marketing-, production-, or other-related (Rugman 1986, 21). Other factors which encourage the creation of Canadian subsidiaries include non-tariff barriers such as federal, state and municipal government regulations and controls.

U.S. FDI via its Canadian subsidiaries is often due to "government-imposed market imperfections such as tariffs, and the nature of the Canadian country-specific advantage," namely the availability of raw materials and resources (Rugman, 1986, 19). NAFTA has lessened the impact of tariffs, encouraging exports rather than continued U.S. FDI (U.S. Dept. of Commerce 1993).

The transfer of goods between cross-border subsidiaries leads to the problem of how the transferred good should be priced. Should profits be taxed in Canada or the U.S.? Should the transfer price be based on a comparable market price or be cost-based? If Canadian and U.S. regulations are incongruent, which regulations take precedence?

Canadian versus U.S. Transfer Pricing Regulations

Canadian TNCs are concerned with three tax issues: transfer pricing, the distinction between capital gains and ordinary income, and tax incentives (O'Connor 1992). The transfer pricing of tangible goods and intangible property is regulated by Revenue Canada in Sec. 69 of the Canadian Income Tax Act. These regulations assume that the arm's-length standard usually results in the price being set at fair market value.[1] This is in accordance with recently revised Organization for Economic Cooperation and