affected by any completed, outstanding or anticipated requests for competent authority assistance? <input type="checkbox"/> Yes <input type="checkbox"/> No		
8. Are any of the amounts (e.g., income, deductions, foreign tax credits) claimed by the reporting person/partnership in the current tax year/fiscal period adjusted to reflect an assessment or a proposed assessment by a foreign tax administration? <input type="checkbox"/> Yes <input type="checkbox"/> No		
9. Are any of the transfer pricing methodologies (TPM) used by the reporting person/partnership predicated on an advanced pricing arrangement (APA) or similar arrangement between any non-resident and a foreign tax administration? <input type="checkbox"/> Yes <input type="checkbox"/> No		
10. Does the reporting person/partnership have to file a NR4, T4, T4A or T4A-NR return(s) for the transactions reported in Part III of the T106 Slips? If yes, state the primary account numbers: 1 2 		
Section 3 – Non-monetary or nil consideration		
1. Has the reporting person/partnership received from or provided to any non-resident any non-monetary consideration for any service, transfer of tangible or intangible property, or anything whatever, under an exchange, swap, barter, bonus, discount or other such arrangement? <input type="checkbox"/> Yes <input type="checkbox"/> No		
2. Has the reporting person/partnership provided to any non-resident any service, transfer of tangible or intangible property, or anything whatever, for which there was nil consideration? <input type="checkbox"/> Yes <input type="checkbox"/> No		
T106 E (10/2017)		(Ce formulaire existe en français.)



Certification		Protected B when completed
Person to contact for more information (please print)		
First name	Last name	Area code () Telephone number
I, _____, certify that the information given on these T106 Summary and Slips is, to the best of my knowledge, correct and complete.		
Date	Authorized signing officer's, person's, or representative's signature	Position, title, or officer's rank

Instructions

If an election has been made under paragraph 261(3)(b) of the *Income Tax Act* to report in a functional currency, state all monetary amounts in that functional currency, otherwise state all monetary amounts in Canadian dollars (no cents). The codes for the functional currencies are as follows:
 AUD – for Australian dollar
 USD – for U.S. dollar
 GBP – for U.K. pound
 EUR – for Euro

Amended returns
 If this is an amended return, tick

You must re-complete the entire T106 package including the amendments (i.e. include all information not amended plus all amended information), and re-file this entire amended T106 package. If the initial T106 was paper filed, then the amended T106 must be paper filed. If the initial T106 was electronically filed, then the amended T106 can be electronically filed or paper filed.

Section 1 – Reporting person/partnership identification
 For partnership code, tick:

☐ 1 If end partners are individuals or trusts.
☐ 2 If end partners are corporations.
☐ 3 If end partners are a combination of 1 and 2 mentioned above.

An end partner is the final recipient (corporation, trust or individual) that receives an allocation of income from the partnership after the income has flowed through the various levels of a tiered partnership.

For individual code, tick:

☐ 1 If the individual or the individual's spouse is self-employed.
☐ 2 If the individual or the individual's spouse is not self-employed.

Section 2 – Summary information
 Q.1. Enter the applicable tax year/fiscal period.


Q.2. State if this is the first time that a T106 has been filed. If "no," enter the last tax year/fiscal period end for which T106 documentation was filed.

Q.5. Enter the gross revenue of the reporting person/partnership. Do not enter the net income or taxable income. When reporting non-arm's length transactions between a related party and a branch, enter the gross income attributable to the branch.

Q.6. State the main business activities of the reporting person/partnership by entering the appropriate North American Industrial Classification System (NAICS) code(s). The list of current NAICS codes can be found at the Statistics Canada internet site, www23.statcan.gc.ca/imdb/p3VD.pl?Function=getVDPPage1&db=imdb&dis=2&adm=8&TVD=118464. Main business activity means any business segment which accounts for more than 10% of the gross revenue of the reporting person/partnership or the non-resident.

Certification
 An authorized officer, person, or representative has to sign this form when it is completed. The certification declaration on this form applies to the T106 Summary and Slips.

Privacy Act, Personal Information Bank number CRA PPU 205

	Canada Revenue Agency Agence du revenu du Canada	T106 Slip	Protected B when completed
Refer to the information and instruction sheet before you complete this form. Tick the applicable boxes and complete the areas that apply.			
			Slip _____ of _____
Part I – Reporting person/partnership information			
Corporation <input type="checkbox"/>	Business Number (BN) <div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> R C </div>	Trust <input type="checkbox"/>	Trust account number <div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> T </div>
Partnership <input type="checkbox"/>	Partnership identification number <div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> R Z </div>	Individual <input type="checkbox"/>	Social Insurance Number <div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
For what tax year/fiscal period are you filing this T106 Slip?			
From		To	
<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> Year Month Day </div>		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> Year Month Day </div>	
Part II – Non-resident information			
1. Name of the non-resident			
2. Address of the non-resident and country of residence (see Instructions for information on country codes)			
			Country code
3. Type of relationship:			
1 <input type="checkbox"/> Non-resident is controlled by reporting person/partnership		2 <input type="checkbox"/> Non-resident controls reporting person/partnership	
		3 <input type="checkbox"/> Other	
If "1", is the non-resident in a country with which Canada does not have a tax treaty?			
Yes <input type="checkbox"/>		No <input type="checkbox"/> If yes, attach financial statements of the non-resident.	
4. State the main business activities for the transactions reported in Part III by entering the appropriate NAICS code(s). See instructions for NAICS codes.			
NAICS code(s): 1		2	
<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	
3		4	
<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	
5. State the main countries for the transactions reported in Part III by entering the appropriate country code(s) – see Instructions.			
Country code(s): 1		2	
<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	
3		4	
<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	
6. Have you prepared or obtained contemporaneous documentation as described in subsection 247(4) of the Income Tax Act for the tax year/fiscal period with respect to the non-resident?			
Yes <input type="checkbox"/>		No <input type="checkbox"/>	
7. Have any of the transfer pricing methodologies (TPM) changed since the previous reporting period with respect to the non-resident?			
Yes <input type="checkbox"/>		No <input type="checkbox"/>	
Part III – Transactions between reporting person/partnership and non-resident			
Enter in the appropriate box the monetary consideration (to the nearest Canadian dollar/ functional currency unit if applicable) derived or incurred for the following transactions with the non-resident. Enter the appropriate transfer pricing methodology (TPM) codes from the list in the Instructions.			
Tangible Property			
Stock in trade/raw materials		Sold to non-resident	Purchased from non-resident
Other (specify):		TPM	TPM
		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Rents, Royalties and Intangible Property			
Rents		Revenue from non-resident	Expenditure to non-resident
Royalties (e.g., for the use of patents, trademarks, secret formulas, know-how)		TPM	TPM
License or franchise fees		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Intangible property or rights (acquired or disposed of)		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Services			
Management, financial, administrative, marketing, training, etc.		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Engineering, technical, construction, etc.		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Research and development		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Commissions		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Financial			
Interest		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Dividends (e.g., common stock, preferred stock, deemed dividends)		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Sale of financial property (including factoring, securitizations and securities)		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Lease payments		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Securities Lending (fees and compensation payments)		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Insurance		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Other (excluding derivatives – see Part V):		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Other			
Reimbursement of expenses		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Other		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Please enter the total of all entries made in each column of Part III.		A =	B =
		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Part IV – Loans, advances, investments and similar amounts			
		Beginning balance	Increase
Amounts owed by reporting person/partnership		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Amounts owed to reporting person/partnership		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Investment in non-resident (ACB)		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>
Please enter the total of all entries made in each column of Part IV.		C =	D =
		<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>	<div style="border: 1px solid black; padding: 2px; display: flex; justify-content: space-between;"> </div>

Part V – Derivatives		Protected B when completed			
	Number of contracts	Notional amount	Revenue from non-resident	Expenditure to non-resident	
101 Interest Rate Contracts		\$	\$	\$	
102 Foreign Exchange Contracts		\$	\$	\$	
103 Credit Contracts		\$	\$	\$	
104 Equity Contracts		\$	\$	\$	
105 Commodity Contracts		\$	\$	\$	
106 Index Contracts		\$	\$	\$	
107 Fees (including commissions)		\$	\$	\$	
108 Other payments / receipts (specify)		\$	\$	\$	
Please enter the total of all entries made in each column of Part V		E =	F = \$	G = \$	H = \$
Please enter in box I the total of all entries made in boxes A, B, C, D, G and H		I = \$			

Part VI – Current accounts				
	Beginning balance	Increase	Decrease	Ending balance
Amount of accounts payable	\$	+	–	= \$
Amount of accounts receivable	\$	+	–	= \$

Instructions

If an election has been made under paragraph 261(3)(b) of the *Income Tax Act* to report in a functional currency, state all monetary amounts in that functional currency, otherwise state all monetary amounts in Canadian dollars (no cents).

Part II – Non-resident information
 Q.1 and Q.2. Enter the name and address of the non-resident. For the list of country codes, see the CRA publication, T4061 – NR4 – *Non-Resident Tax Withholding, Remitting and Reporting guide*, Appendix A – Country Codes, at: cra.gc.ca/E/pub/tg/t4061/t4061-e.html.

Q.3. State the type of relationship that exists between the reporting person/partnership and the non-resident. The Canada Revenue Agency needs the relevant financial statements (in English or French) of the non-resident if the non-resident is controlled by the reporting person or partnership and is resident in a non-treaty country. Canada has income tax conventions (treaties) with more than 60 countries. These include the United States, the United Kingdom, France, Japan, and Australia. For information about the countries with which Canada has concluded an income tax treaty, contact your tax services office or consult the Internet at: fin.gc.ca.

Q.4. State the main business activities for the transactions reported in Part III by entering the appropriate North American Industrial Classification System (NAICS) codes. The current NAICS codes can be found at the Statistics Canada internet site, www23.statcan.gc.ca/imdb/p3VD.pl?Function=getVDPPage1&db=imdb&dis=2&adm=8&TVD=118464. You can enter more than one code.

Q.5. State the main countries for the transactions reported in Part III by entering the appropriate country code. You can enter more than one code. For the list of country codes, see the information provided under Q1. and Q2. above.

Q.6. Enter yes or no to the question. In general, subsection 247(4) of the *Income Tax Act* relates to the requirement to maintain and make available contemporaneous transfer pricing documentation. You can find more information on contemporaneous documentation requirements in Information Circular 87-2, *International Transfer Pricing*. The circular is available at our tax services offices and on the Internet at: canada.ca/taxes.

Part III – Transactions between reporting person/partnership and non-resident
 Enter (to the nearest Canadian dollar/functional currency unit if applicable) the monetary consideration derived or incurred for the transactions in Part III. Only record in Part III those amounts that apply to the non-resident described in Part II. Report gross amounts in the two columns.

The "Sold to non-resident" and "Revenue from non-resident" refers to gross sales and revenue received from non-arm's length transactions with non-residents. For example, this includes transactions related to exports from Canada and services provided to the non-resident.

The "Purchased from non-resident" and "Expenditure to non-resident" refers to gross purchases and expenditures made relating to non-arm's length transactions with non-residents. For example, this includes transactions related to imports into Canada and services provided by the non-resident.


For the banking industries, the line for "Stock in trade/raw materials" must be used to report bonds, debentures, loans, mortgage transactions. The normal interest income and expense on loans and advances with the non-arm's length non-resident(s) must be reported in the Financial section.

Part V – Derivatives
 The column for Notional Amounts applies to swap transactions. The terms used in this section are described below:

Descriptions 101 Interest Rate Contracts This section includes – forward rate arrangements – swaps – options purchased – options written 102 Foreign Exchange Contracts – forward contracts – cross currency swaps – cross currency interest rate swaps – options purchased – options written 103 Credit Contracts – risk transfer arrangements	104 Equity Contracts – includes contracts used to transfer the economic benefits of securities and debt instruments 105 Commodity Contracts – includes swaps, forward contracts and options 106 Index Contracts – includes all contracts that derive their value from publicly traded indices 107 Fees – any fee or commission charged on derivative transactions 108 Other Payments / Receipts – other payments and receipts not identified above
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Do you need more information?
 For general enquiries, contact the Business Enquiries section of your tax services office. For detailed information about completing the form, contact the International Audit Division of your tax services office. The address and telephone number of the tax services office are listed under "the Canada Revenue Agency" in the Government of Canada section of your telephone book and on the Internet at: canada.ca/taxes.

Privacy Act, Personal Information Bank number CRA PPU 205

 Canada Revenue Agency	Agence du revenu du Canada	Information Return of Non-arm's Length Transactions with Non-residents T106 Information and Instructions
Purpose The T106 Summary and Slips are annual information returns used to report non-arm's length transactions between reporting persons or partnerships and non-residents under section 233.1 of the <i>Income Tax Act</i> . The T106 Summary and Slips are prescribed forms.		
Definitions Under section 233.1 of the <i>Income Tax Act</i> : A "reporting person" for a taxation year means a person (corporation, trust or individual) who, at any time in the year, (a) is resident in Canada; or (b) is non-resident and carries on business (other than a business carried on as a member of a partnership) in Canada. A "reporting partnership" for a fiscal period means a partnership (a) a member of which is resident in Canada in the period; or (b) that carries on business in Canada in the period. A "reportable transaction" means (a) in the case of (i) a reporting person for a taxation year who is not resident in Canada at any time in the year, or (ii) a reporting partnership for a fiscal period no member of which is resident in Canada in the period, a transaction or a series of transactions that relate in any manner whatever to a business carried on in Canada by the reporting person or partnership in the year or period or a preceding taxation year or period; and (b) in any other case, a transaction or series of transactions that relate in any manner whatever to a business carried on by a reporting person (other than a business carried on by a reporting person as a member of a partnership) or partnership in a taxation year or fiscal period.		
The terms arm's length and non-arm's length are discussed in Interpretation Bulletin IT 419, <i>Meaning of Arm's Length</i> . Refer also to sections 251 and 252 of the <i>Income Tax Act</i> .		
Who has to file A reporting person has to file T106 documentation for a tax year in respect of reportable transactions in which the reporting person and the non-arm's length non-resident person (or partnership of which that non-resident person is a member) participated in the period. The reporting person has to file the T106 documentation if the amount of the total reportable transactions for all the non-residents combined is more than CAN \$1,000,000 (i.e., the total of all Box I amounts is more than CAN \$1,000,000). A reporting partnership has to file T106 documentation for a fiscal period in respect of reportable transactions in which the reporting partnership and the non-arm's length non-resident person (or partnership of which the non-resident person is a member) participated in the period. The reporting partnership has to file the T106 documentation if the amount of the total reportable transactions for all the non-residents is more than CAN \$1,000,000 (i.e., the total of all Box I amounts is more than CAN \$1,000,000). File T106 documentation for the partnership only and not for each partner. Where a reporting person or partnership's total amount of the transactions with a particular non-resident during the taxation year is below \$25,000, there is no need to report these transactions in Part III of the T106 Slip. Please see the notice at cra.gc.ca/tx/nrdsdnts/ntcs/t106-eng.html for additional information.		
Branches A Canadian branch of a foreign-based corporation or a foreign-based branch of a Canadian corporation does not have to file T106 documentation for notional transactions. However, non-arm's length transactions between a branch and a non-arm's length party have to be reported in the reporting person's/partnership's T106.		
When to file T106 documentation has to be filed on or before the following dates: Corporations – six months after the end of the tax year. Partnerships – the due date is the same as the due date for filing a partnership information return under section 229 of the <i>Income Tax Regulations</i> . If no partnership information return has to be filed, the reporting partnership's due date is the day by which the partnership information return would be required to be filed if section 229 did apply to the reporting partnership. Trusts – 90 days after the end of the tax year. Individuals – April 30 after the end of each calendar year. For individuals who are self-employed, or individuals whose spouse is self-employed, the filing due date is extended, as with their T1 individual income tax returns, to June 15 after the end of the calendar year. For short tax years/fiscal period ends, T106 documentation is due at the same time as the filing due date of the T1, T2, and T3 income tax returns or the T5013 information return. For short tax years/fiscal periods which together do not exceed 12 months, one set of T106 documentation is enough if information for the tax years/fiscal periods is detailed in a letter that must accompany the T106 documentation.		
What to file Each reporting person or partnership has to file one T106 Summary, as well as a separate T106 Slip for each non-resident. The information reported in the T106 is filed in respect of the corporation, partnership, trust or individual and not by sub-division, cost centre or individual partner.		
Where to file T106 documentation has to be mailed to the Winnipeg Taxation Centre, Data Assessment & Evaluation Programs, Validation & Verification Section, Foreign Reporting Returns, 66 Stapon Road, Winnipeg MB R3C 3M2. <u>T106 documentation has to be filed separately from the income tax return. Do not attach T106 documentation to your income tax return.</u>		
Penalties Late Filing – A late filing penalty, or multiple late filing penalties for more than one T106 Slip may be assessed under subsection 162(7) of the <i>Income Tax Act</i> where T106 documentation is filed after the due date. The penalty is equal to the greater of \$100 and \$25 per day, as long as the failure to file continues, to a maximum of 100 days. Failure to file – A failure to file penalty may be assessed under subsection 162(10) of the <i>Income Tax Act</i> where reporting persons or partnerships knowingly, or under circumstances amounting to gross negligence, fail to file or fail to comply with a request by the Canada Revenue Agency (CRA) for T106 documentation. The minimum penalty is \$500 per month, to a maximum of \$12,000 for each failure to comply. Where the CRA has served a demand to file T106 documentation, the minimum penalty is \$1,000 per month, to a maximum of \$24,000 for each failure to comply. False statement or omission – A false statement or omissions penalty may be assessed under subsection 163(2.4) of the <i>Income Tax Act</i> where information provided on the T106 Summary or Slip is incomplete or incorrect. The penalty is \$24,000.		
T106 E (10/2017) (Ce formulaire existe en français.) 		

Transfer Pricing Methodologies (TPM)

Use the codes listed below to reflect the main transfer pricing methodology.

- 1 Comparable Uncontrolled Price
- 2 Cost-Plus
- 3 Resale
- 4 Profit Split
- 5 Transactional Net Margin
- 6 Qualifying Cost Contribution Arrangement
- 7 Other

You can find more information on transfer pricing methods in Information Circular 87-2, *International Transfer Pricing*. The circular is available at our tax services offices and on the Internet at: canada.ca/taxes.

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- Hines, J. and Rice, E. 1994. Fiscal Paradise: Foreign Tax Havens and American Business, *The Quarterly Journal of Economics*, 109, (1), 149–182.

Notes

1. Canada Revenue Agency: Tax Gap – A brief overview.
<https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/corporate-reports-information/tax-gap-overview.html>
2. Canada Revenue Agency: Tax Avoidance.
<https://www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/tax-alert/tax-avoidance.html>
3. Ibid.
4. Canada Revenue Agency: Tax Avoidance.
<https://www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/tax-alert/tax-avoidance.html>
5. The Internal Revenue Agency (IRS) in the United States published its assessment of the tax gap for the years between 2008–10.

IRS: Tax Gap Estimates for Tax Years 2008–2010.
<https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>

Her Majesty's Revenue & Customs (HMRC) in the United Kingdom published its assessment of the tax gap for the year of 2016–17 last year.

HMRC: Measuring tax gaps 2018 edition - Tax gap estimates for 2016–17.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/715742/HMRC-measuring-tax-gaps-2018.pdf

The Australian Taxation Office (ATO) in Australia published its assessment of the tax gap for various taxes levied for the years between 2013–2015.
<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/>
6. *Income Tax Act*, R.S.C. 1985, s.241, c. 1(5th Supp.).
7. Canada Revenue Agency: Tax gap estimates in Canada.
<https://www.canada.ca/en/revenue-agency/news/2018/06/tax-gap-estimates-in-canada.html>
8. Canada Revenue Agency: Tax Gap and Compliance Results for the Federal Corporate Income Tax System. <https://www.canada.ca/content/dam/cra-arc/corp-info/aboutcra/tax-gap/txgp2019-en.pdf>
9. *Income Tax Act*, R.S.C. 1985, s.247, c. 1(5th Supp.).
10. OECD: Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm>

11. OECD: Signatories and Parties to the Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting.
<http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>
12. <https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/electronic-funds-transfer-reporting.html>
13. European Commission. Internal market.
https://ec.europa.eu/commission/priorities/internal-market_en
14. GDP data is from The World Bank, World Development Indicators. Data for 2017 is used as 2018 data is not available at time of publishing. World Bank national accounts data, and OECD National Accounts data files. GDP (current US\$), annual.
<https://databank.worldbank.org/data/indicator/NY.GDP.MKTP.CD/1ff4a498/Popular-Indicators>
15. The CORPNET research group uncovers, investigates and aims to understand global networks of corporate control in contemporary global capitalism. The five-year project started in September 2015 and is funded by the European Research Council (ERC starting grant). It is located at the Amsterdam Institute for Social Science Research, University of Amsterdam.
16. CORPNET's OFC Meter: available at: <https://www.ofcmeter.org/>
17. Data for a country's cross-border position is from Bank for International Settlements. Cross-border positions, by location of reporting bank and sector of counterparty, outstanding at end-December 2018.
<https://stats.bis.org/statx/srs/table/a2?m=S&p=20184&c=>
18. Data for a country's net investment position is from Statistics Canada. Table 36-10-0008-01. International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by country, annual (x 1,000,000)
<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610000801>
19. The list was initially created on December 5, 2017 and has been updated a few times since. To view the evolution of the list, see:
https://ec.europa.eu/taxation_customs/sites/taxation/files/eu_list_update_17_05_2019_en.pdf
20. See CORPNET's OFC Meter: available at: <https://www.ofcmeter.org/>. Note that of the 24 jurisdictions identified as sink-OFC, 17 are also listed on the EU's list of non-cooperative tax jurisdictions. As for the 5 jurisdictions identified as conduit-OFC, only one is also on EU's list: Switzerland.
21. Since EU updates its list from time to time, we considered in the blacklist any country that has been on that list at some point between its inception and today. We did the same thing for countries on the gray list, except we left on the blacklist countries that moved to the gray list at some point because they improved their transparency, since the improvement has taken place after our last year of data.
22. A copy of the T106 package can be found at:
<https://www.canada.ca/content/dam/cra-arc/formspubs/pbg/t106/t106-10->

[17e.pdf](#). The summary form and the slip are also reproduced in Appendix B of this report.

23. Section 233.1 of the *Income Tax Act* defines a reporting person as a corporation, trust or individual who, at any time in the year is resident in Canada or is a non-resident and carries on business in Canada. While reporting partnerships must also file T106 documentation and are not considered a reporting person, for ease of reading this report refers to a reporting person as also meaning a reporting partnership.
24. This means corporations must file the T106 before six months after the end of the tax year; individuals before April 30 (self-employed before June 15); trusts before 90 days after the end of the tax year; partnerships the same as the due date for filing a partnership information return.
25. The data for 2018 is largely incomplete as it only contained returns received and processed as of October 3, 2018.
26. Since Canada's tax system is based on the self-assessment principle, the T106 data, like any other CRA tax form, can contain incorrect values because of filing errors or voluntary efforts by a filer to hide information. Furthermore, only a subset of filers will be selected for risk-based audits where these errors can be detected. Since penalties for false reporting or omissions are weak, there is a low incentive to file correctly. The CRA cleaned the T106 dataset that was used, to correct some involuntary errors such as double counting of the same transaction and incorrect units. However, it is possible that some incorrect values remain in the dataset we used for our analysis.
27. These amounts are reported at point 4 of Section 2 – Summary Information of the T106 Summary Form. They represent the sum of all box "I" amounts from all the T106 slips.
28. Sum of box A and B. For 2017, we only have information on the total value of reportable transactions (sum of all box I amounts) and the gross revenue of the reporting person (box 5). The data breakdown by type of transactions was only available for years 2014 to 2016.
29. Corporations represent slightly more than 95 per cent of all T106 filers, partnerships account for about 4 per cent and trusts less than 1 per cent. Note that that we do not include income from partnerships because it would lead to double counting since each member must report its share of the partnership's income on its tax return.
30. Part III of the slip contains the revenue and expenditure from all transactions except derivatives (recorded in Part V) and increases or decreases in loans to or from non-residents (recorded in Part IV, however Part III would record interest payments on these loans).
31. The positions were reversed in the two previous years. The US provided net payments of \$36 billion in 2015 and \$106 billion in 2014 while Luxembourg provided net payments of \$28 billion in 2015 and \$18 billion in 2014.
32. A patent box is a preferential tax regime offered by many countries to the income generated by intellectual property. For more information on patent

boxes, see U.S. Congressional Research Service (2017) available at:
<https://fas.org/sqp/crs/misc/R44829.pdf>

33. See note 15.
34. See note 16.
35. Since the T106 data we accessed covers years before EU's initial list, we considered in the blacklist any country that has been on that list at some point between 2017 and today. We did the same thing for countries on the gray list, except we left on the blacklist countries that moved to the gray list at some point because they improved their transparency, since the improvement has taken place after our last year of data.
36. *Income Tax Act*, R.S.C. 1985, s.163(2.4), c. 1(5th Supp.).
37. Canada Revenue Agency, *Information Request 0411*, 18 April 2019.
38. Christine Lagarde. "Opening Remarks by Christine Lagarde on Corporate Taxation in the Global Economy" (speech, Peterson Institute for International Economics, Washington, D.C., March 25, 2019).
<https://www.imf.org/en/News/Articles/2019/03/25/sp032519-md-piie-opening-remarks-on-international-corporate-taxation>
39. PBO classified a firm as an MNE if one of the following conditions applied:

The firm operated a subsidiary in Canada, but its ultimate corporate parent was overseas;

The firm operated a subsidiary overseas, but its ultimate corporate parent was in Canada;

The firm operated a subsidiary and had an ultimate corporate parent in Canada, but the entity's headquarters was overseas.
40. As a comparison, for 2015, when sales and net income of Canadian affiliates of U.S. MNEs are compared to the total sales and net income of the U.S. parents and all their affiliates, the percentage of the sales and net income of all Canadian affiliates is approximately 3.21% and 2.06% respectively, see: Bureau of Economic Analysis, Interactive Tables: Activities of U.S. Multinational Enterprises, <https://www.bea.gov/data/intl-trade-investment/activities-us-multinational-enterprises-mnes> (accessed 17 June 2019).