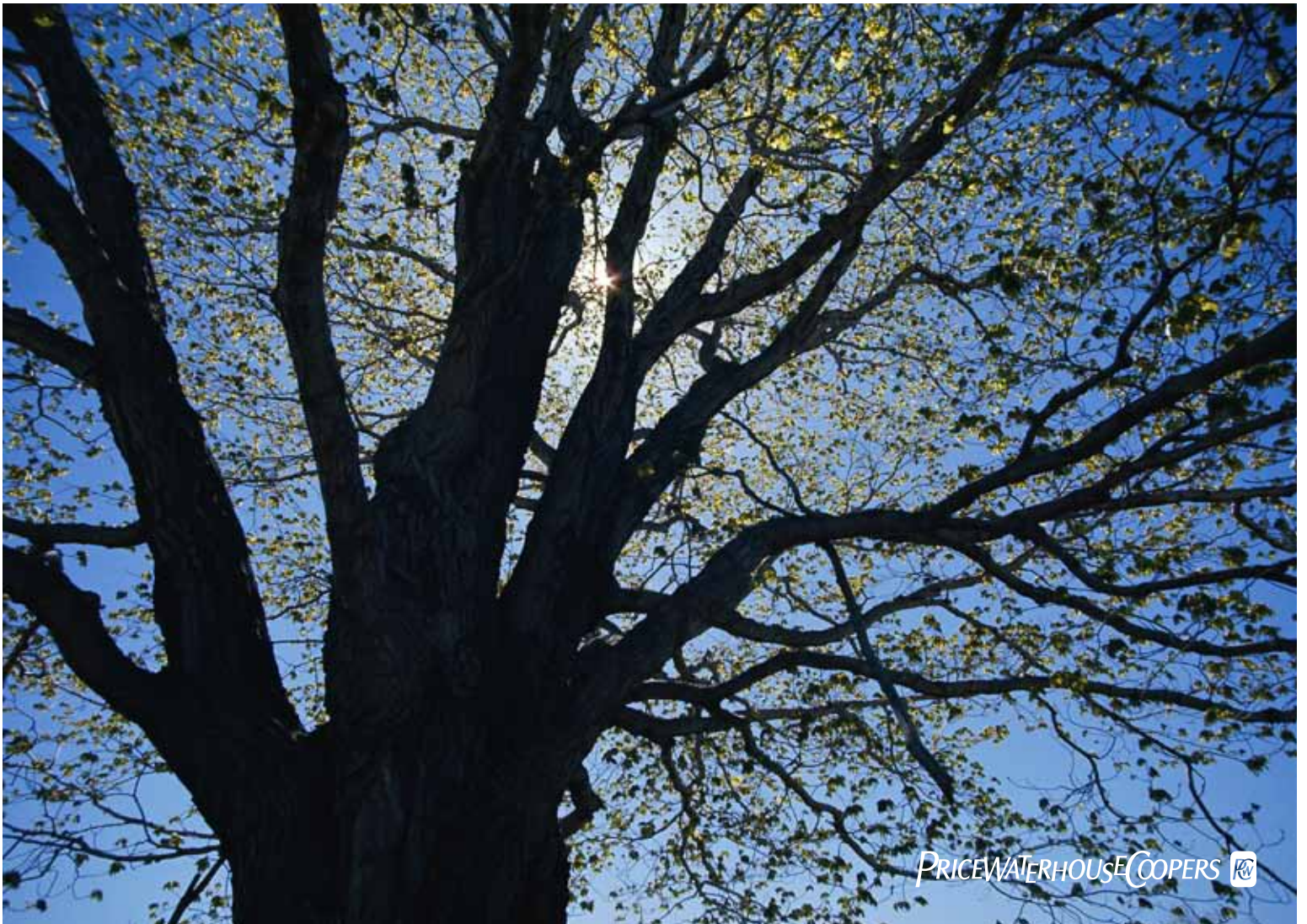


New entrants— Increased enforcement—  
The Latin American perspective

# Transfer pricing perspectives

Re:solutions  
moving towards certainty



# New entrants—Increased enforcement— The Latin American perspective

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When thinking about transfer pricing in Latin America, companies must take two important factors into consideration:

- Brazil has its own set of rules applicable to transfer pricing matters.
- Even in countries in the region that do not have specific transfer pricing regulations, significant compliance requirements are in force.

Several tax administrations have developed audit processes and made pronouncements that provide useful information about dispute resolution within the region.

## **The Latin American environment**

Formal aspects are important in Latin America. When referring to formalities, we include the transfer pricing forms and reports<sup>29</sup> and the formal documentation of the specific transactions (contracts, certainty about the date of the transaction, adjustments to increase comparability, etc.).

The Organisation for Economic Co-operation and Development's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) are accepted and, in some cases, are specifically quoted in the legislation, with the exception of Brazil. However, they are interpreted with a Latin flavour.

In the countries that have adopted transfer pricing regulations, the audit process begins under the requirement of the tax authority. In countries that do not require companies to submit a transfer pricing report every year, the audit process begins with such a request.

Companies should consider that the tax authority can apply sanctions prior to the audit process. In Venezuela, Peru, and Colombia, fines could result from the lack of compliance with the formal obligations.

Most of the audit processes and discussions are still being developed, some at the administrative level and some in the tax courts. Notable in the court pronouncements so far:

- In countries such as Argentina and Venezuela, the tax authorities have exchanged information with other tax authorities.
- Tax administrations have used secret comparables. Some countries have allowed the use of such comparables in legislation, including Peru and Argentina, while in other countries the comparables have been recognised by the tax courts.

<sup>29</sup> In Argentina and Ecuador, taxpayers are obligated to deliver the transfer pricing report every fiscal year.

## **Main objections given by tax authorities**

Tax authorities have announced their opinions and objections in several transfer pricing matters. Regarding methodology, for example, the authorities have shown a strong preference for the comparable uncontrolled price, or CUP method. In addition, Argentina and Uruguay have a specific method for commodities exports.

For comparables used in the analyses, there is a strong preference for internal comparables. And in most audit cases when tax authorities must use external comparables, they have cross-checked the financial information obtained from databases with the financial statements of the selected comparables.

Likewise, tax authorities have objected regarding specific comparability issues. The main objections include the following:

- The recognition of the inflationary process in local financial statements. Tax authorities have questioned the adjustment of holding results.
- The use of true-up or year-end adjustments.
- An analysis based on average business cycle.
- The adjustment of foreign comparables' financial information to the local environment, including idle capacity, severance payments, bad debts, commercial risks, and country risk adjustments.

One hot issue involves the deductibility of corporate expenses and intercompany services. In these cases, the tax authorities have objected over the effective rendering of the services and whether the expenses were necessary to conduct the business activities of the local company. So far, the formal implementation of the services and the lack of proof that the services and related benefits had actually been received by the local entity have been two important issues for tax administrations.

The Brazilian Tax Authority requests an annual calculation based on contemporaneous information, as well as compliance with the digital tax and accounting systems (SPED) transmission on a regular basis.

### **The Brazilian style**

As noted earlier, Brazilian transfer pricing rules are particularly complex and do not follow the OECD arm's length standard. The Brazilian rules state that no profit-based method is accepted and that all methods must be applied on a product-by-product basis. Moreover, the taxpayer may freely choose the method to be applied because there is no preference for any method.

Several discussions are continuing between the Brazilian Tax Authority and the local taxpayers regarding the local methodology. So far, we highlight the following subjects of those discussions:

- The restrictions on the application of the resale minus method, because the local tax authorities have modified their criteria for use of this method;
- The imposition of a cost definition (discussions looked at what should be considered the cost base and specific adjustments during the revaluation of the Real); and
- The lack of a method to be applied on special transactions.

The Brazilian Tax Authority requests an annual calculation based on contemporaneous information, as well as compliance with the digital tax and accounting systems (SPED) transmission on a regular basis. Finally, it put automated procedures for transfer pricing audits in place in January, the beginning of fiscal year 2009. During 2008, the tax authorities were more active, making significant transfer pricing adjustments on multinational companies.

## Perspectives

After reviewing the environment in the region and the actions so far of the tax administrations, we expect to see the following in the coming years:

- Stronger formal requirements related to transfer pricing issues spurred by the increase in audit activity;
- A focus on the substance and purpose of intercompany transactions, as well as on supporting documentation; and
- An increased focus by tax authorities on financial operations, intragroup services, and technical assistance, in addition to the current auditing activity based on tangible goods transactions (including commodities).

The transfer pricing environment in Latin America requires local taxpayers to be prepared, especially if budget constraints cause a local tax administration to increase its efforts to maintain the level of tax collections. Also, the consistency between formal agreements and their economic substance is a key to succeeding in a transfer pricing dispute.

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