CANADA

Acquisitions

Foreign Take-Overs and the "Hollowing Out" of the Canadian Corporate Sector: Reality or Myth?

By Mark Katz (Davies Ward Philips & Vineberg LLP)

The continuing spate of foreign acquisitions of Canadian companies has given rise to concerns about the "hollowing out" of the Canadian corporate sector. Proponents of this view argue that foreign takeovers lead to the disappearance of Canadian head offices, resulting in a direct loss of head office employment – particularly senior management functions – as well as a reduction in demand for ancillary financial, legal and other services.

A recent study by Statistics Canada, however, has found that there may be no basis for these concerns. Looking at the data for the years 1999 to 2005, the study reports that foreign takeovers have not had a negative impact on employment in Canadian head offices. Instead, more head offices were actually created than were closed as a result of foreign takeovers, and there was a net increase in levels of head office employment. By contrast, firms that went from foreign to Canadian control experienced a decline in head office employment.

Indeed, more generally, much of the dynamism in Canada's head office sector is generated by foreign-controlled firms. Thus, between 1999 and 2005, foreign firms accounted for all of the growth in the number of head offices in Canada and the majority of the gains in head office employment.

These findings have important implications for the various debates surrounding foreign investment in Canada. First, there have been suggestions that the *Investment Canada Act* should be strengthened (or at least its administration toughened up) in order to stem the loss of Canadian head offices. The Statistics Canada study would appear to remove the rationale for any dramatic changes of this kind. Second, there continues to be discussion about whether key sectors of the Canadian economy should be opened to greater foreign ownership (e.g., transportation and telecom). Again, the fact that foreign control does not necessarily lead to a reduction in head office employment, or senior management input, would tend to remove at least one argument against liberalizing foreign ownership rules in Canada.

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Transfer Pricing

Canada Revenue Agency Revisits Transfer Pricing Review Committee

By Tony Anderson, Sandra Goldberg and Gary Zed (Deloitte and Touche LLP)

The Canada Revenue Agency recently updated its guidelines regarding the Transfer Pricing Review Committee (TPRC) and referrals to the International and Large Business Directorate (ILBD).

The CRA issued Transfer Pricing Memoranda TPM-07, which cancels and replaces TPM-01, provides changes regarding the TPRC, and adds guidelines on referrals to the ILBD. TPM-07 also covers possible assessments under paragraph 247(2)(b), penalties under subsection 247(3), and qualifying cost contribution arrangements (QCCAs) under subsection 247(1) of the Canadian Income Tax Act (ITA).

Changes to the Composition of the Transfer Pricing Review Committee

TPM-07 clarifies that committee members will vary depending on the type of referral under review. For recharacterization referrals, the committee will exclude the director of the Competent Authority Services Division (CASD), and the senior economist must be from International Tax Operations Division (ITOD) as opposed to ITOD and/or the CASD in the case of penalty referrals. It maintains the option to invite other relevant CRA representatives.

