

7th Annual Latin American Transfer Pricing Conference

April 12, 2012



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Transfer Pricing Global Trends – Impact on Latin America and Asia

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Agenda

1. Transfer Pricing Global Trends

1. Transfer Pricing: Principles, Actors and Issues
2. Permanent Establishments
3. Selected Transfer Pricing topics
4. Tax planning & Double non-taxation in the Spotlight
5. Concluding thoughts

2. Concerns and Opportunities for Tax Directors

1. Formulation and effective execution of your Transfer Pricing Strategy
2. Strategic Risk Assessment
3. Transfer Pricing issues on Intangibles Valuation
4. Tax Planning issues
5. Conclusions and Best Practises

3. Landscape in Latinamerica

Global Transfer Pricing Trends

Garry Stone – PwC USA

Global Transfer Pricing Trends

1. Transfer Pricing Principles, Actors and Issues

Garry Stone – PwC USA

1. Transfer Pricing

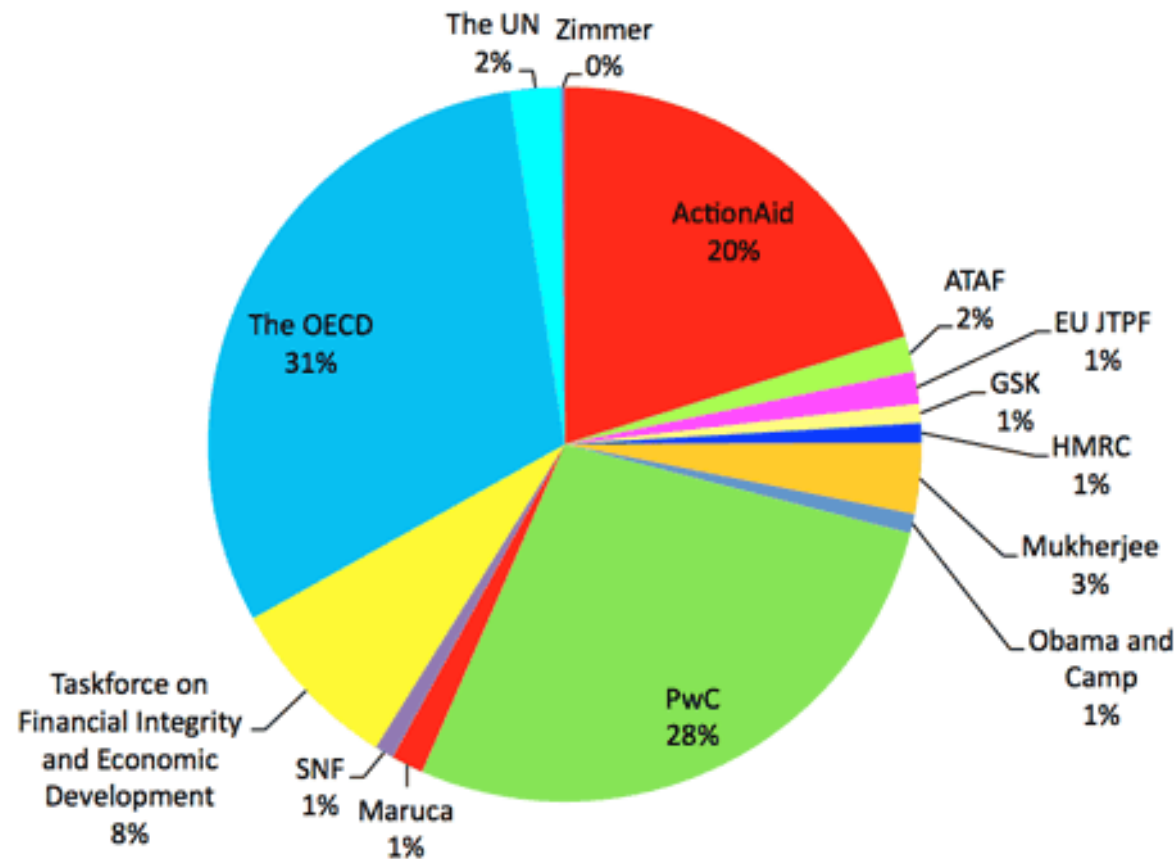
Principles, Actors and Issues

They say it's rather an art than a science...

- Arm's length principle: "Prices agreed between independent parties for similar transactions in similar circumstances"
- Actors: OECD, European Commission, UN, National Tax Authorities
- OECD Transfer Pricing Guidelines:
 - Consensus view of 34 countries on how the arm's length principle should be applied
 - Guidance on functional analysis, comparability factors, transfer pricing methods...
- But business models change over time and are affected by the wishes of multiple stakeholders

1. *Transfer Pricing*

TP Week Survey of Key Contributions to the Transfer Pricing Debate



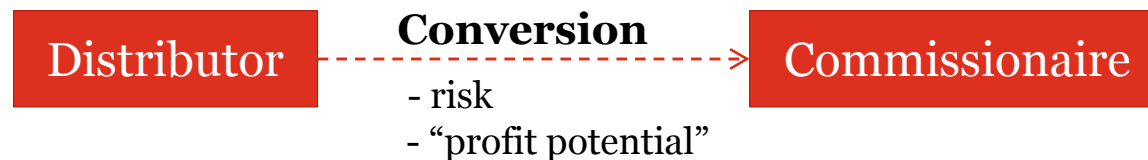
Ashley, Sophie. TPWeek's top five leading forces in global transfer pricing." *TPWeek Transfer Pricing Weekly News from International "Tax Review.*, 29 Mar. 2012. Web. 3 Apr. 2012.

1. Transfer Pricing

Principles, Actors and Issues

Merit of the OECD TP Guidelines in the light of....

- CFC rules?
- Thin-cap rules?
- Global IP developments
- Other specific local rules (e.g. deployment/transfer of functions)?



Transfer Pricing Global Trends

2. Permanent Establishments Article 5 OECD Model Tax Convention

Garry Stone – PwC USA

2. Permanent Establishments

Recent developments – OECD Discussion Draft

OECD Discussion Draft on Article 5

- Assessment as to whether or not the requirements for the existence of a permanent establishment (‘PE’) in practice often ambiguous
- Release of public Discussion Draft on 12 October 2011:

“Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention”

Purpose

- Proposals/recommendations for additions and changes to the Commentary on Article 5 Model Tax Convention (‘MTC’)
- Intention to include proposed amendments through the next update of the Commentary on the OECD MTC currently scheduled for 2014

2. Permanent Establishments

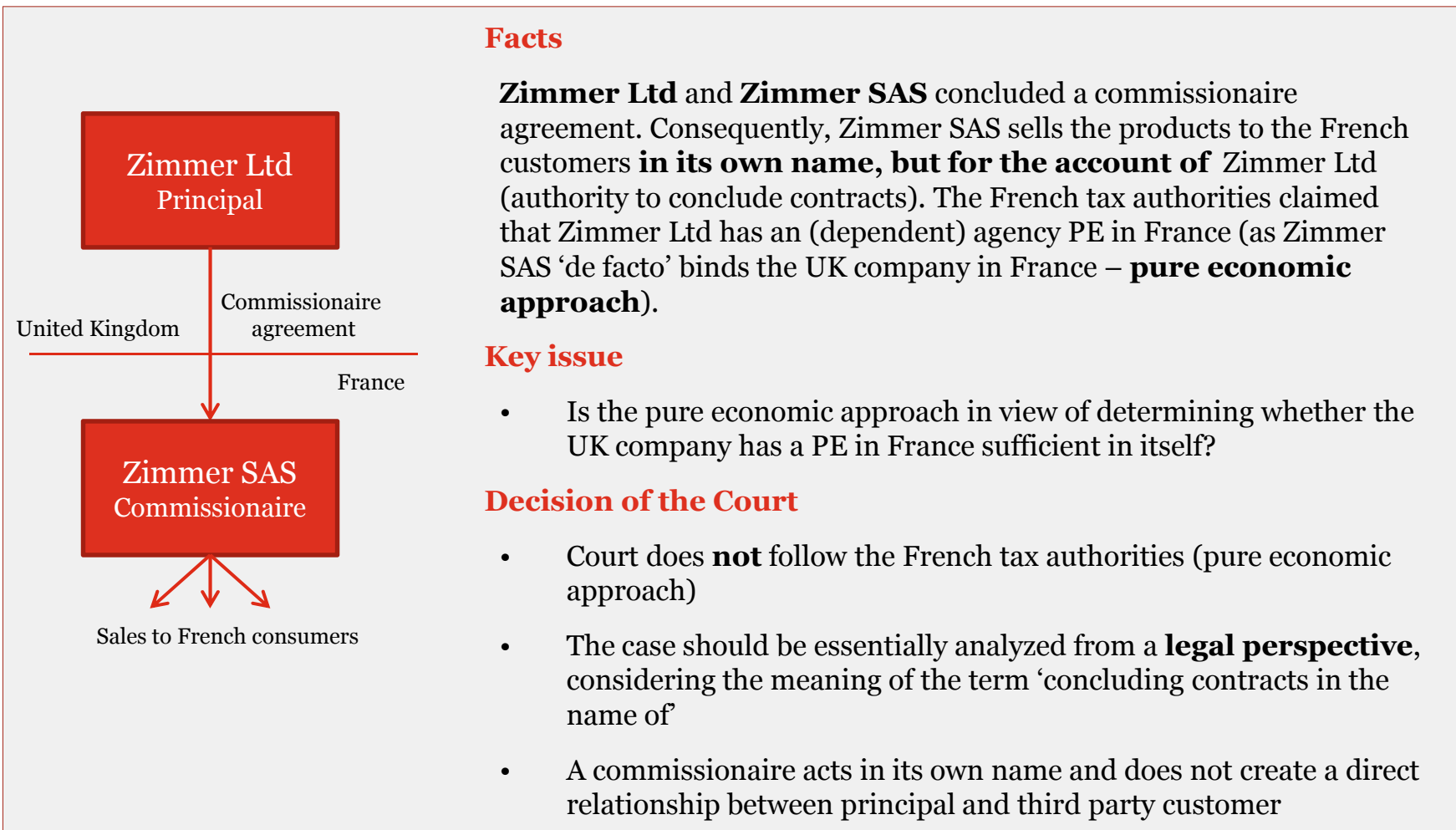
TP Digest of OECD Discussion Draft on Article 5

“To conclude contracts in the name of the enterprise”

- Legal versus economic interpretation
- Clarification on conditions for the creation of a PE through a dependent agent
- Addition to the Commentary to clarify that the acts of agents for *undisclosed* principals may fall within the scope of Article 5
- Notion on “economically bound” in the context of commissionaire arrangements may trigger wider & wilder interpretations
- Upon “opportunistic reading”: Potential impact of *transfer pricing methods* based on a cost plus or targeted gross/net margin in disputes on the “economically bound” concept?
- Milestone court decisions on commissionaire structures (Dell DUF / Zimmer Ltd.)

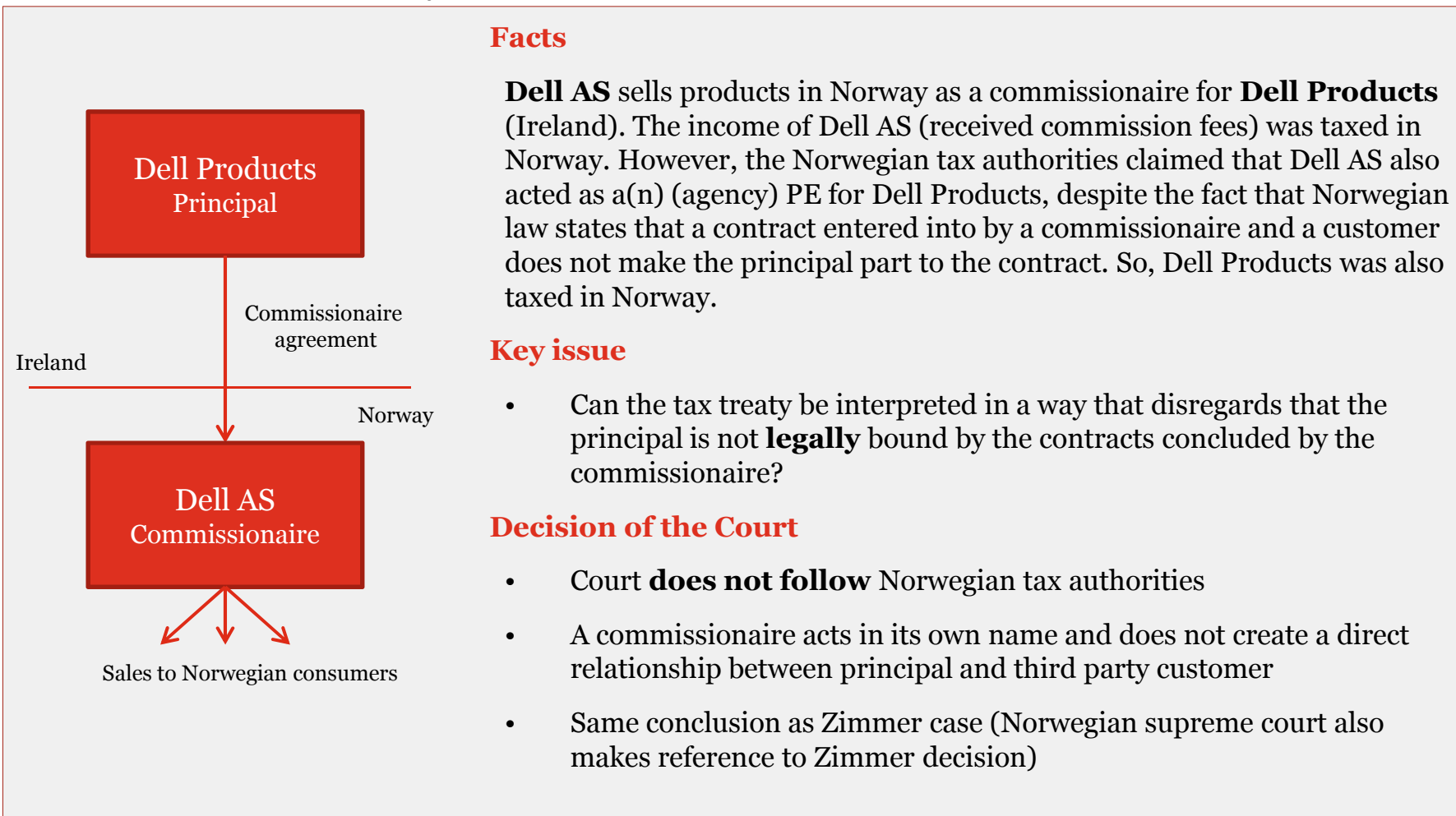
2. Permanent Establishments

Zimmer Case (France, Conseil d'Etat, 31/3/2010)



2. Permanent Establishments

Dell case (Norway, Dell Products v. Skatt Ost, 2/12/2011)



2. Permanent Establishments

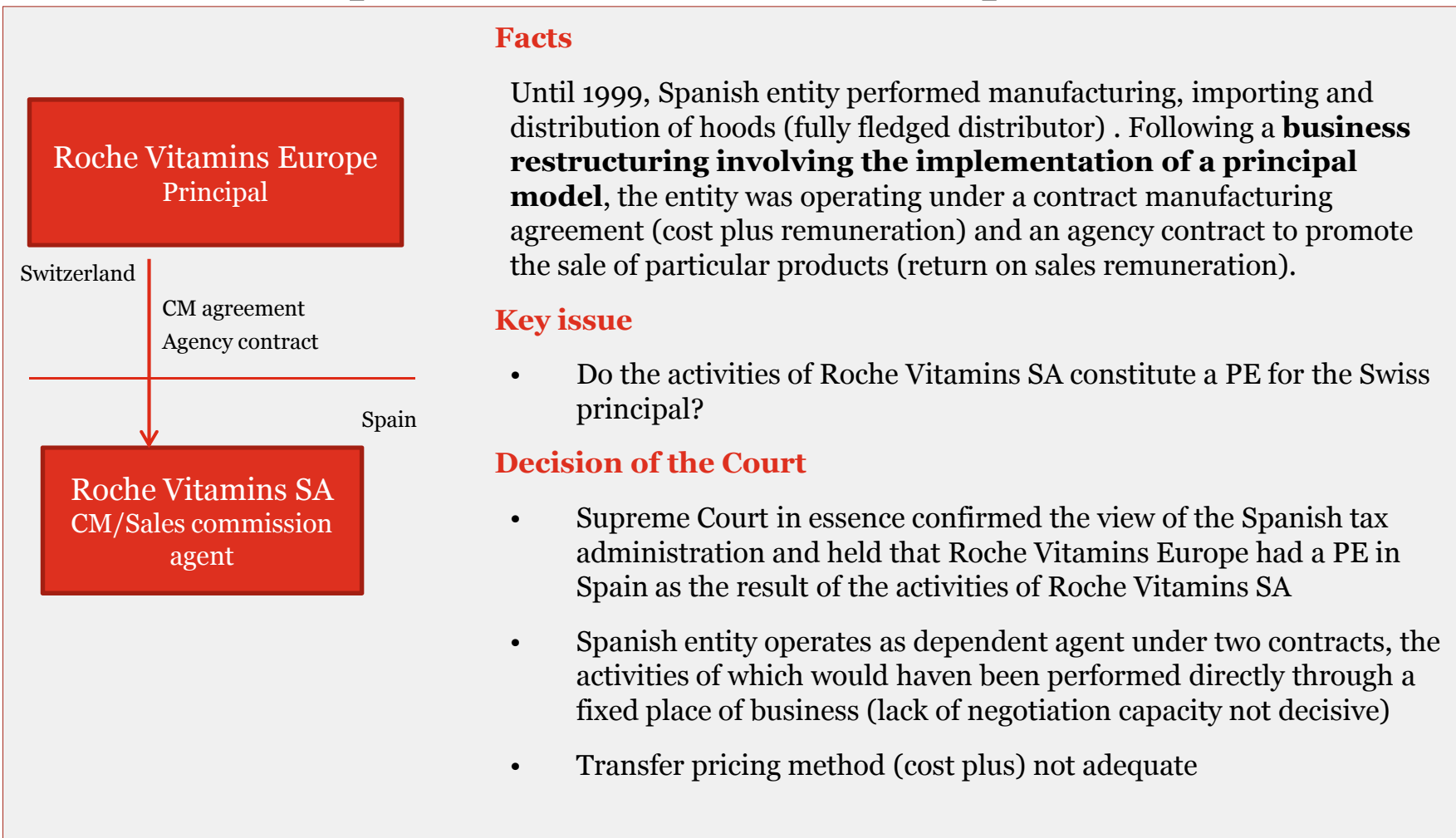
TP Digest of OECD Discussion Draft on Article 5 (cont'd)

“Can the premises of a (converted) local entity constitute a PE of a foreign enterprise?”

- Local entities may hold assets, manage risks or perform activities for the account of a foreign enterprise
- Example on contract manufacturing: does not constitute a PE (irrespective of whether result of a business restructuring or not)
- Changed §4.2. (Meaning of “at the disposal”): where an enterprise has no right to be present at a location and in fact does not use that location itself, that location is clearly not at the disposal of the enterprise
- Important for VCT projects and *principal structures*

2. Permanent Establishments

Roche Case (Spain, Roche Vitamins Europe Ltd., 12/1/2012)



2. Permanent Establishments

Conclusions of the Roche case

- Extremely wide interpretation of dependent agency clause
- Decision in contrast with other leading cases (Dell / Zimmer)
- Interrelationship between transfer pricing rules and the PE clause is questionable
- Ignorance of intra-group service contracts in sharp contrast with the OECD Transfer Pricing Guidelines & Discussion Draft
- Impact of the decision on principal structures yet to evaluate

Transfer Pricing Global Trends

3. Selected Transfer Pricing Topics

Garry Stone – PwC USA

3. Selected Transfer Pricing topics

Risk assessment & administrative simplification

Sophisticated guidance for complex transactions vs. cost-effective use of resources

OECD project on the administrative aspects of transfer pricing

- Survey on administrative simplification measures and public consultation
- Review of and possible amendments to the safe harbour guidance in Chapter IV of the OECD Transfer Pricing Guidelines

Risk assessment (EU JTPF & UN)

- Identification of key risks in the area of transfer pricing
- Means to assess and manage transfer pricing risk

3. Selected Transfer Pricing topics

Work of the OECD on the aspects of intangible assets

Scope of the project: Dealings between associated enterprises involving intangible assets (Article 9 OECD MTC)

- Setting a framework
- Definitional aspects / terminology
- Categories of intangibles
- Intangible transfers
- Right to share return in the absence of ownership
- Cost contribution arrangements
- Valuation

3. Selected Transfer Pricing topics

Work of the OECD on the meaning of ‘Beneficial owner’

Article 12 (1) OECD Model Tax Convention:

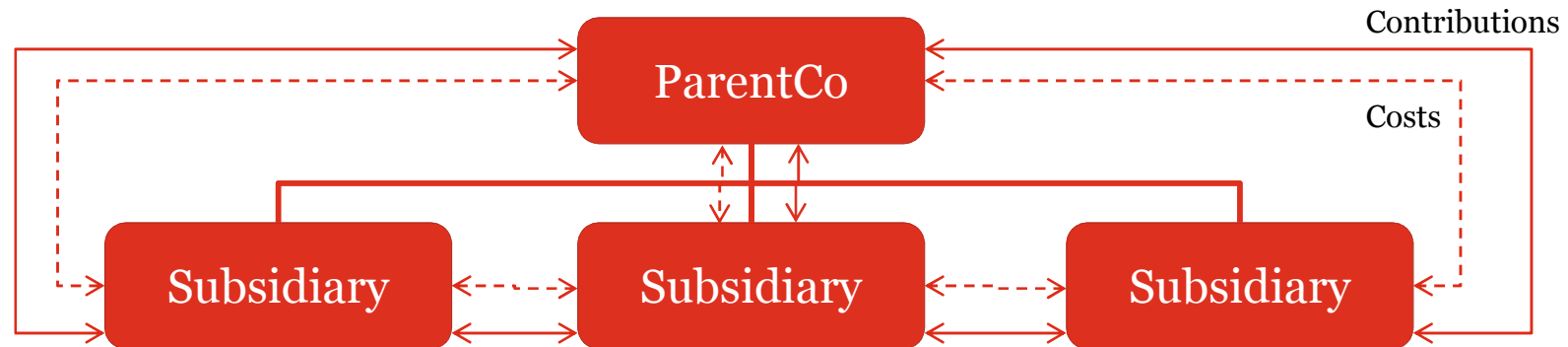
*Royalties arising in a Contracting State and **beneficially owned** by a resident of the other Contracting State shall be taxable only in that other State.*

Clarification on the meaning of ‘**beneficial owner**’ under the OECD MTC (Discussion Draft of 29 April 2011)

- Concept as general anti-avoidance tool?
- Rejection of domestic interpretation based on narrow technical meaning
- Notion on conduit entities retained (no beneficial owner if only narrow powers)
- Treatment of agents and nominees
- Reference to the “*substance*” of the relevant facts and circumstances

3. Selected Transfer Pricing topics

Cost contribution/Cost sharing arrangements



US Final Cost Sharing Regulations (16 December 2011)

- Extensive guidance
- Focus on CSA creating intangibles

Work of the EU JTPF on CCAs not creating intangibles

- Differentiation intra-group services vs CCAs on services
- Application of mark-up/expected benefit test/contributions

Recent Events Affecting Transfer Pricing in Practice

1. India APA Program
2. HK APA Program
3. Russian Transfer Pricing Documentation rules now in effect and follow OECD Guidelines
4. Surge in Audit Activity Globally
5. IP Issues – Brand Value and “Network” IP Issues

Transfer Pricing Global Trends

4. Tax Planning in the Spotlight

Garry Stone – PwC USA

4. Tax Planning in the Spotlight

Aggressive Tax Planning

OECD Report on Corporate Loss Utilisation through Aggressive Tax Planning (30 August 2011)

- Report emphasises the considerable size of tax losses carried forward
- **Key risk areas** identified in the report:
 1. Use of financial instruments
 2. Corporate reorganisations
 3. *Non-arm's length transfer pricing*
- What is meant by “**Aggressive Tax Planning**”?

4. Tax Planning in the Spotlight

Aggressive Tax Planning involving developing countries

- UN Transfer Pricing Manual: make arm's length principle “understandable and workable” for developing countries
- Specific considerations of intra-group transactions involving “know-how” and service arrangements
- Inappropriate transfer pricing involving developing countries high on the agenda of policy makers, NGOs and the media

Tax evasion robs developing countries of \$900bn a year

The Observer, Sunday 30 November 2008

*“The world's poorest countries lose \$900bn each year - nearly 10 times greater than the global aid budget - through illicit flows of capital, new research shows. Illicit capital is defined as money extracted from bribery and corruption, **the illegal pricing of goods to avoid taxes**, and outright tax evasion by individuals and companies. [...]”*

Transfer Pricing Global Trends

5. Concluding thoughts

Garry Stone – PwC USA

5. Concluding thoughts

Transfer pricing is in everything you do

1. **It is inherent:** the vast majority of global trading involves trading within multinational groups and requires transfer pricing
2. **It is ambiguous:** the OECD Transfer Pricing guidelines offer a framework, but individual countries may deviate/apply different approaches (UN may potentially issue an alternative approach)
3. **It is constantly evolving:** Court decisions and ongoing discussions of major stakeholders may question existing transfer pricing approaches (APAs and Arbitration taking a bigger role)
4. **It is sensitive:** interest of media proliferation and social networks require a prudent approach to tax planning and transfer pricing

Concerns and Opportunities for Tax Directors

Horacio Peña – PwC USA

Agenda

1. Formulation and effective execution of your Transfer Pricing Strategy
2. Strategic Risk Assessment
3. Transfer Pricing issues on Intangibles Valuation
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Concerns and Opportunities for Tax Directors

1. Formulation and Effective Execution of your Transfer Pricing Strategy

Horacio Peña – PwC USA

Current Challenges for the Tax Function

Current challenge	Impact
Financial crisis / global recession	Focus in cash management.
Steadily increasing regulatory requirements	FRS, 404, FIN 48, FAS 123R, transactions to be reported, transfer pricing, Obama proposals, increased audit pressures.
Globalization	Additional and more complex issues to address, including coordination between different tax authorities.
Risk tolerance has come crashing down	CFO, steering committees and or external auditors increase scrutiny of tax issues, since it is considered as a high risk area. Taxes are #1 issue for 404.
Global shortage of tax resources	Tax department often does not have enough resources nor the adequate skills for success; strong dependence of non tax department resources (like Finance, Business IT) to carry out key tax process..
Access to quality information is a constant struggle	Tax department is one of the largest data consumers in an organization; Tax department may invest up to 50% of its time, recollecting, working and validating data.

Convergence of these events has led many companies to focus on ways to improve the operational and financial performance of their tax function. Tax can realize significant value by improving the way it uses the organization's human resources, technology and data infrastructure

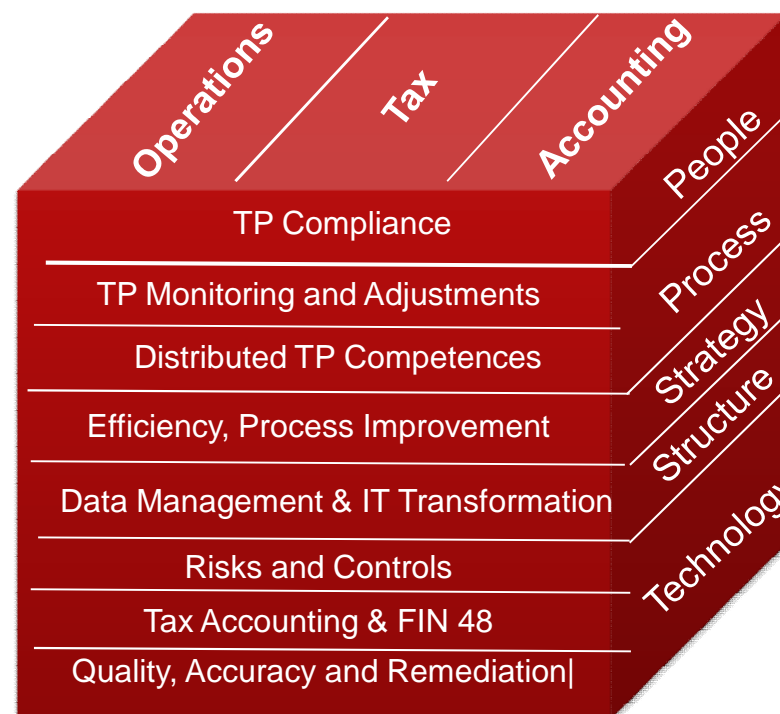
Renewed Focus on Transfer Pricing

- Different business sectors are being subject to tax and transfer pricing audits.
- New interpretations and changes in the Tax Codes and regulations are disproportionally impacting those industries in the middle of a transformation process, which depend on intellectual property and often report higher profit margins..
- Recent changes in the tax rules and its interpretations are challenging the fundamentals of traditional transfer pricing policies.
- Other business and tax risks may include:
 - Launching new business models
 - New products with intensive intangibles
 - M&A: post-merger harmonization
 - Business restructuring

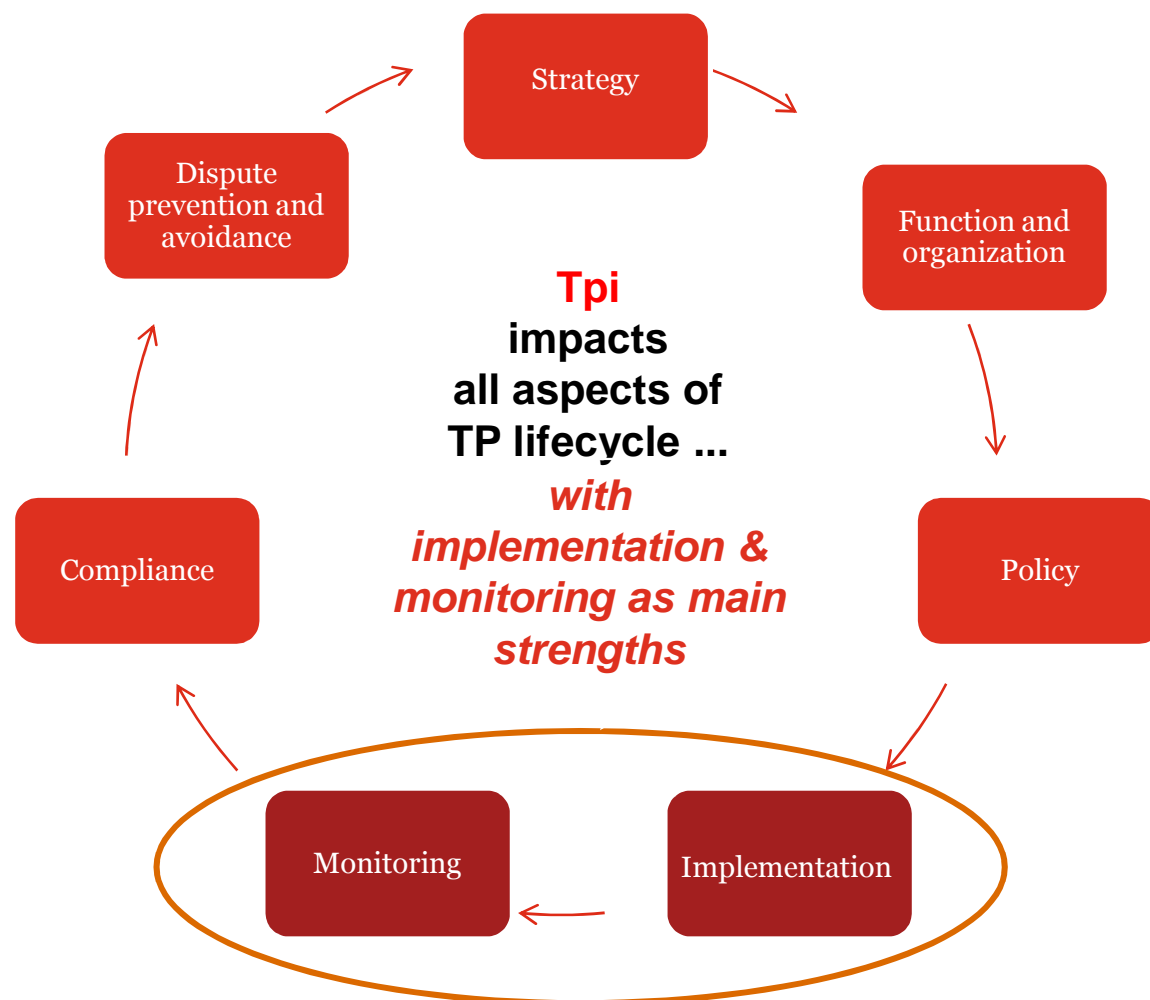
Transfer Pricing Integration (TPi)

What is TPi?

Aligning a company's business, operation, accounting, IT, legal and tax functions to implement and monitor transfer pricing policies and procedures more effectively.



Transfer Pricing Integration (Tpi)



One example scenario might be:

- Companies typically have transfer pricing strategies/policies, but struggle with implementation
- Poorly designed ERP systems force tax to manage transfer pricing manually outside of system, typically in Excel model
- This situation may generate different impacts like significant adjustments, double taxation, penalties, etc.
- Systems can be designed in a way that can streamline TP processes, provide enhanced transparency, and significantly decrease financial and compliance risk

Evidence of “uncertainty” related to traditional cross border tax disputes

- Few areas generate more “uncertainty” than those related to cross border tax audits and disputes.
- Number of cases of tax audits is increasing worldwide in both developed and emerging countries.
- New Audit techniques – for example, simultaneous audit, “Joint Audits”, visits to foreign sites and specialized SWAT teams are increasing.
- Exchange of information is dramatically increasing between or within the tax authorities.
- Increasing need for transparency – Disclosing uncertain tax positions (UTP).
- MAP cases inventory is on his higher historic levels (60% + increasing), introducing serious tension in the system.

Which are the main causes of uncertainty related to cross border tax controversy?

- Governments reinforces its authority to restructre valid business transactions, despite the existance of economic substance and evidence of proper documentation.
- Tax Authorities keep on litigating theories or cases rejected in the Tax Courts.
- Clear double taxation risks in certain cases.
- Multi jurisdiccional cases where no succesful dispute resolution mechanism can be found.
- Significant pressure from some NGOs.

Concerns and Opportunities for Tax Directors

2. Strategic Risk Assessment

Horacio Peña – PwC USA

Strategic Risk Assessment

- Strategic Risk assesment allows companies to:
 - Identify potential areas of improvement in the audit management and the dispute resolution process.
 - Quantify material tax risks and the exposure for those fiscal years open to audit.
 - Prepare and inventory of transactions ordered by type, country and materiality.
 - Is there any potential cost that should have been registered as a transactions?
 - Has been identified inconsistencies between the intercompany agreements, the accounting treatment, the real transfer price applied and or the intercompany results achieved?
 - Do the royalties reflect the current market value and the potential benefits provided by the company's intangibles?

Open Questions

Mitigate areas of potential risk

- Reevaluate the current policies for changes in functions, risks, assets and profit potential.
- Identify and evaluate the application of transactional methods.
- Evaluate secondary methods to corroborate significant transactions with high level of materiality.
- Evaluate aggregated transactions between related parties particularly those with similar risks and activities..
- Classify the intercompany transactions considering the level of risks and or its materiality (for example: high, medium and low).
- Calculate the potencial contingency for the open fiscal years, considering the double taxation implications, the impact on a Competent Authority process, interests and penalties..
- Develop a strategy for handling and communication potential accounting reserves with the auditors and the tax authorities.

Concerns and Opportunities for Tax Directors

3. Transfer Pricing Issues on Intangible Valuation

Horacio Peña – PwC USA

Valuation Issues

IRS trends to:

- Use alternative methodologies (like DCF / APM / MCM).
- Use the methodologies applicable for *Cost Sharing Agreements* to different transactions like licenses and royalty payments.
- Use a broad definition of intangible property, including concepts like “contributions to the technology platform”.
- Assume a perpetual lifecycle in case of intangibles.

Concerns and Opportunities for Tax Directors

4. Tax Planning Issues

Horacio Peña – PwC USA

Tax Planning Issues

New business strategies

New geographies

Change in the economic environment

Causes for the business change:

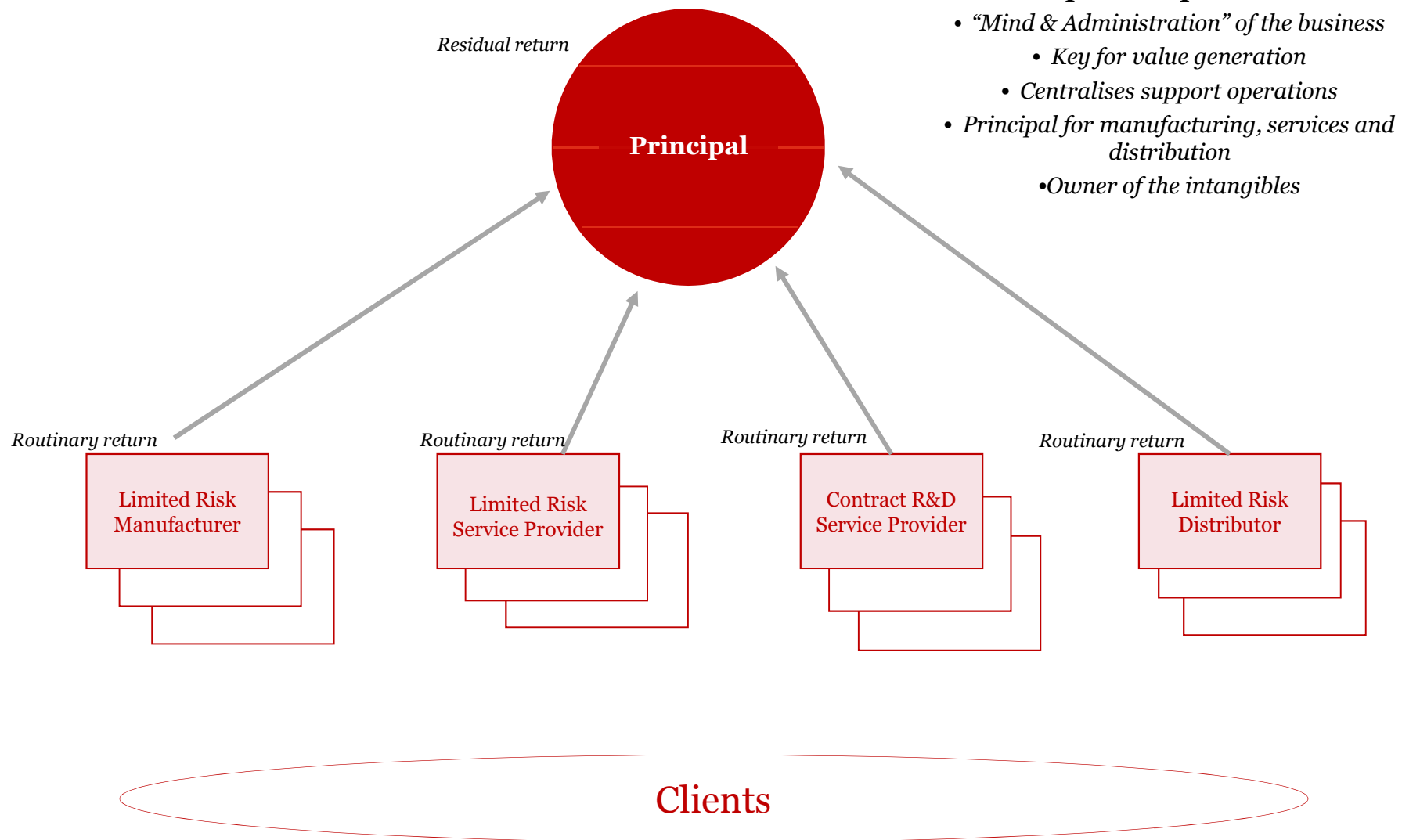
- Product innovation
- Quality
- Improvement in the manufacturing process
- Supply chain efficiencies
- Avoid distortions in the supply chain

Global Trends: Focus on Models that provide incremental benefits (illustrative graph)

Procurement model chosen depends on “fit” between operational desire for (increasingly global rather than regional) centralisation of decision making and risk management and degree of tax benefits sought ...



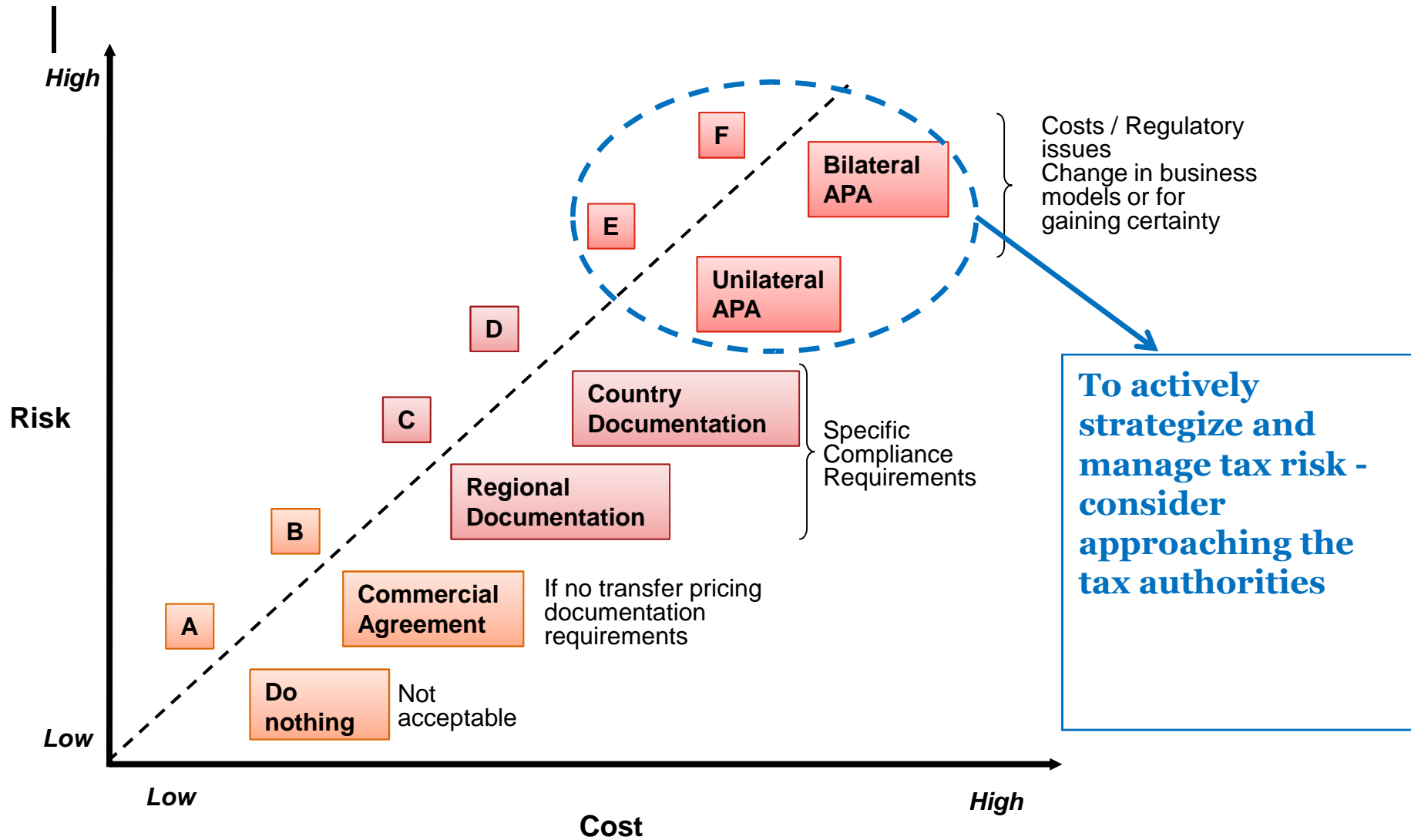
Principal Structure



Effective Control of the Risk within a Multinational Group – The OECD view

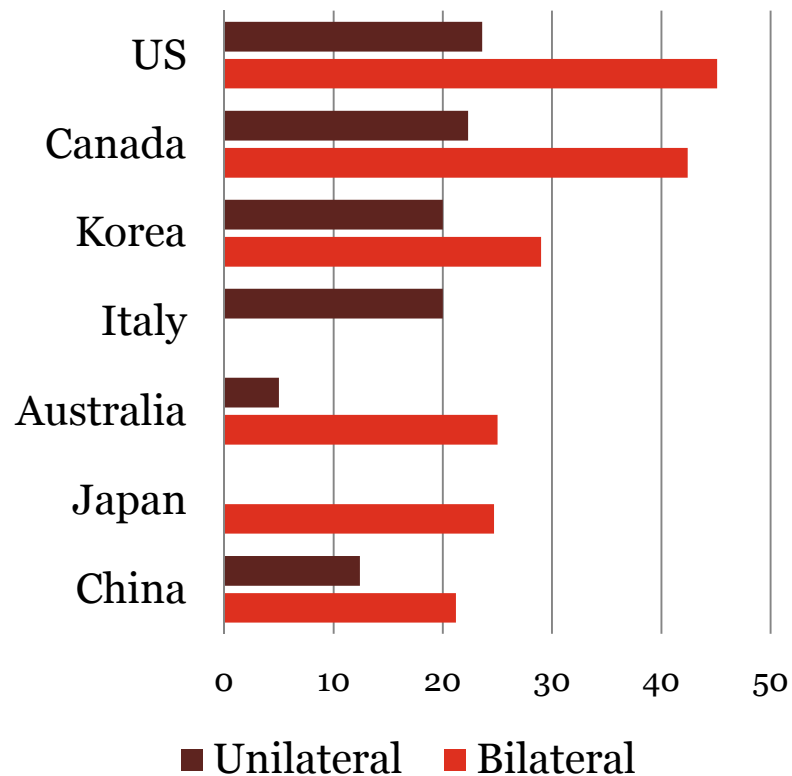
- In a multinational group, each member's behaviour will be the best evidence about the real risks allocation.
- A intercompany agreement signed between members of a controlled group would be considered as long as the risks is similar to those agreed between unrelated parties.
- The examination of which party has greater control over the “risk” can be a relevant factor to assist in the determination of whether a similar risk allocation would have been agreed between independent parties.
- Control in this context means:
 - *“the capacity to make decisions to take on the risk and decisions on whether and how to manage the risk, internally or using an external provider”.*
- This would require the company to have people – employees or directors – who have the authority to, and effectively do, perform these control functions (Significant People Functions).

APAs as a Risk Management Strategy

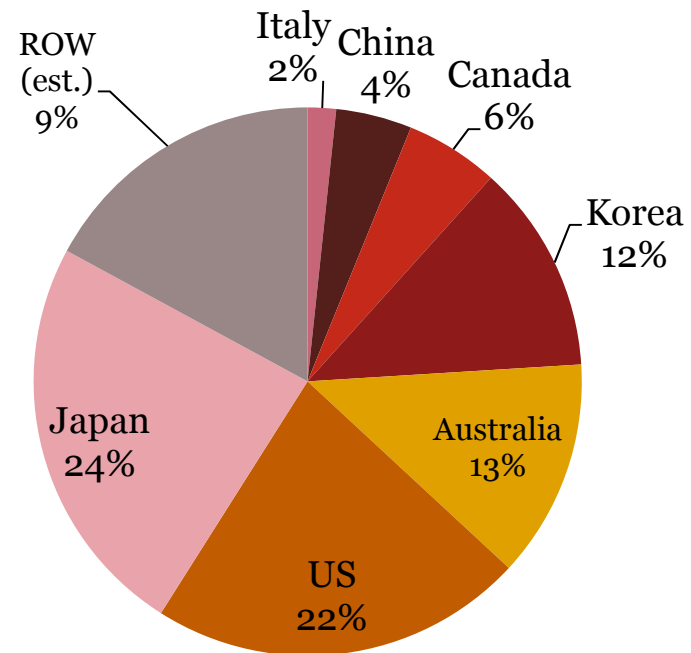


APAs – International Comparison

Months to completion



APAs by jurisdiction, 2009



Sources: APA Reports for China, US, Korea, Australia, Italy, Canada and Japan

Concerns and Opportunities for Tax Directors

5. Conclusions and Best Practices

Horacio Peña – PwC USA

Conclusions and Best Practises:

1. Substance and business objectives: people, implementation of the strategy and financing
2. Industrial analysis: documenting significant changes
3. Definition and segregation of the intangibles: differentiation among routinary services and intangibles
4. Comparables: preference for using actual transactions at market price (vs. Complex methodologies based on multiple hipotesis)
5. Selecting the Best TP Method: Accept and reject other methodologies
6. Financial Analysis: proper use of the discount rates and betas
7. Lifecycle of the Product: Relationship between the lifecycle of the product, the economic substance and the industry trends
8. Proper execution: Accounting records and intercompany agreements

Landscape in Latin America

Juan Carlos Ferreiro– PwC Argentina

Everything changes

Even when the local environment does not differ from the global, Local Tax Authorities might consider different approaches.

Some countries are establishing or updating its transfer pricing rules.

- Chile
- Brazil
- El Salvador

Regional Tax Authorities recognises that transfer pricing issues are complex and challenges local tax administrations.

Next steps

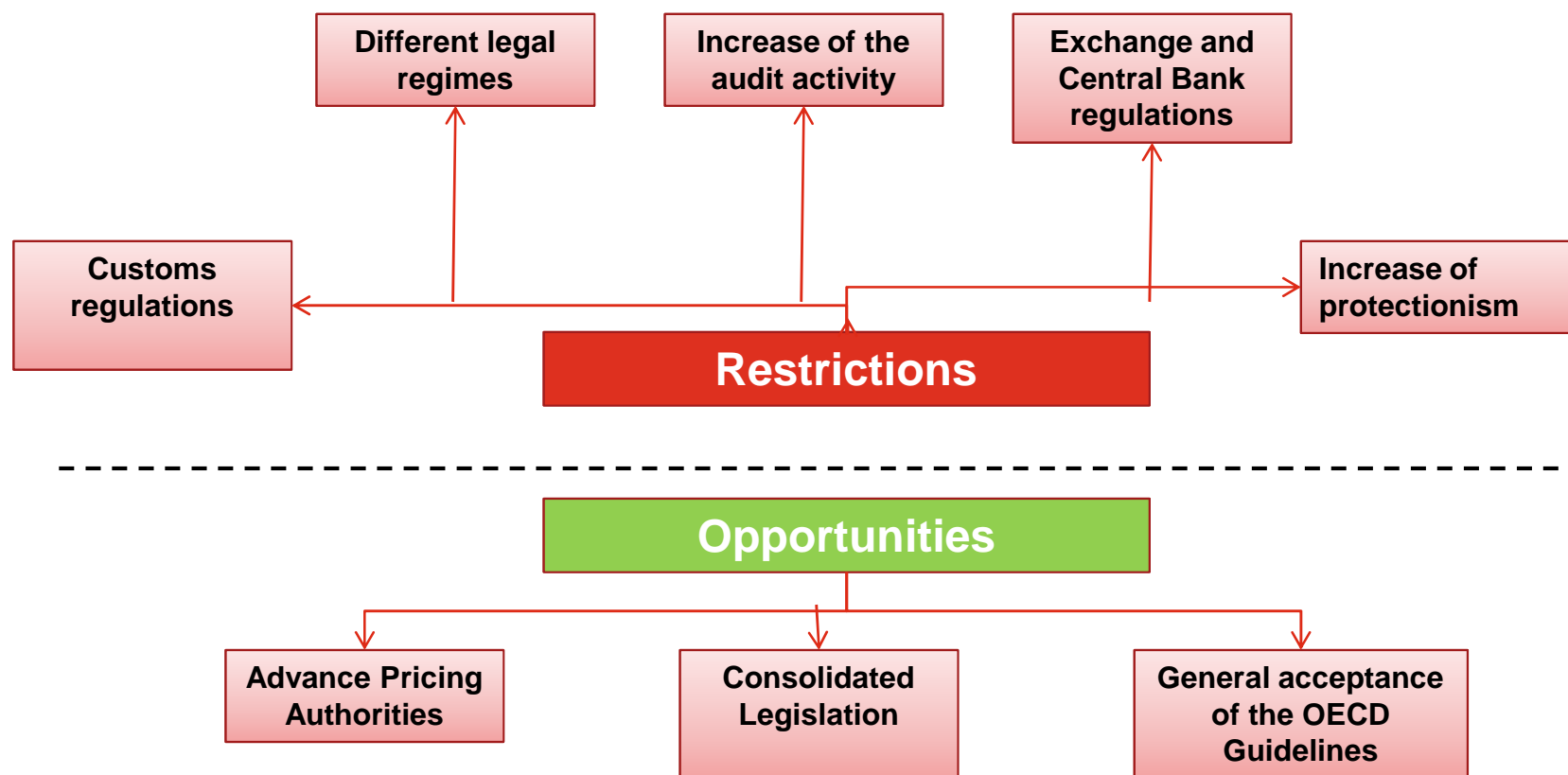


Tax Authorities

Taxpayers

Tax Courts

Tax Authorities Attitudes



What the taxpayer's attitude should be?

Document extraordinary business circumstances

Proof as key issue in a transfer pricing discussion. Legal cases in South America

Test locally the impact of business restructuring and business models globally defined

Transfer Pricing issues

Other taxes like VAT and customs implications.

Tax Authorities attitude towards the new structure.

Tax Courts first decisions

Even when the number of tax cases is not significant, some preliminar lessons could be learned from the first Tax Courts decisions:

- Once the dispute is being discussed on Court, the burden of proof is equal both for the taxpayer and the Tax Authorities.
- The principle that there is not tax without law is relevant.
 - Significant in those cases where the transfer pricing legislation is incomplete, since central elements required for a transfer pricing adjustment are not included in the law.
 - OECD Guidelines as reference in Latinamerica
- Use of secret comparables.

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Recent Changes In The Brazilian Transfer Pricing Rules

(Provisional Measure - 563/12)

Cassius Carvalho – PwC Brasil

Agenda

1. Introduction
2. Effectiveness
3. Resale minus Method (PRL)
4. Comparable Independent Price Method (PIC)
5. Commodities (Import & Export) Methods
6. Tested Price
7. Change of methods during audit procedures
8. Interests

Recent changes in Brazilian Transfer Pricing rules

1. Introduction

- The Executive Branch of the Federal Brazilian Government issued the Provisional Measure (PM) 563, introducing significant changes to the existing Brazilian transfer pricing regulations.
- PM has the effect of law while it is analyzed by the Brazilian Congress, that can approve (with amendments or not) or reject it.
- This process should take place within a 60-day period, a term that may be extended for an additional 60-day period.

Recent changes in Brazilian Transfer Pricing rules

2. Effectiveness

- If Congress does not act within this 120-day period, the PM expires and loses effectiveness (as occurred to MP 479, issued in 2009, which introduced PVL with profit margin of 35%).
- If approved by the Congress, PM 563 shall be effective for transactions to be carried out as of 2013.
- Taxpayers may choose to adopt its provisions for 2012, under conditions that shall be issued in the near future by the tax authorities.

Recent changes in Brazilian Transfer Pricing rules

Resale Price Method (PRL)

- The methodology to calculate the former PRL-60 (previously applicable when value was added in Brazil) should be adopted under the new PRL method (to inputs or resale).
- PRL should be calculated considering a specific mark-up determined for economic sector, and a mark-up of 20% for the economic sectors which are not specified in the PM.
- PRL methodology based on the percentage participation of imported goods, services or rights in the total cost of the sold goods, services or rights.

Recent changes in Brazilian Transfer Pricing rules

Resale Price Method (PRL) - specific margins per sector:

40% mark-up	30% mark-up
-production of pharma-chemicals and pharmaceutical products;	- production of glass and glass products
- production of smoke products	- production of chemical products
-production of optical, photographic and cinematographic equipment and instruments	-production of pulp, paper and paper products
-trading of machines, apparatus and equipment for dental, medical and hospital use	- metallurgy
- extraction of oil and natural gas	
- production of oil derivative products	

Recent changes in Brazilian Transfer Pricing rules

Resale minus method (PRL) - matter requiring further clarification

- concept of economic sector and its various possible practical applications in view of the PRL Method.

Recent changes in Brazilian Transfer Pricing rules

Comparable Independent Price Method (PIC)

- The use of the taxpayer's own transactions with third parties for purposes of the use of the PIC method will be acceptable only to the extent the comparable transactions are equivalent to 5% of the tested transactions.
- When it is not possible to identify purchases and sales in the same period to which prices under investigation refer, comparison may be made with prices practiced in immediate prior period, provided they are adjusted by variations in the exchange rates of the reference currencies between the date of one transaction and the other.

Recent changes in Brazilian Transfer Pricing rules

Commodities Methods (PCI – imports / PECEX - exports)

- Imports and exports of commodities, quoted in commodities exchange market, must be tested through the use of the newly introduced methods PCI and PECEX, respectively.
- Based on these methods, taxpayers shall compare the transactions values with the daily average quote for each product.
- The Federal Revenue Service shall issue instructions on how these methods shall be applied, including which recognized stock exchanges quotations could be used.

Recent changes in Brazilian Transfer Pricing rules

Tested Price

- Taxpayers are no longer required to include custom duty and other customs expenses in the tested price.
- Also, they are not required to include freight and insurance contracted with third parties, provided such third parties are not located in low tax jurisdictions or benefit from privileged tax regimes.

Recent changes in Brazilian Transfer Pricing rules

Methodology change during audit procedures

- Taxpayers must annually elect the method to be used for the tested products/services and changes to the method adopted will be accepted only before the start of the audit procedure, unless the tax authorities disqualifies the existing documentation.

Recent changes in Brazilian Transfer Pricing rules

Interest

- Interest on related party loans, even if duly registered with the Brazilian Central Bank, will be deductible only up to an interest rate equal to the LIBOR dollar rate for six-month loans plus a spread to be annually determined by the Ministry of Finance based on an average market rate.

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Current Context of Transfer Pricing in Chile— Legal Changes

Alberto Cuevas - Chilean IRS

Roundtable of Latin American Tax Authorities – Hot Topics and Trends

Fiscal Authorities of :
Chile
Uruguay
Venezuela

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Commodities and Transfer Pricing – Elements to Consider and Regional Experiences

Jose María Segura – PwC Argentina
Gabriel Bernal – PwC Chile
Rudolf Roeder – PwC Perú
Elys Aray – PwC Venezuela

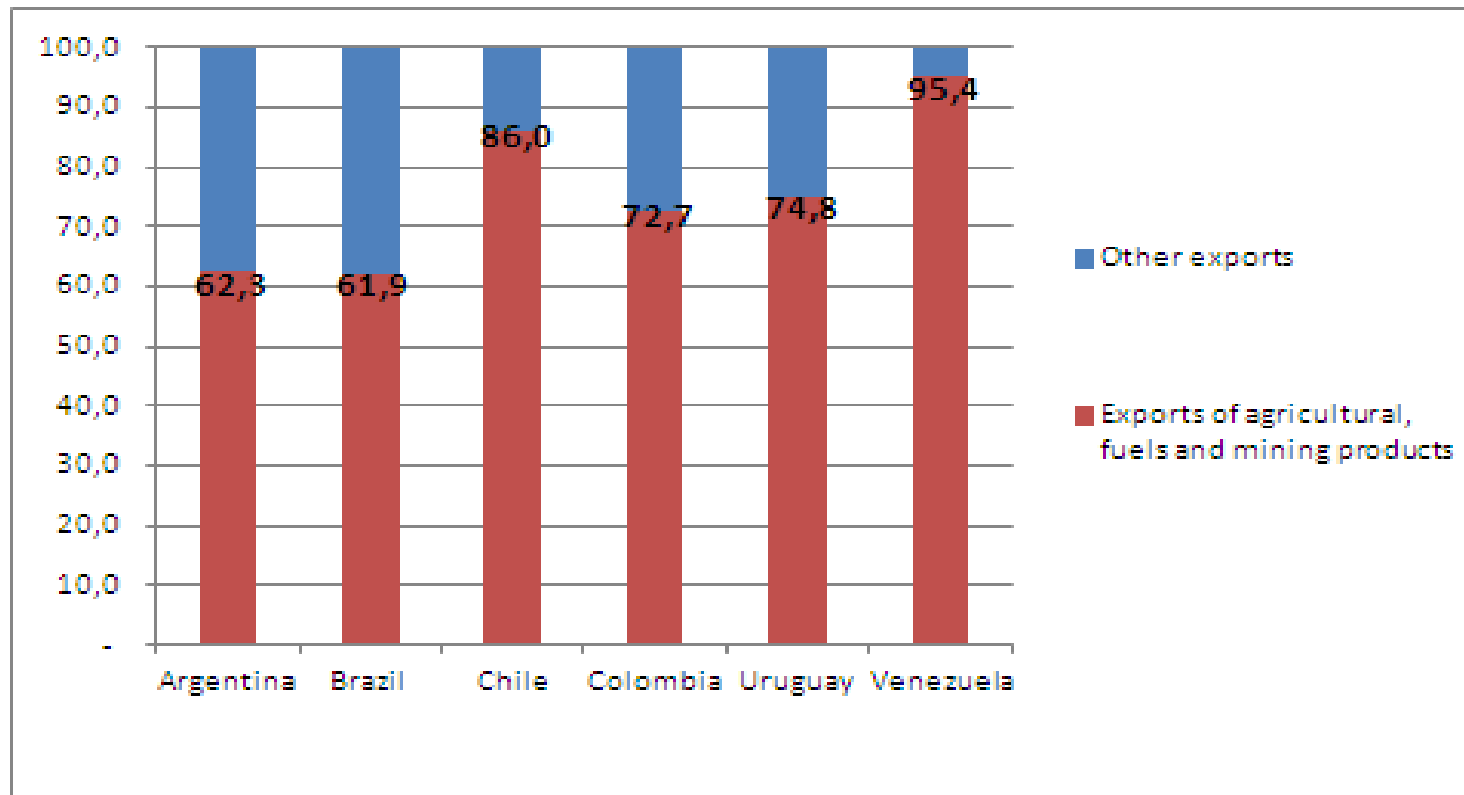
Agenda

- Relevance of commodities in the region.
- Comparable Uncontrollable Price method.
- Specific sectors.
 - Grains.
 - Oil.
 - Mining.
- Alternative methods to analyze the transactions.
 - OECD.
 - Country specific.
- Fiscal activity and case law.

Relevance of commodities in the region

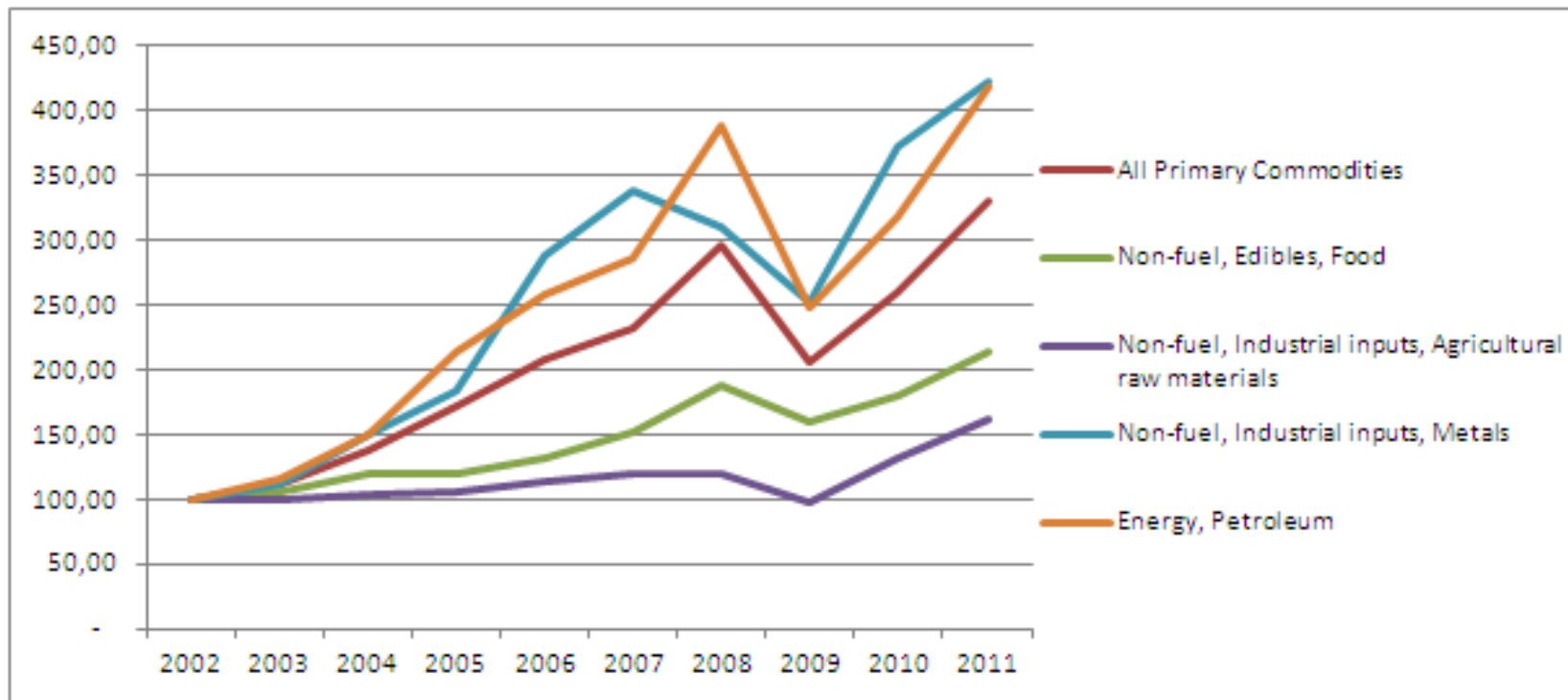
José María Segura – PwC Argentina

Weight of commodities in total exports of major countries in the region



Source: World Trade Organization. Year 2010.

Primary Commodity Prices Indices



2002=100

Source: IMF.

Comparable Uncontrollable Price method (CUP)- General considerations for its application in commodities transactions

José María Segura – PwC Argentina

Commodities pricing

- How can commodities prices be established?
 - Flat.
 - Price Basing.
 - Long term agreements.

CUP method definition

Comparable Uncontrollable Price method:

- Price agreed with or between unrelated parties.
- In comparable transactions.
- High degree of comparability.
 - Of goods
 - Of circumstances.
 - May require adjustments to enhance comparability.

Internal and external comparables

- **Internal comparables:** Comparable transactions agreed by any of the companies involved in the transaction with independent parties.
- **External comparables:** Comparable transactions agreed between independent parties.

Difficulties in CUP implementation - Internal comparables

- Although the existence of purchase and sale transactions with independent parties, are there any internal comparables?
- Differences in quality.
- Unique contracts.
- Price volatility limits comparability.
- As a result of price fixing methods, exports in the same day and under similar circumstances, may differ in prices.
- Contracts signed at different moments.
- **Conclusion:** The use of internal comparables is not possible in any case.

Difficulties in CUP implementation - External comparables

Prices agreed in business-to-business transactions differ systematically from international prices, affected by specificities, such as:

- Exporter location.
- Product destiny (local competition).
- Supply contract nature.
- Product quality.
- Transaction volume.
- Payment terms and conditions.
- Commercial barriers or alternative commercial agreements.
- Circumstances in which a transaction was made.

Comparables - Adjustments

Although the existence of internal or external comparables for a transaction under analysis, it may be necessary to apply adjustments in order to enhance comparability.

Especific Sectors

1. Cereals

Jose María Segura– PwC Argentina

Price formation methodology

Contract date (when the transaction is agreed):

- Transaction conditions are agreed.
- Price structure and spread are agreed.

Reference future + spread (premium or discount)

At contract date, the price consists of an objective and unknown part (reference price - e.g.: Chicago future prices for cereals -) and other subjective part (spread or premium), which is agreed according to factors affecting its magnitude.

Price fixing date:

- The real price for the transaction is obtained. This price is given by quotation at that moment of the future used as reference, plus the spread agreed.

Considerations

- Conditions must be evaluated at the time the transaction is agreed.
Not when the price is fixed.
- The spread must be analyzed at the time it was agreed.
- At the time the price is fixed, the future used as reference must be the correct one, regarding the transaction analyzed and its conditions.

Example

An export transaction of 100 tons of soybean is agreed for May 30, 2012.

First stage: Transaction agreement.

- Agreement date: February 1, 2012.
- Soybean future for May 2012 (Chicago) at February 1: usd 380 per ton.
- Local market fob price for May 2012: usd 360 per ton.
- Spread: usd -20 per ton.

Example (continuation)

Second stage: Price fixing.

- Price fixing date: April 1, 2012.
- Soybean future for May 2012 (Chicago) at April 1: usd 350 per ton.
- Local market fob price for May 2012: usd 340 per ton.

According to the price fixing methodology, the price is fixed at usd 330 per ton (350-20).

Example (continuation)

If we compare the price at which the transaction was made (usd 330 per ton) with the local market price at the time the transaction was agreed (usd 360 per ton), we can observe that the final price is lower than the comparable price, which might lead to a taxable base adjustment.

However, this assumption is not correct because the transaction conditions must be analyzed at the time the transaction was agreed (February 1, 2012), and not when the price is fixed (April 1, 2012).

An appropriate analysis should be as follows:

- Analyze whether or not the spread settled at the time the transaction was agreed is consistent with market conditions
($380 - 20 = 360$)
- Analyze whether or not the future used as reference at the time the price is fixed, is correct according to the transaction conditions.
($350 - 20 = 330$)

Example (continuation)

Finally, it is important to note that the evolution of commodity may not be relevant for the trader, whereas it is possible to hedge the price volatility risks trading in futures.

Example:

February 1: sell future (May) at	usd 380
April 1: Buy future (May) at	usd 350
	<hr/>
Result of trading in futures:	usd 30
Difference in the flat market (330-360):	(usd 30)
	<hr/>
	usd 0

Specific Sectors

2. Oil and its derivatives

Elys Aray – PwC Venezuela

Commodities in Transfer Pricing

The Oil Industry

The oil *industry includes global* processes involving exploration, extraction, refining, transport (frequently by means of Oil Tankers and products) and marketing of oil products. Products with the greatest volume within the industry are fuels and gasoline. The oil is the raw material of several chemical products including pharmaceutical products, dissolvent, fertilizers, pesticides and plastics.

The oil industry is normally divided in three stages :

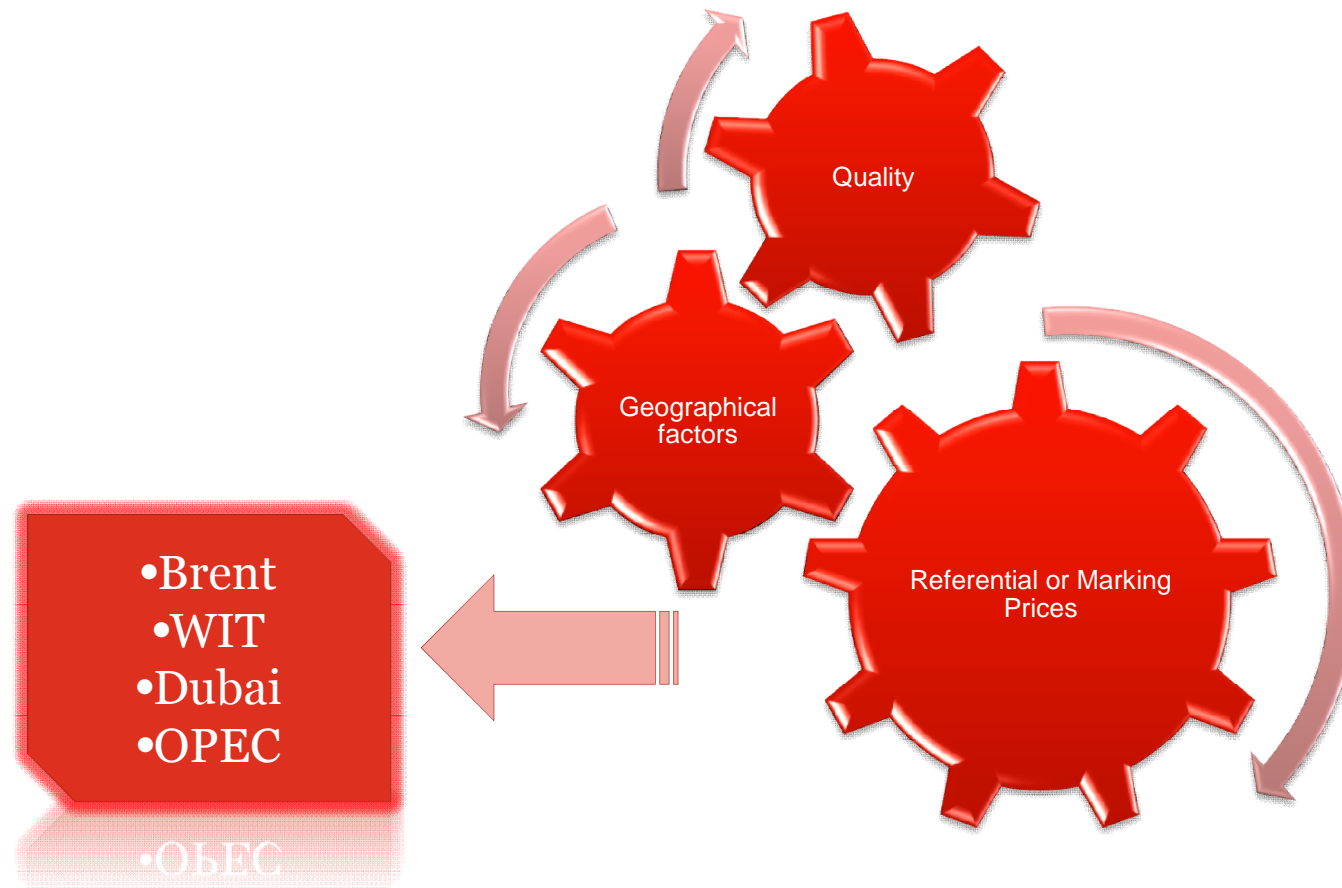
"Upstream": Exploration and production.

"Midstream": Transport, processes and storage.

"Downstream": Refining, sale and distribution.

Commodities in Transfer Pricing

Referential Oil Prices



Commodities in Transfer Pricing – Oil

Relevant aspects for comparing product and price in a commodity exchange transaction between related parties:

- *Temporal* Element (dated agreed upon)
- Type of contract (futures or spot)
- Geographical location
- Quantity (bushel, barrels, oz.)
- Sale condition (FOB-CIF)
- Specifications of product or service, mostly quantity

NOTE: Differences in these aspects result in differences in public prices regarding premiums and discounts.

Commodities in Transfer pricing

Types of Oils and their Prices

Main aspects
which define the
determination of
Oil prices

Demand / Supply

Mechanism of Trade (spot –
futures)

Quality (light– heavy)

Cost of Transport, Political and
Economic Conditions

External Comparables - Sources

Sources	Characteristics
Platt's	Price quoting known to public
NYMEX	Futures energy agreements
<i>West Texas Intermediate W.T.I</i>	<i>Oil : known as Texas Light Sweet</i> for its relatively low density and high sulfur content (light crudes)
<i>Brent Oil</i>	Fifteen crudes compound originated from extractions fields located in the Brent and Ninian systems of the North Sea (light crude)
<i>Cesta OPEP</i>	This oil is heavier that the Brent and WTI crudes

Commodities in Venezuela

Final Considerations

- There is a difference materially affecting the sale price
- Possibility of adjusting to comparable transactions comparables
- Application of econometric and statistical methods
- In case there are no internal comparables, there is public information on the prices of various crudes

Specific Sectors

3. Mining

Gabriel Bernal – PwC Chile

Mining - Chile

- In the context of Chile's entry to the OECD, the Chilean Internal Revenue Service (SII) has announced an update of local current regulations regarding transfer pricing in Chile – in line with the Guidelines.
- Some commodities exports sectors have been subject to TP audits by the SII.

❖ Chilean Copper Comission – “Cochilco”

- Technical insitution, specialized in copper and its sub products, as well as other metallic and non metallic substances, except coal and hydrocarbons.
- Among its functions, Cochilco is in charge of providing technical assistance to the Chilean IRS (SII) in order to: i) control costs and profits derived from copper transactions; ii) analyze relevant information to determine the taxable base of mining companies in Chile.

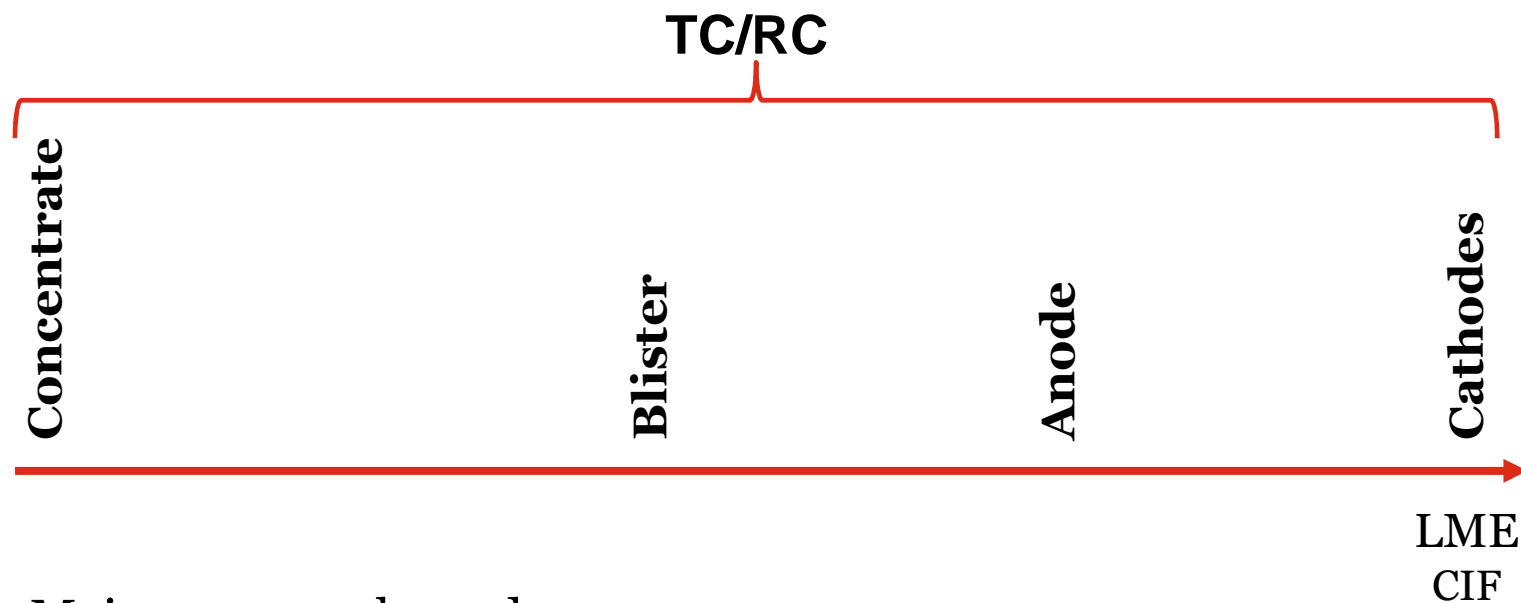
Mining - Chile

- Cochilco acts as an information compiler, since mining companies are required to provide details regarding its copper sales contracts. This information is also known by the Chilean IRS thru Cochilco.
- Cochilco carries out a follow up and control of contractual obligations, which also feeds an important database that could be used by the Chilean IRS in the context of a TP audit.
- Its importance with regards to business restructuring.

❖ Chilean Customs' Role

- Copper exports' final prices are provided by the Chilean Customs to Cochilco, institution that proceeds to perform information comparisons with the data that was previously provided by the Chilean copper exporters.

Mining - Chile



Main copper sub products:

- Molybdenum.
- Sulfuric acid.
- Anodic Bars.

Copper pricing - Analysis

- Since commodities are traded in international stock markets, the CUP method would seem to be the natural method to analyze transactions that involve this type of goods.
- **Particular conditions in a transaction are reflected in the application of premiums or discounts** over the reference quotation .
- For example, in the case of copper anodes, in general terms, the pricing methodology is as follows:

LME + Premium or Discount.

- In the case of a controlled transaction agreed with the abovementioned methodology, the price would be comprised by an objective part - LME quotation – and a subjective one - premium or discount-.

To determine comparable prices for this transaction, it could be derived from the application of the quotation reference (objective part) and comparable premiums or discounts.

Comparable premiums or discounts

- Premiums or discounts adjust reference prices to the transaction's particular characteristics.
- The magnitude of this price factor is widely affected by comparability factors.
- Premiums agreed in comparable transactions must be used.

Comparability factors	Example
Product destiny	Chinesse Premiums vs. European Premiums.
Type of contract	Annual Supply vs. Spot.
Agreement date	Premiums evolution during the year.
Incoterms conditions	FOB premiums lower than CIF premiums
Quality	Grade A vs. Off Grade / Good Delivery
Payment terms	Premiums implicit interests.
Source	Electro Obtained / Electro Refined
Prestige	Producer / Counterpart

Internal / External Comparables

Comparable premiums could be:

- **Internal CUTs**: Transactions agreed by the entity under review with independent parties.
- **External CUTs**: Information from government institutions or industry publications (Cru Monitor, Brook Hunt, Metal Bulletin, etc.)

In case external comparables are selected, particular care should be taken with regards to location and delivery terms of the reference price.

Copper Concentrates

- Copper Concentrates have an additional difficulty when analyzed from a TP perspective, since the exported goods usually differ among each other.
- **The laws vary between each concentrate, reason why the implementation of the CUP method using as reference that agreed with an independent party would make no sense, even if there are matching factors such as destiny, incoterms, date, etc.**
- Further, two identical concentrates, exported the same day, may have different prices without altering its arm's length nature. (e.g. different quotation periods)

Concentrates Pricing

- Copper (and other metals) laws are used to determine the fine content of each metal in a concentrate.
- Based on the price reference and quotation period, **the fine content's value** is established.
- Then deductions are applied for:
 - **Payable content:** usually predetermined or standard conditions.
 - **Treatment and refining charges:** very variable and affected by the same comparability criteria that were mentioned for copper anodes.

Objective and Subjective Conditions

- In general terms, there are the following conditions:

Type	Condition
Objectives	Concentrates' laws. + Quotation reference. = Fine content value
Subjectives	Payable contents Treatment charges Refiningcharges

- In order to determine a comparable price in TP, the value that would have been agreed by third parties should be taken into account. **Such value would be achieved by applying to the fine content's value of the controlled transaction (objective), the deductions agreed with or among independent parties.**

Arbitrage's perspective

- Usually, there is insufficient information regarding price references or premiums for goods delivered in the client's country (related).
- Consequently, it is difficult to find exact comparables for FOB values of goods being exported from South American ports.
- However, there are premiums or price references for goods placed in the destination market (e.g. delivered China)
- One way to arrive at comparable FOB export prices with the destiny of reference is to calculate the export parity.
- This is, taking the price reference and premium from the destination market and then, deduct the necessary expenses to locate the product in this place.

General Comments

- **Quotation periods:** are they really objective?
- Need to have a certain date for the contracts, in order to justify the non manipulation of the quotation periods.
- It is recommendable to have stable quotation periods.
- To respect contractual clauses and avoid modifying the contracts in a repeated way.
- Use of broker's premiums and discounts.
- **Intermediary intervention:** need to carry out real functions.
- **Industry publications:** need to carry out adjustments when external comparables are used.
- Documentation of location alternatives.

Special situations

- Off-take agreements*
- Purchase agreements to secur credits*

Rudolf Roeder – PwC Perú

Off-take agreements

Buyers of minerals (refineries or others) invest in shares of mining company to ensure supply of such minerals. In return, they expect:

- First right to purchase purchase mineral resources from the mine
- Preferred conditions and prices to purchase mineral resources usually below market.

Off-take agreements

- Are both companies related for purposes of transfer pricing?
- Is it relevant if the off-take agreement is entered into before or after the time when the investment is made by the mineral purchaser?
- Is it possible to “compensate” the lower mineral sales price (granted to the investor / purchaser) with the “costs” associated to the investment made?
- If it should be possible to make the above economic compensation ¿what other tax exposures could the company be exposed to?

Purchase agreements to secure credits

Entities financing mining projects may require that the project secures selling contracts such that they ensure that the output will be sold at prices that will allow to repay the debt, before they actually commit to finance the project. In these cases, the committed buyer assumes part of the risk in exchange of:

- Preferred conditions
- Prices below market.

Purchase agreements to secur credits

- Will there be two related parties as a consequence covenants or other conditions imposed by the buyer in the purchase contracts?
- How shall we value the price for assuming the risk by the buyer?
- Is this agreement the equivalent of a financial collateral?
- There are timing differences, since the collateral is granted before the discount is made effective: how should one deal with it?
- Is this one or two transactions for purposes of VAT?

Other methods – General Considerations

José María Segura – PwC Argentina

Profit Split - Conditions for its application

This method can be applied in the following cases:

- Highly integrated operations (e.g.: Global Trading).
- Functions, assets and risks involved by the parties to the transaction not easily separated.
- Both parts contribute with unique and valuable intangible assets

This methodology consists in splitting the transaction's total earnings, and allocating them to each party according an specific driver.

Sixth paragraph method of Argentine Income Tax Law - Conditions for its application

Argentine tax authorities introduced this new method for analyzing transactions involving exports of goods with a known price ("commodities") to related parties, carried out through an international intermediary.

- The best method consists in applying the quotation of the exported goods at the day of shipment, regardless of the type of transportation used or the price agreed with the intermediary.
- If the price agreed with the international intermediary were higher than the quoted price of the good at the shipment date, the price agreed between the parties must be applied in order to determine the transaction value.

Sixth paragraph method - Applications

This method would only be applicable in the following cases:

- Exports of goods to related subjects.
- When the goods involved have a publicly quoted price in transparent markets (reference is made to grains, oil-seeds, fruit, other earth-grown produce and any other goods with a listed price).
- When an international intermediary other than the actual receiver of the goods disposed of is involved.

Fiscal Activities and Case Law

Elys Aray – PwC Venezuela
Gabriel Bernal – PwC Chile

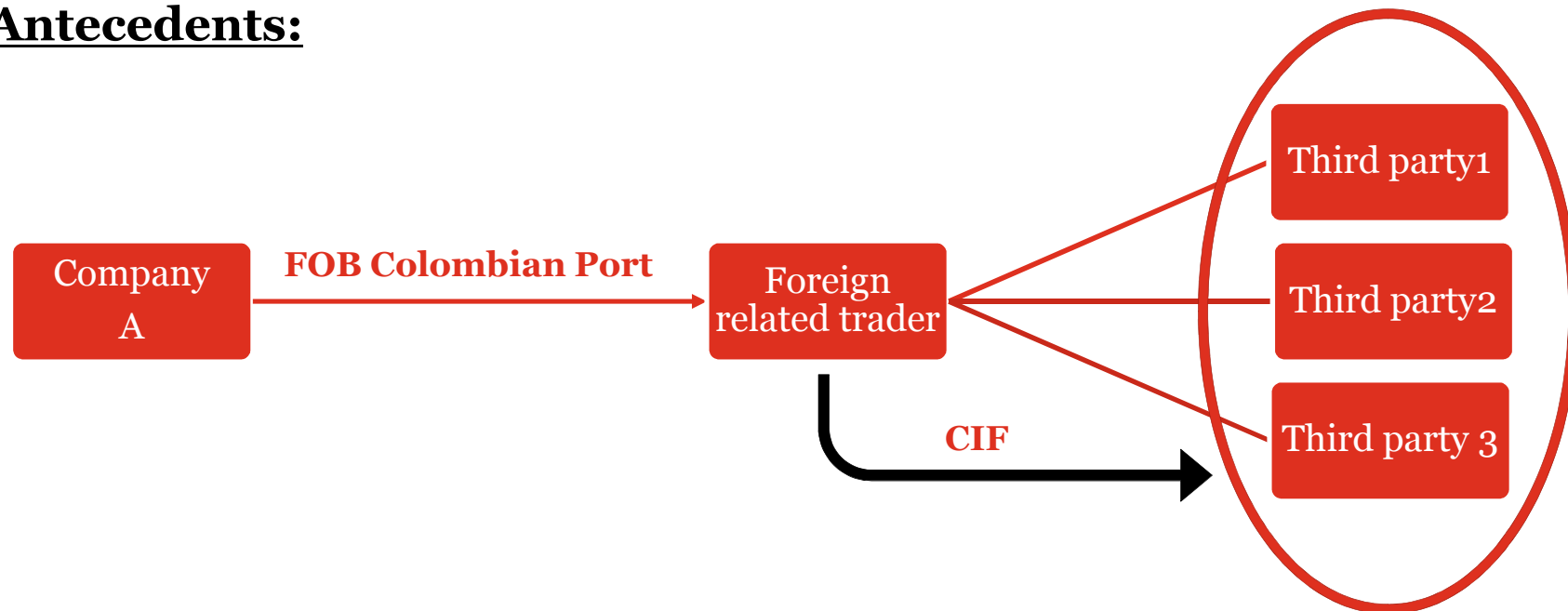
Chile

Chilean IRS' TP audit trends – *Commodities*:

- The Chilean IRS has carried out audit processes in some commodities sectors, such as fruits, mining, among others.
- The Chilean Tax Authority knows that centralized trading structures are an international practice, that have an adequately supported business substance, but that additionally bring tax benefits for the Group. These type of structures have brought the interest of several jurisdictions.
- Cochilco is an important source of information for the Chilean IRS (regarding TP), and there is no doubt that it is being used in a strategic way in the mining sector's TP review.

Colombia

Antecedents:



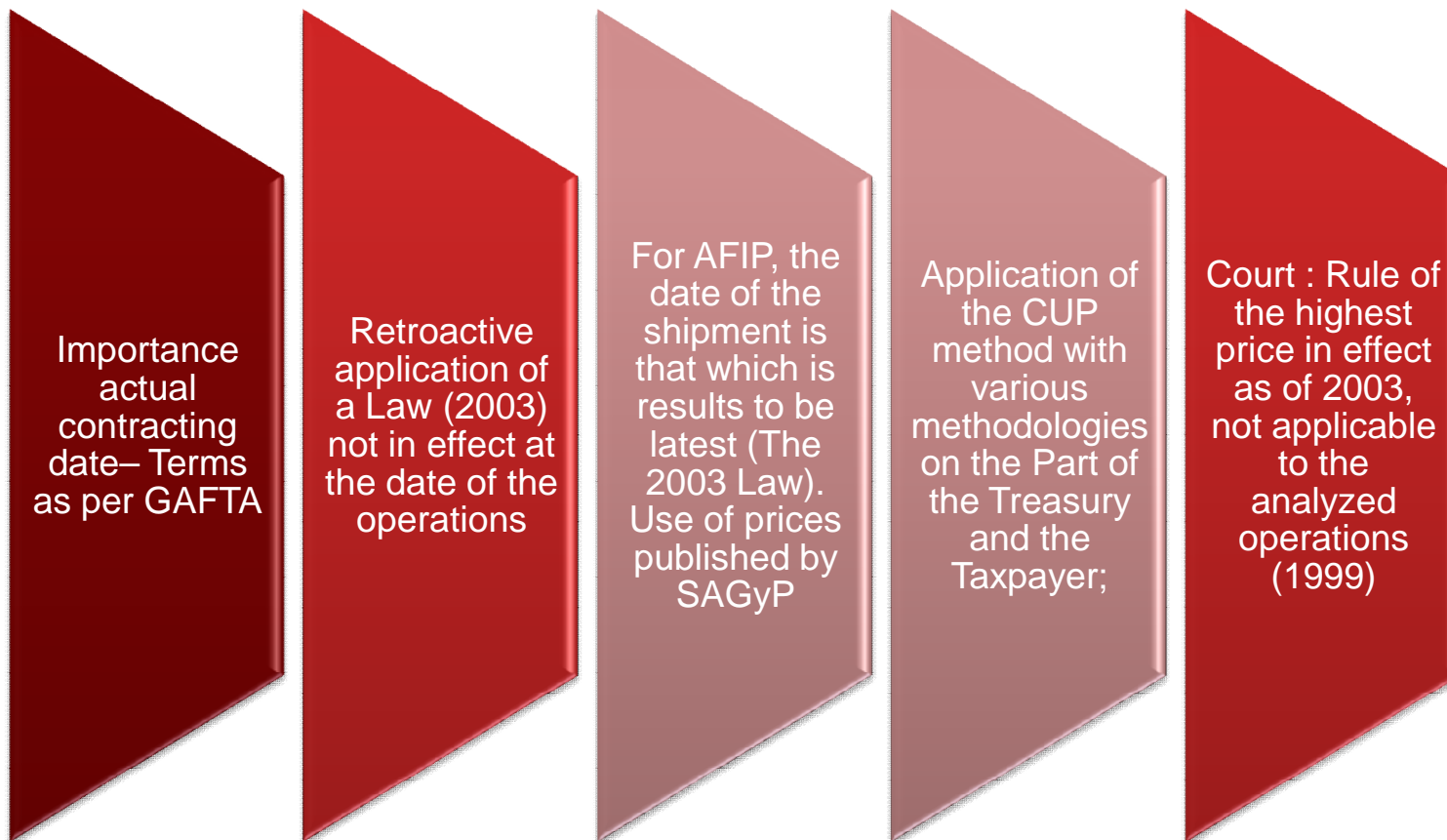
The foreign related trader assumes market, inventory and receivables risks, with regards to the fraction of the production bought to the Colombian company's production.

Colombia

Colombian Tax Authority's position (DIAN):

- Even though at a first stage DIAN conceptually challenges the trader's remuneration, it did not perform any TP adjustment under this concept.
- DIAN performed information exchanges with other tax authorities, with the purpose of confirming the foreign related trader's profit margin in this transaction.
- The Colombian Tax Authority rejected the comparables used in the analysis reported by the taxpayer.
- DIAN carried out an adjustment to the comparables' median that it selected, which reported a profit margin considerably higher than the one presented by the taxpayer.
- The Colombian Tax Authority has shown inexperience on the mining sector.

Commodities - Fiscal Activities and Case-laws : Exportation of grains (1999)



Commodities - Fiscal Activities and Case-laws: Exportation of Grain and oilseed (1999)

Lack of actual
contracting
date— Terms
as per GAFTA

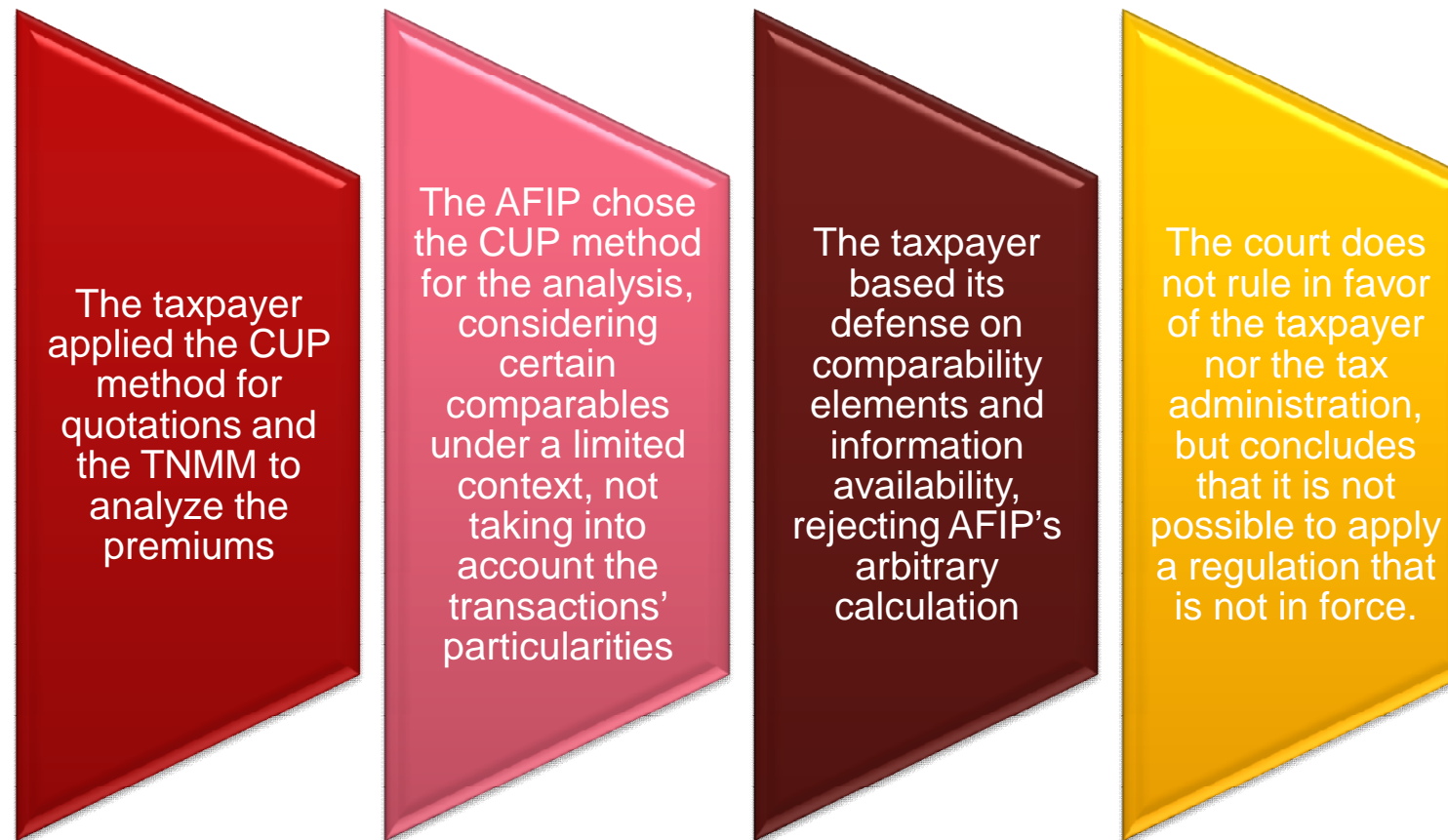
Retroactive
application of
a Law (2003)
not in effect at
the date of the
operations

For AFIP, the
date of the
shipment is
that which is
results to be
latest (The
2003 Law).
Use of prices
published by
SAGyP

Application of
the CUP
method with
various
methodologies
on the Part of
the AFIP and
the Taxpayer;

Court : Rule of
the highest
price in effect
as of 2003.
Nonetheless,
given the lack
of actual
contracting
dates the
shipment date
is applied

Commodities - Fiscal Activities and Case-laws: Trade of liquid and gaseous fuels (2000)



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7th Annual Latin American Transfer Pricing Conference

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Best Practices for Documenting a Transfer Pricing Policy

Violeta Maresca - PwC Argentina
Rafael Parra – PwC Colombia
Adolfo Calatayud – PwC México

Establishing a Transfer Pricing Policy

Rafael Parra– PwC Colombia

Do you know the transactions of your Company?

Although at first glance the answer will be yes, what usually happens is having the knowledge of the most important transactions (value and frequency), the core of the business, however it is important to take into consideration:

- Does your company engages in transactions with related party similar or equal to those engaged with unrelated parties?

Sale/Purchases of goods and rendering or reception of services.

- Are there invisible transactions?

Existence of regional positions whose wages are not recharged to the other countries. Wages are fully deductible.

Do you know the transactions of your Company?

- Do you receive services at cost or with a mark up?
- Are there expenses reimbursements?
Both income and expense
- Do you receive a proportion of Group expenses?
Publicity, insurance policies, etc. Pass-through expenses from third parties.

Is there a Transfer Pricing policy in your Company or Multinational Group?

- The price of manufactured goods is established on a cost plus basis.
- Interest income for treasury overnights in the Group's Finance PLC is at Libor – 25 points.
- The profitability of the Company comes from the distribution activity rather than the manufacturing activity.
- Royalties are computed as a percentage of the revenue or for example there is no royalty charge.

Transfer Pricing Policies

- A transfer pricing policy has to be adequately supported, meaning that the company has to know and be able to prove that said policy fulfills the arm's length principle.
- The Company has to have all necessary supporting documentation to prove that it is fulfilling the policy.

Invoices from third parties

Segmentation of services invoiced at cost

Considerations Regarding Transfer Pricing Policies

- Make an inventory of all the transactions of the company including the invisible ones.
- Research the existence of a transfer pricing policy for each one of them.
- Ask yourself if the price agreed with related parties would be a price agreed with third parties.
- Gather all necessary documentation to adequately support the price in a transaction and its deductibility.

Managing Changes to a Transfer Pricing Policy

Violeta Maresca – PwC Argentina

Managing Changes to a Transfer Pricing Policy

Why are there changes to the transfer pricing policies?

- Because of the introduction of new markets.
- Introduction of new lines of products or businesses.
- Due to changes in functions, risks and assets related to existing business lines.
- Introduction of new remuneration guidelines: intangibles, services, implementation of regional centers, etc.

Managing Changes to a Transfer Pricing Policy

Issues to be considered when a change occurs

- Transfer pricing legislation of the country affected by the change
- Criteria used by the tax authorities in the interpretation of tax laws
- How prior fiscal years are affected by change
- Compatibility with customs and exchange regulations
- Reasons, substance and evidence

Managing Changes to a Transfer Pricing Policy

More common changes in price policies

- *Distribution*: transformation into a mere distributor or commission agent
 - Effective transfer of functions, risks
 - Issuance of Debit or Credit Notes
 - Incidence in customs and exchange regulations
- *Manufacture*: Transformation into a Contract Manufacturer or Toll Manufacturer
 - Effective transfer of functions, risks and assets
 - Incidence in customs regulations
 - P E

Managing Changes to a Transfer Pricing Policy

- *Business Restructuring*: For example, interposition of a third operator
 - Substance: An effective relocation of functions, risks and assets
 - Remuneration commensurate with these relocated functions, risk and assets
 - Possible transfer of intangible assets
 - Incidence in customs and exchange regulations

Managing Changes to a Transfer Pricing Policy

Services and remuneration of intangible assets:

- Royalties
- Franchise Fee
- Implementation of regional service centers
- Overheads
- Evidence of the actual provision and of benefits to the company
- Arm's length remuneration

How to Manage a Transfer Pricing Audit Process

Adolfo Calatayud– PwC México

First things first, what should the company do?

- Comprehensive policies on transfer pricing for intercompany transactions.
- Periodic policy reviews (at least annually).
- Implementation of solid and defensible contract agreements.
- Cost/benefit analysis from both parties – Does the transaction make economic sense for both parties involved?

Main areas of interest from the tax authorities in Transfer Pricing audits

General

- Analysis of overall profitability vs. transactional profitability
- Verification of financial information for (economic) cycles longer than one year
- Lack of comparability in the analysis
- Use of the appropriate PLI (ROCE, MOTC, etc.)
- Comparable company selection/rejection procedure
- Lack of use of internal comparables

Main areas of interest from the tax authorities in Transfer Pricing audits

Related topics of interest

- Withholding rates (benefits of international treaties)
- Requirements for deductions
- Thin capitalization rules
- Transaction recharacterization

Current Transfer Pricing audit programs

- Corporate restructurings
- Migration and use of intangibles
- Financing, thin capitalization and debt push downs.

Examples of Transfer Pricing risk indicators

- Significant transactions with related parties located in tax havens
- Transfer of intangibles to related parties located in countries with lower tax regimes
- Business restructuring
- Various payments to related parties (interests, insurance, royalties, technical assistance, administrative services, reimbursements, etc.)
- Recurring losses and atypical outcomes or periodic patterns of risk
- Low effective tax rates
- Lack or deficient Transfer Pricing documentation.
- Excessive debt (insufficient capitalization)

Administration in a Transfer Pricing Review by tax authorities

- Contemporaneous Transfer Pricing documentation
- Supporting documental evidence of operations with related parties (provision of services, functions performed and risks assumed)
- Implementation of multidisciplinary Transfer Pricing teams (accountants, economists, attorneys, etc.)
- Clear and concrete answers to the requirements and inquiries of tax authorities
- Timely approach and extensive collaboration with the tax authorities to resolve any doubts and concerns regarding transactions with related parties
- Appropriate use of MAP's and APA's

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Transfer Pricing and International Transactions Planning – Impact in Emerging Countries

Cassius Carvalho – PwC Brasil
Loreto Pelegrí - PwC Chile
Matías Pedevilla – PwC USA
Daniel García – PwC Uruguay

Agenda

- Introduction – Global environment
- Planning models
- Countries to establish the Principal
- Business restructures
 - *Uruguay*
 - *Chile*
 - *Brazil*
- Conclusions

Introduction – Global Environment

Matías Pedevilla– PwC Chile

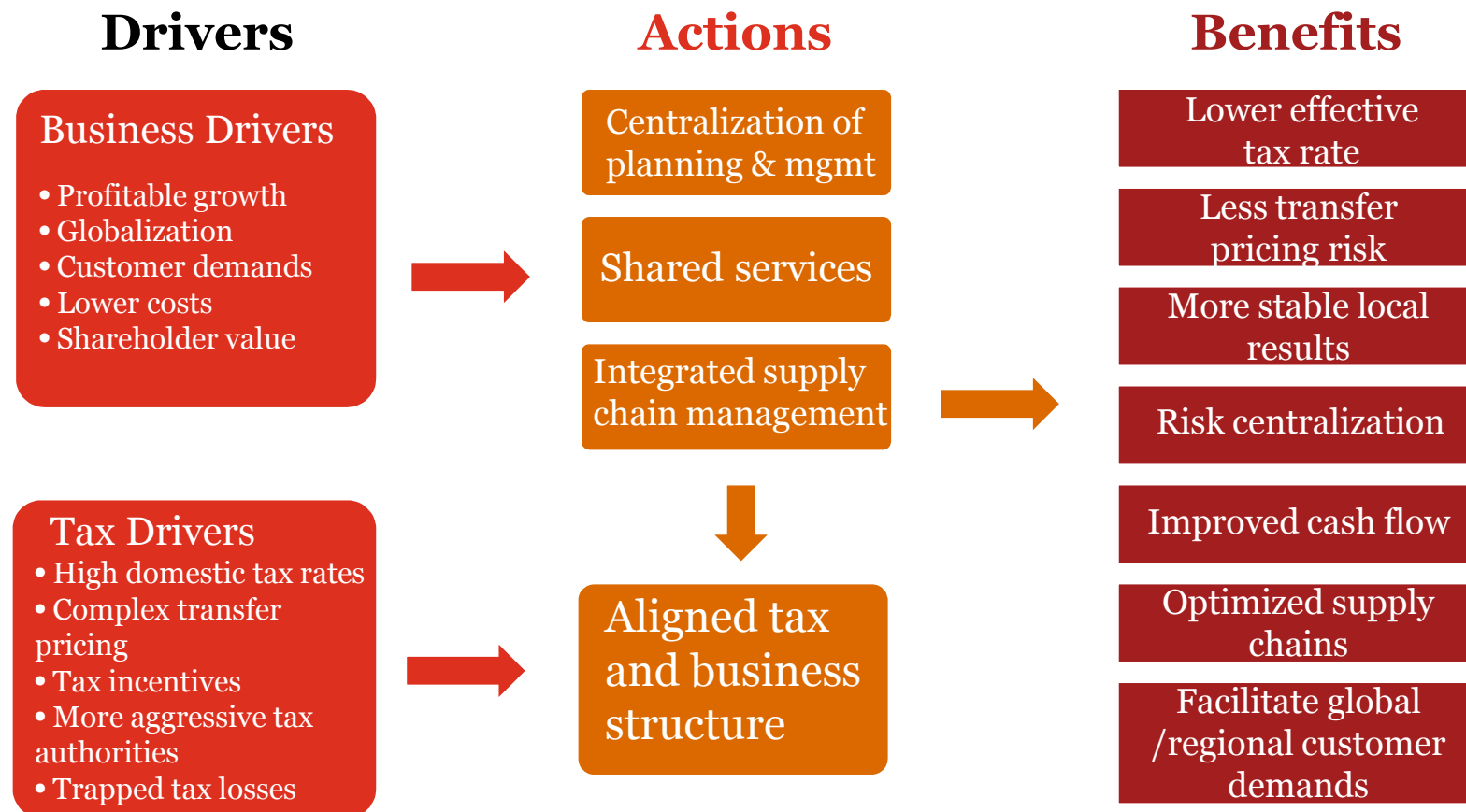
Introduction – Global Environment

- After one of the worst economic crisis in the last decades, now companies have cash in their books
- The improvement of macroeconomic data has reactivated the activity and the need of companies to grow and consolidate their operations
- This economic environment has created internal pressure for business planning and the need to search for different restructuring alternatives
- Tax authorities have increase tax audits in the Region with specific focus on economic substance

What companies are good candidates for business planning?

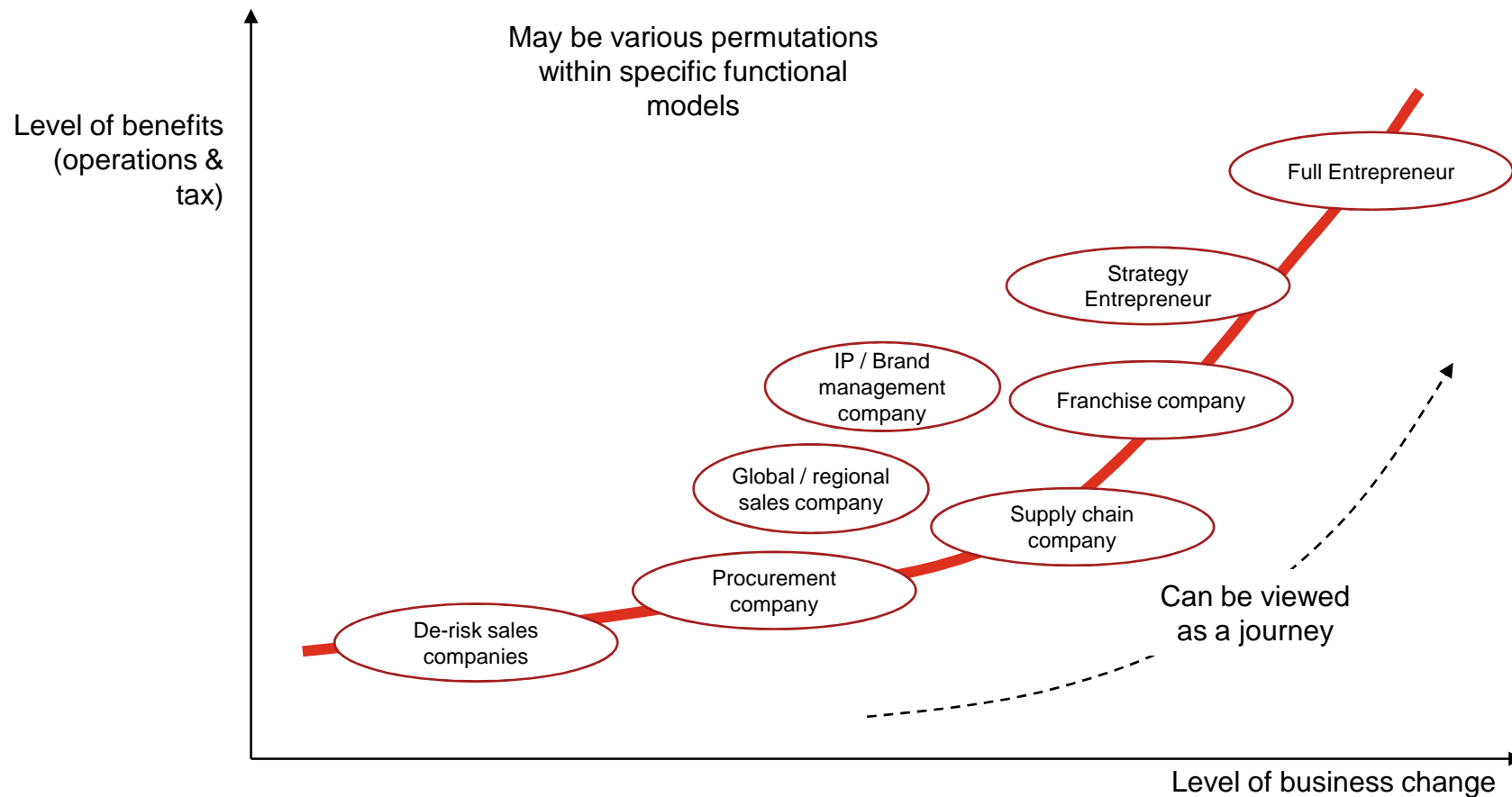
- Recent acquisitions or mergers
- Significant investment in R&D, product development
- New business line
- Global expansion
- ERP/Systems implementation or upgrade
- Comparatively higher effective tax rate relative to peers

Planning fundamentals



Planning models

There is no single model — Planning principles can be applied around a continuum



Entrepreneur Business Model

Entrepreneur Company

- Responsible for regional operations
- Responsible for major risks, functions and strategic direction of the business
- Business substance necessary to perform these responsibilities, e.g.
 - Employ regional operations management
 - Negotiate and enter into contracts with customers and service providers
 - Oversee purchase and sales orders
 - Engage in IP management activities
 - Approve product forecast
 - Approve quality requirements
 - Approve engineering and/or process changes and budgets
- Profitability of Principal will depend on its functions, responsibilities, risks, and assets (often the residual profit after compensation paid to Limited Risk entities)

Other entities Limited Risk Centers of excellence

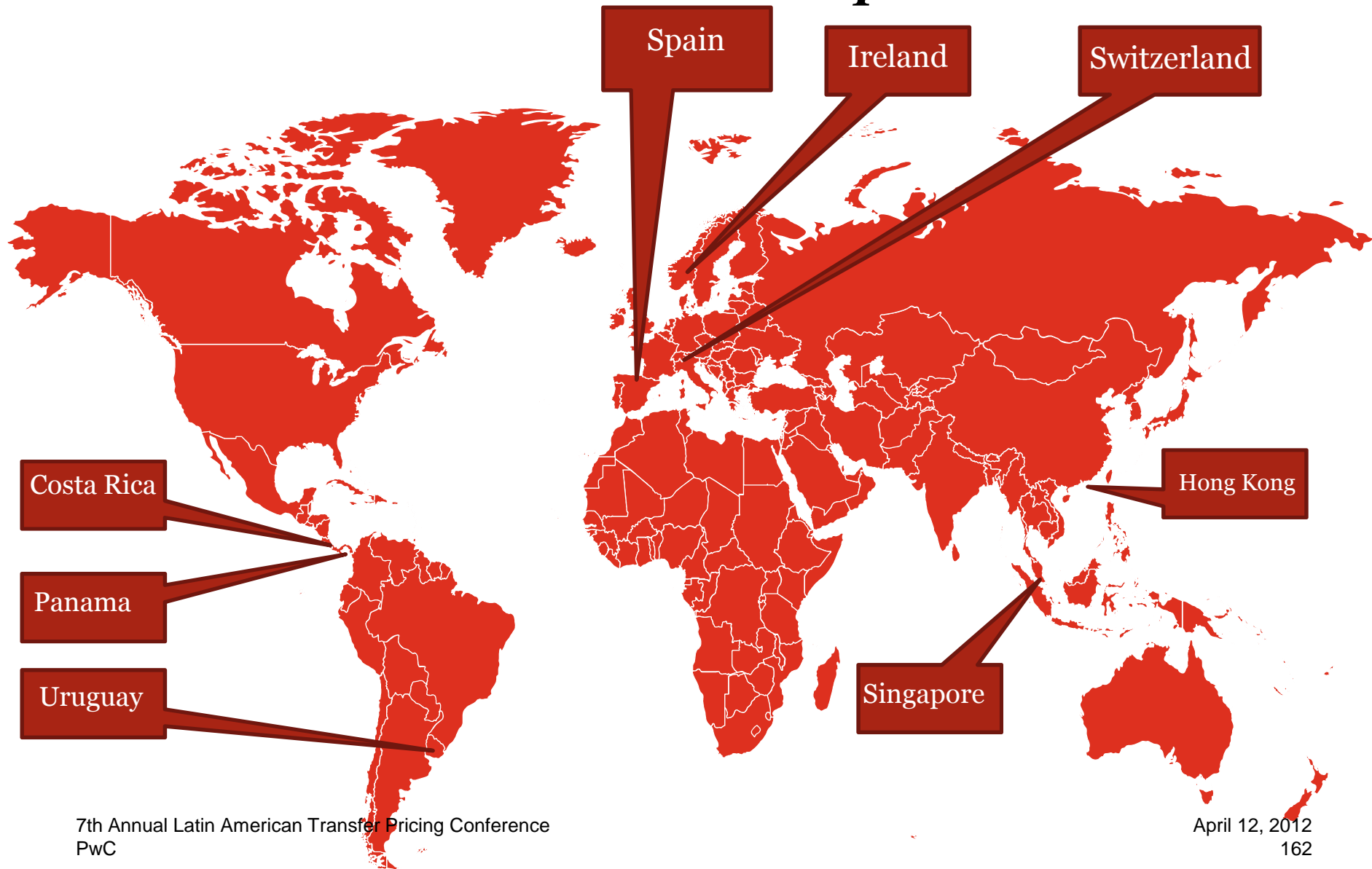
Marketing Production

Customer Relationships

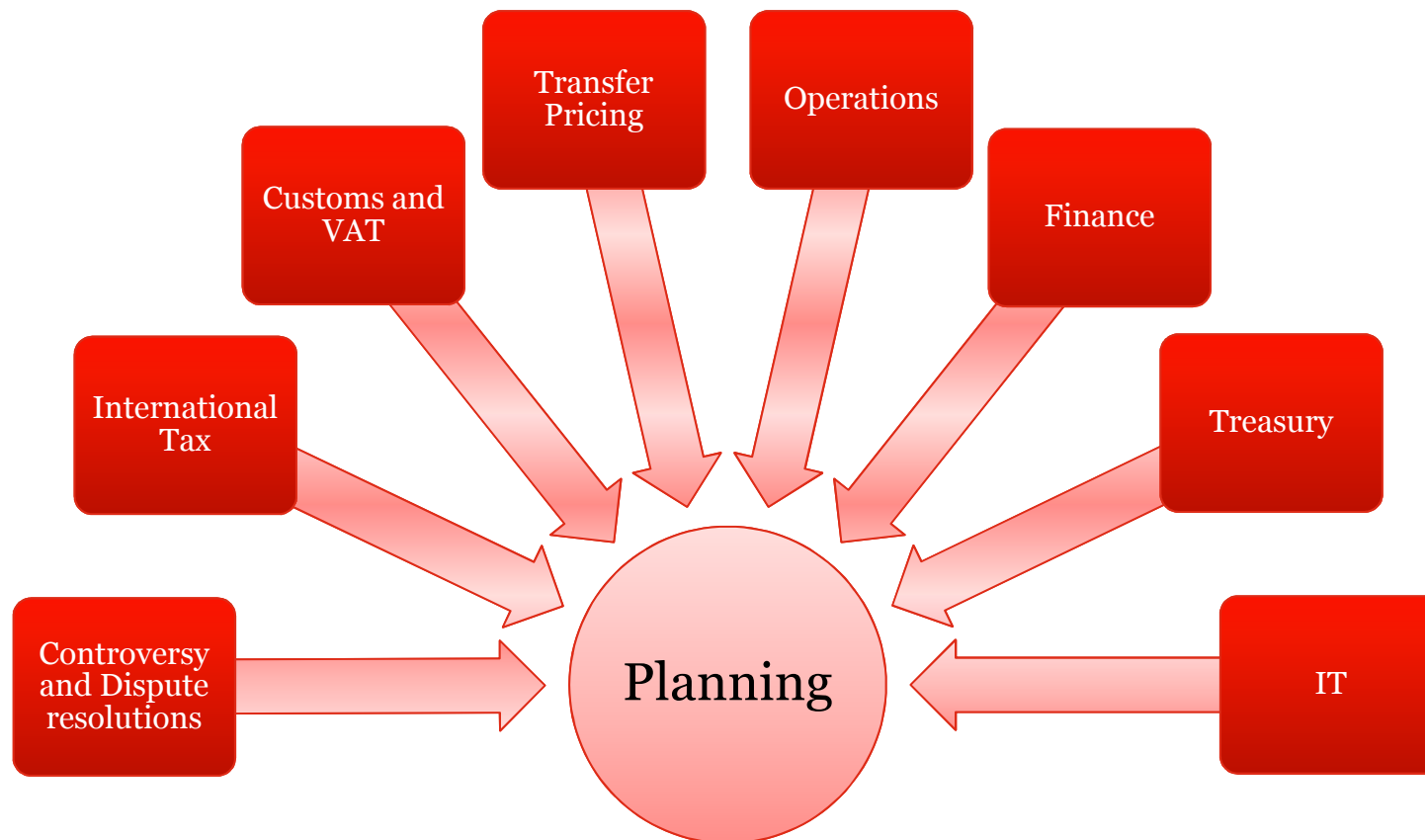
Distribution / Shared Services

- Centers of excellence that provide services to the Principal
- Potential for reducing local profit reflecting level of assets and risks
- Service providers deliver high quality focused service
- Sales force may remain locally
- Cost Centers take back-office processes out of business units

Countries to establish the Principal



Action – who is involved?



Key aspects to consider

In general, Latin America does not include specific regulations in regards to business restructures. However, taxpayers need to consider the following aspects:

- Economic substance
 - Transfer of personnel
- Business reasons
 - Not only considering tax benefits
- Exit charges
 - Whether there is any transfer of intangible property which needs to be remunerated
- Evaluate customs implications
- Evaluate if the new structure creates a Permanent Establishment
- Potential benefit and cost reduction
- Support and evidence:
 - Transfer pricing documentation, intercompany agreements, invoices, etc.

Uruguay – Business Restructurings

Daniel García – PwC Uruguay

Business Restructurings

- The OECD defines business restructurings as “the cross-border reorganization of functions, assets and risks in a multinational company”.
- The business restructurings within companies of the same group, need to establish a financial and commercial relationship as if they were dealing with unrelated parties in similar conditions (*arm’s length*).
- As part of the analysis, one of the key aspects to consider is the location of the functions, assets and risks where they can maximize the benefit.

Business Restructurings

- The profits of each entity will depend on the assets, functions and risks identified. More assets, functions and risk will increase profits.
- Generally, the company's profit is assigned to the intangible assets, financial and entrepreneurial risks.
- Intangible goods, functions and risks are easier to move than fix assets.
- Entities involved in a business restructuring change their functions and risk profiles.

Business Restructurings

- In summary, a business restructuring needs the following considerations:
- **Business rationale**
- **Economic substance**
- **Decision making skills**
- **Financial capacity to assume risks**
- **Real changes on functions**

Uruguay

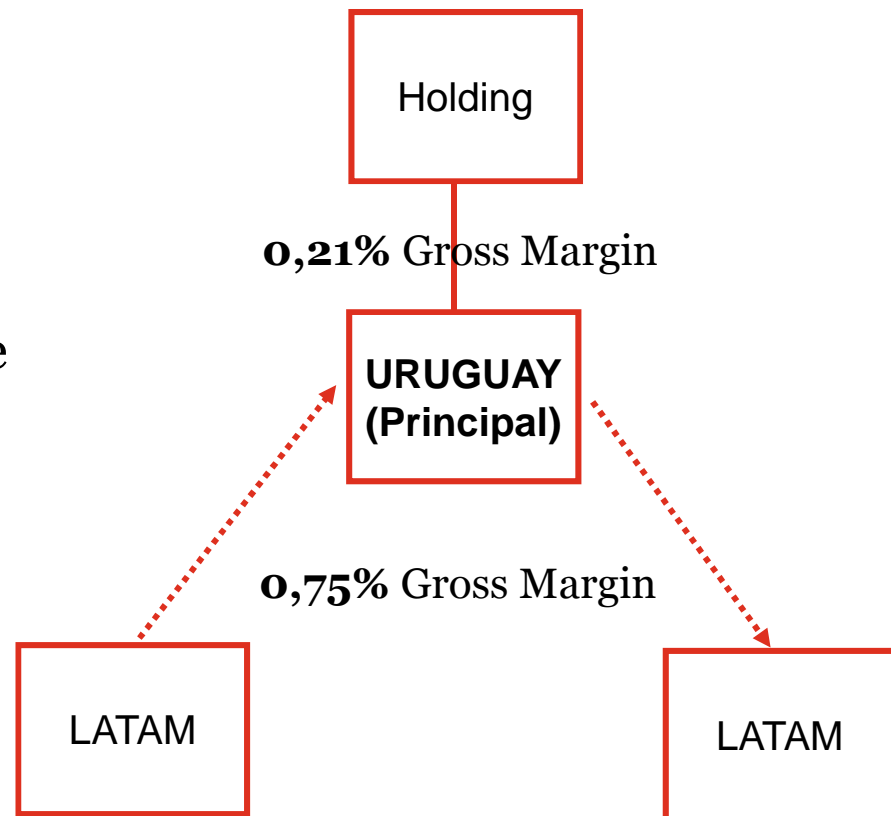
- **Source principle:** Under this principle, Uruguay is usually used for purposes of international and Regional business restructuring (does not require any law or specific instrument).
- **Specific Incentives:** If there is no specific tax benefit for the source principle, there are certain specific tax law incentives (i.e. free trade zone, investment law, etc.).
- **Free trade zone:** Tax exemption, created or to be created.
- **Treaty Network:** New treaty network, strengthen tax benefits.
- **APAs:** Advanced Pricing Agreements provide certainty to taxpayers.

Uruguay

Example 1: Source principle

URUGUAY = PRINCIPAL

- Buy/sell intermediary of tangible goods or services (no physical presence or utilization in Uruguay)
- Entity subject to general tax regime
- Income tax rate: 0,75% of gross margin (3% x 25%)
- Dividend rate: 0,21% of gross margin (3% x 7%)
- Mark-up subject to Transfer Pricing rules



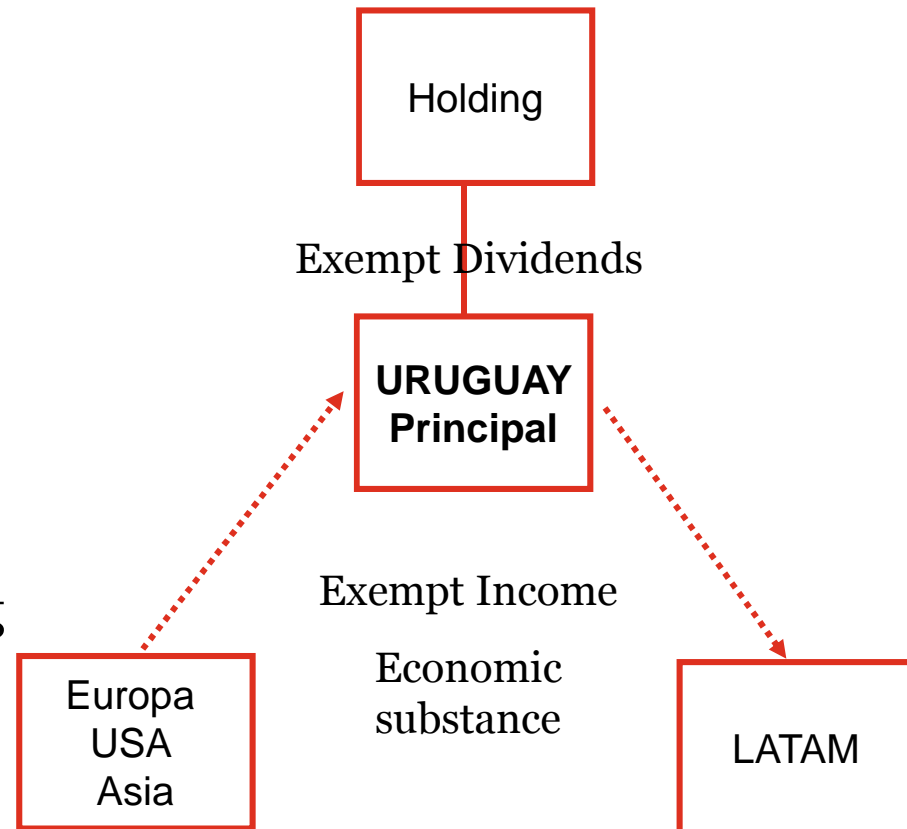
Uruguay

Example 2: Free trade zone

URUGUAY - PRINCIPAL

- Total tax exempt
- Exempt dividends
- Exempt payments for services of non-residents and use of intangibles
- Exempt payments to non-resident directors
- Mark-up subject to Transfer Pricing rules
- Economic substance: local requirement

(Treaty Network)



Chile – Business Restructurings

Loreto Pelegrí – PwC Chile

Business Restructurings – General Ideas

- Chile does not have specific legislation for “business restructurings”.
- According to local legislation (Constitución Política Art. 19N° 21 and 19N° 22 and Código Civil art. 1437 and 1445), entities are free to organize their business operations and therefore look for their own interest.
- Art. 64 CT and Art. 17 LIR, grant special power to Chilean IRS to assess the sales of tangible and intangible goods if the price is significantly lower than the arm’s length.

Business Restructurings – Applicable Rules

- When a business restructuring takes place, functions and risks of the restructured entity are modified.
- There is no specific rule or case law in Chile that treats the tax consequences of changing functions and risks, agreements, or structures, which can imply a modification of local profits.
- Art. 64 CT only treats domestic business restructuring (M&A). There is no rule that establishes an “Exit charge”.
- Transfer Pricing rules in Chile (Art. 38 de LIR) apply whether an entity has restructured or structured its business operations.

Business Restructurings and Double Tax Treaty

- Business restructurings can obtain benefits from double tax treaties.
- In Chile, from the “Exit Country” perspective, the taxpayer can obtain a benefit through the payment of certain goods or services necessary to produce income.
- All changes need to have “Economic substance”.
- A service payment can qualify as “business benefit” or as a “royalty” payment.

Business Restructurings and Tax Consequences – “Chile as an Entry Country”

- There is transfer of intangible risks, functions and more financial and commercial risks
- Restructure compensation – The transfer of “potential profit” generates a compensation payment. ¿Tax deductibility? Art. 31 of LIR
- Transfer Pricing rules apply
- Tax Credit - Payments received are considered ordinary income and therefore a tax credit for such payments or amount withheld will exit.
- Goodwill or intangible transfers. No amortization expense for tax purposes.

Business Restructurings and Tax Consequences – “Chile as an Exit Country”

- The intangible assets, functions and financial and commercial risks are transferred to other country
- Transfer Pricing rules apply
- Compensation: The payment received can be assessed by the Chilean IRS.
- PE risk: Employees with faculties to close business” / 183 days threshold.
- “Service Fee”- compensation based on functions, risks and assets, leaving an appropriate mark-up in “Exit Country”, considering activities in Chile.
- Local legislation does not consider an “Exit Tax”

Business Restructurings and Tax Consequences – “Termination or renegotiation of Agreements”

- There is no specific rule that regulates the termination or renegotiation of existent agreements - art. 1545 CC.
- “Exit Country” – compensation received for a reduction in “potential profits” is classified as ordinary income.
- “Entry Country” – Deductibility of the expense necessary to produce income.

Business Restructurings and Cases

- Change from “*Full Fledged Distributor*” to “*Commissionaire*”
 - There is no specific rules that grants SII the right to object such restructure
 - Taxation from SII (art. 64) when the transfer prices differs from the arm’s length.
- *Centralization of IP Rights and R&D activities*
 - “Exit Country” perspective = Substance and expense (norm art. 31 LIR) – additional tax
 - “Entry Country” perspective – Chilean IRS power to asses - ordinary income - tax credit.

Brazil – Business Restructurings

Cassius Carvalho – PwC Brasil

Key Aspects

- Different methods may apply to different types of transactions
- No “best method” or “most appropriate method” rule to determine the method to apply
- The selected method can be changed from one period to the next but once selected it must be applied to all transactions of same kind in that period
- The basis for the calculation is per product
- A “5% Divergence Margin” is admitted with respect to the benchmark price calculated according the methodology selected

Comparison Between Brazil and OECD Approach

Description	OECD approach	Brazil
Methods	Traditional: CUP, RPM, Cost Plus Transactional: Profit Split, TNMM	Traditional: CUP, RPM, CAP, with mark up defined by law. No profit based methods accepted
Methods selection	The taxpayer may select the most appropriate method to the circumstances of the case	The taxpayer may freely choose the method to be applied
APA	Yes	No
Approach	Methods could be applied per type of business (manufacturing, resale, distribution)	Methods should be applied per part number (product by product)
Documents requirements	Depends on each country	Annual calculation based on contemporaneous information
Penalty on failure to comply with requirements	Depends on each country	75% of unpaid tax

Risks and Opportunities Faced by Multinationals in Brazil

Practical Challenges

- TP documentation must be prepared on annual basis
- Import and export documents must comply with strict formalities; there are no provision of transfer in consignment or sale on behalf of , in case of cross-border transactions
- It is not possible to obtain APA in Brazil and existing rulings are limited to:
 - i. the clarification or enforcement of TP legislation
 - ii. to file a specific request in order to change the margin provided for in the legislation - not common in practice

Opportunities

- Taxpayers are allowed to choose the TP method that provides the most tax efficient result, and it can apply different TP methods per product in a given year

Some considerations on TP Planning in Brazil

- ✓ Sales or manufacturing models which are applicable to OECD standard may not be feasible under the Brazilian regulations, notably because our TP rules are not oriented by a functional or economic analysis (assets, risks and functions) but on a product by product analysis and also due to the fact that, under the Brazilian rules, in order for an entity to engage in manufacturing and local sales it should be incorporated as a Brazilian entity
- ✓ An efficient TP planning for Brazil should be oriented by a balance between the international rules and Brazilian rules and by reducing margins generated within the whole production chain the company would reduce the tax exposure for each transaction. The compliance with local rules is mandatory

Some considerations on TP Planning in Brazil

- ✓ VAT (Federal/State) impacts and customs duties must be taken into account in order to evaluate each scenario
- ✓ Need of business purpose and substance
- ✓ Cost-sharing arrangements: highly controversial matter, with divergent positions from the administrative and judicial courts

Interest deductibility

How to determine the deductibility of interest income / expense in Brazil?

- **Intercompany loan contract registered with the Brazilian Central Bank (“BACEN”)**: interest deduction is accepted according to the interest rate “approved” by the BACEN, and provided that thin cap rules are also observed (please refer to the next slide)
- **Intercompany loan contract NOT registered with the Brazilian Central Bank (“BACEN”)**: interest deduction is accepted if interests do not exceed US-Dollar LIBOR for six-month deposits plus a 3% annual spread
- **Thin capitalization rules**: must also be observed for loans contracted with related parties and with parties located in tax havens or under privileged tax regimes

Thin Capitalization Rules

- Interest expense must be viewed as necessary to the company's activities
- **Related parties**: different “debt / equity” tests applied based on a **2:1** ratio when interest is paid by a Brazilian company to a foreign related party
- **Tax havens**: For foreign parties (irrespective of being related parties) resident or domiciled in a tax haven or in a jurisdiction under privileged tax regime, a 0.3:1 ratio applies
- Not applicable to local debts / Interest on Net Equity

Tax Havens

Anti avoidance rules - tax havens

- Black list of tax haven jurisdictions recently updated by the Brazilian tax authorities
- Includes 65 tax havens (up from 53 published in 2002)
- Main adverse tax consequences for tax havens:
 - ✓ WHT rate increased from 15% to 25% on cross-border payments (royalties, services fees, interest on net equity) and capital gains accrued by non-residents
 - ✓ Potential non-deductibility of payments made to tax havens
 - ✓ Mandatory transfer pricing requirements/documentation
 - ✓ Lower debt-to-equity ratio (0.3:1 instead of 2:1)

Updated List of Tax Havens

- Andorra
- American Samoa
- American Virgin Islands
- Anguilla
- Antigua and Barbuda
- Aruba
- Ascension Island
- Bahamas
- Bahrain
- Barbados
- Belize
- Bermuda
- British Virgin Islands
- Brunei
- Campione D'Italia
- Cayman Islands
- Channel Islands
(Alderney, Guernsey,
Jersey and Sark)
- Cook Islands
- Costa Rica
- Cyprus
- Djibouti
- Dominica
- Dutch Antilles
- French Polynesia
- Gibraltar
- Granada
- Hong Kong
- Isle of Man
- Kiribati
- Labuan
- Lebanon
- Liberia
- Liechtenstein
- Macau
- Madeira Island
- Maldives
- Marshall Islands
- Mauritius Islands
- Montserrat
- Monaco
- Nauru
- Niue Isle
- Norfolk Island
- Oman
- Panama
- Pitcairn Island
- Queshm Island
- Saint Helena Island
- Saint Pierre and Miquelon
- Saint Kitts and Nevis
- Saint Vincent and Grenadines
- San Marino
- Santa Lucia
- Seychelles
- Singapore
- Solomon Islands
- Swaziland
- ~~Switzerland~~ **temporarily
suspended**
- Tonga
- Tristan da Cunha Island
- Turks and Caicos Islands
- United Arab Emirates
- Vanuatu
- West Samoa

List of Privileged Tax Regimes

The following types of entities were included in the list:

- Holding Companies in Luxembourg - **excluded**
- Financial Investment Corporations (SAFI) in Uruguay – **up to 2010, no longer in force**
- Holding Companies in Denmark, without substantial economic activity
- Holding Companies in The Netherlands, without substantial economic activity – **temporarily suspended**
- International Trading Companies (ITC) in Iceland
- Offshore Companies (KFT) in Hungary
- LLC in the US, owned by non-residents and not subject to US federal income tax
- Holding Companies (ETVE) in Spain - **temporarily suspended**
- International Trading Companies (ITC) and International Holding Companies (IHC) in Malta

Other Aspects Regarding Interest Deduction

Anti avoidance rules - deductibility limitation rules

Deductibility of cross-border payments to beneficiaries resident in tax havens / privileged tax regimes is subject to certain conditions:

- i. The effective beneficiary of the payment is identified
 - ii. Evidence that the payment beneficiary has operational capacity (i.e., substance)
 - iii. There is adequate documentation to support the relevant payments and the corresponding supply of goods, rights or utilization of services
- Not applicable to Interest on Net Equity

Tax Havens / Privileged Regimes: Summary

Tax havens / privileged tax regimes – adverse tax consequences

Rules	Non-related parties	Related parties	Tax haven (related or not)	Privileged tax regimes (related or not)
Transfer Pricing	No	Yes	Yes, no safe harbor for exports	Yes, no safe harbor for exports
Thin-Cap	No	2 : 1	0.3 : 1	0.3 : 1
Specific deductibility rules	No	No	Yes	Yes
WHT on royalties, services fees, capital gain and interest on net equity	15%	15%	25%	15%

Conclusions

- In summary, the critical factors for success in designing and implementing a model that delivers commercial value to the organization are:
 - ✓ A commercial model with tax input – not the other way around
 - ✓ Strong internal sponsorship of the change
 - ✓ Strong governance and central coordination
 - ✓ A team with key relationships across the business
 - ✓ Awareness that project teams will have different perspectives and motivation for change
 - ✓ Use of technical tools (i.e., documentation and APAs) or other mechanisms such as “rulings” that could give certainty to taxpayers in regards to such business restructures.

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