1. Where property is transferred in a non-arm's length transaction, the parties sometimes include a price adjustment clause in the covering agreement. This bulletin deals with those agreements which state that if the Department determines that the fair market value of the property is greater or less than the price otherwise determined in the agreement, that price will be adjusted to take into account the excess or the shortfall. The Department is only concerned in the valuation for purposes of administering the Act and determining the tax consequences. It is neither a valuator nor an arbitrator for the parties. If the parties have agreed that, if the Department's value is different from their's, they will use the Department's value in their transaction, that is their choice and the Department will recognize that agreement in computing the income of all parties, provided that all of the following conditions are met:

(a) The agreement reflects a bona fide intention of the parties to transfer the property at fair market value and arrives at that value for the purposes of the agreement by a fair and reasonable method.

(b) Each of the parties to the agreement notifies the Department by a letter attached to his return for the year in which the property was transferred
   (i) that he is prepared to have the price in the agreement reviewed by the Department pursuant to the price adjustment clause,
   (ii) that he will take the necessary steps to settle any resulting excess or shortfall in the price, and
   (iii) that a copy of the agreement will be filed with the Department if and when demanded.

(c) The excess or shortfall in price is actually refunded or paid, or a legal liability therefore is adjusted.

2. Whether the method used by the parties to determine fair market value is fair and reasonable in the Department's view will depend on the circumstances in each case.

3. In recognizing the price adjustment clause, appropriate adjustments in computing the income of all parties to the agreement will be made in their taxation years in which the property was transferred. If the purchaser has filed returns and claimed capital cost allowances, deductions from income based on cumulative eligible capital, or exploration and development expenses in respect of the property for taxation years subsequent to that in which it was transferred, any necessary adjustments will be made in those subsequent years. Likewise, any reserves claimed by the vendor to defer the reporting of income will be adjusted.
4. Amended Forms T2022 on the sale of accounts receivable or amended agreements on the price paid for inventory may be required.

5. If all the conditions mentioned in paragraph 1 are met, the Department will not apply subsection 15(1) to tax a benefit to shareholders.

6. Where taxpayers have included price adjustment clauses in agreements that relate to transactions reported in tax returns already filed, they should notify the District Office immediately if they wish to have the clause considered in the light of the comments in this bulletin.