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# Venezuela

## Introduction

Venezuela experienced significant tax reform in 2001, especially in the area of transfer pricing. The 1994 Edition Venezuelan Master Tax Code (MTC) was amended in October 2001. The 2001 MTC establishes several transfer pricing principles, including penalties relating to noncompliance with transfer pricing regulations, specific rules for transfer pricing audit procedures and the introduction of advance pricing agreements (APAs) to the Venezuelan tax system. Additionally, in December 2001, Venezuela enacted new transfer pricing regulations under the Venezuelan Income Tax Law. The new Venezuelan transfer pricing rules adopt the arm's-length standard for related party transactions, adhere to the Organisation for Economic Co-operation and Development (OECD) Guidelines, eliminate the safe harbor regime established during 1999, impose transfer pricing documentation and filing requirements and contain APA provisions. With the addition of these new transfer pricing rules, Venezuela has taken an important and positive step towards the harmonisation of its tax system with the internationally accepted standards. Moreover, in February 2007, Venezuela introduced thin capitalisation rules to its Income Tax Law.

## Statutory rules

The newer transfer pricing rules came into force on 28 December 2001. The provisions are applicable to all fiscal years initiated on or after 1 January 2002. The newer transfer pricing rules are based on the internationally accepted arm's-length standard, and thus eliminate the previous safe harbor approach that specifically aimed at two types of transactions: importing, exporting and analysis of interest conducted by multinationals with their related parties in Venezuela.

Related parties are defined as parties that are directly or indirectly managed, controlled or owned by the same party or group, intermediary agents and any relationship between a Venezuelan taxpayer and entities located in low-tax jurisdictions (i.e. a country included in the list of tax havens). The arm's-length standard applies to all transactions, including transfers of tangible and intangible property, services and financial arrangements.

A controlled transaction meets the arm's-length standard if the results of the transaction are consistent with the results that would have been obtained if uncontrolled taxpayers had engaged in comparable transactions under comparable circumstances.

A controlled transaction may be compared to an uncontrolled transaction if that transaction complies with at least one of the following conditions:

- None of the differences, if any, between compared transactions or companies that carry out the compared transactions will materially affect the price or margin in the free market.
- Reasonably accurate adjustments may be made to eliminate the material effects of these differences.

The factors required to determine the differences between controlled and uncontrolled transactions, in accordance with the method used, are the following:

- The characteristics of the transactions.
- The functions or activities, including the assets used and risks assumed in the transactions, of each of the parties involved in the transactions.
- The contractual terms.
- The economic circumstances.
- The business strategies, including those related to the penetration, permanence and expansion of the market.

The transfer pricing methods specified in the Venezuelan Income Tax Law are basically the same as those contained in the OECD Guidelines:

- Comparable uncontrolled price method.
- Resale price method.
- Cost plus method.
- Profit split method.
- Transactional net margin method.

In terms of selection of the method, the Venezuelan Income Tax Law establishes that the taxpayer shall consider the comparable uncontrolled price as the method of first choice. The tax authorities will evaluate whether the method applied by the taxpayer is the most appropriate one given the characteristics of the transaction and the economic activity performed.

In late December 2010, through the Official Gazette N° 39.577, the Venezuelan Tax Administration introduced the procedure for the calculation of the arm's-length range. The procedure confirms the use of the inter-quartile range. Also, the procedure establishes that when the price, margin or amount of the transaction carried out between the taxpayer and foreign related parties is not within the arm's-length range, the taxpayer must adjust the results to the median.

### *Documentation*

Transactions and arrangements with foreign related parties must be reported to the tax authorities through an Informative Return, which must be filed within six months following the end of the fiscal year. This informative return must describe the types of inter-company transactions, the dates on which the transactions were executed, the amounts of each type of transaction, the transfer pricing method applied, and the result of each transaction (i.e. profit or loss). Further appendices require the taxpayer to disclose the profit and loss statement segregated in two columns: related and unrelated parties.

Moreover, the taxpayer must develop and maintain a transfer pricing documentation to support the analyses of its inter-company transactions. The Venezuelan rules

also require an extensive list of formal duties on transfer pricing (background documentation) that includes, among others, the following items:

- An analysis of fixed assets and the commercial and financial risks related to the transaction, including documentation to support the acquisition and use of assets.
- An organisational and functional overview of the taxpayer, including information about the relevant departments and/or divisions, strategic associations and distribution channels.
- Information regarding the foreign related parties, including type of business, main clients and shareholdings in group companies.
- An overview of the controlled transactions, including activities carried out, dates, prices paid or charged and the applicable currency.
- Information on the main activities carried out by each of the relevant group companies as well as data on any changes affecting the group as a whole, such as capital increases or mergers.
- Financial statements for the taxpayer's fiscal year, prepared according to generally accepted accounting principles, including balance sheet, income statement, stockholders equity statement and statement of cash flow.
- Agreements, conventions or treaties entered between the taxpayer and foreign related parties, including agreements related to distribution, sales, credits, guarantees, licenses, know-how, use of trademarks, copyrights, industrial property, cost allocation, research and development, advertising, trusts, stock participation, investments in securities, and other transfers of intangible assets.
- The method or methods used to set the transfer prices, indicating the criteria and objective elements considered to determine the proper application of the selected method.
- Information regarding the operations of the uncontrolled comparable companies.
- Specific information about whether the related parties abroad are or were subject to a transfer pricing audit or if they are involved in procedures by the transfer pricing competent authority or a court. In that case a resolution shall be issued by the competent authorities and a copy of the findings must be filed.
- Information regarding the inventory controls.
- Information related to functional analysis and transfer pricing calculations; and
- Any other information that may be deemed relevant or required by the Tax Administration.

## *Legal cases*

Some transfer pricing cases have been brought to the courts and one of them was resolved with ruling in favor of the Tax Administration. Transfer pricing audits began in February 2005 and have been expanding since then, both in the number of audits performed and in the scope of their requirements. Initially, the National Integrated Customs and Tax Administration Service (SENIAT as per its Spanish Acronym) visited several taxpayers requiring the transfer pricing support documentation detailed above, and the Tax Administration usually gave the taxpayers a three-to five-day period to submit the required information.

In July 2006, the SENIAT conducted the first extensive transfer pricing audit to the local subsidiary of a global Japanese automotive company. The SENIAT explained that the audit procedure was applied to control the transactions among the Venezuelan taxpayer and its foreign related parties, so as to ensure that such transactions were conducted at arm's length. SENIAT, acting under the guidelines of the 'Zero Tax

Evasion Plan', ensured that tax collection in this matter was not reduced as a result of illicit acts.

By the end of 2006, SENIAT's tax audit manager announced the reinforcement of the 'Zero Tax Evasion Plan' regarding transfer pricing audits, changing its previous focus on formal documentation compliance (availability of said documentation) thorough the audit of the arm's-length nature of the inter-company transactions that were detected by SENIAT's computerised system. Moreover, he stated that SENIAT's transfer pricing unit would be expanded and certain tax inspectors would be relocated from the economic studies section to the tax audits management.

Consequently, a few weeks after that announcement, the SENIAT notified the local affiliate of a foreign global oil and gas company that a transfer pricing adjustment of 17.7 million United States dollars (USD) was assessed by the transfer pricing unit using its databases, supporting documentation and analyses. This was the first transfer pricing adjustment in Venezuela, and it is related to certain financial transactions of the Venezuelan taxpayer involved with its foreign related parties. In addition, SENIAT's head officer had warned that the transfer pricing audits were going to be reinforced and would focus on the oil and gas industry.

In April 2007, a local filial company of the foreign oil and gas company accepted part of the transfer pricing adjustment proposed by the SENIAT and paid USD 13.7 million, concluding the first transfer pricing case in Venezuela.

During 2007 and 2008, the audit activity in the oil and gas business and related sectors in Venezuela continued as part of the migration (conversion) from operating agreements and strategic associations of the Orinoco Oil Belt to mixed companies. The main issue in these audits was the transactions carried out with related parties abroad.

Since the beginning of 2009, SENIAT has carried out several transfer pricing audits of taxpayers from several industrial sectors and concluded some audits with adjustments to taxpayers, including the automotive, pharmaceuticals and good-composition companies. Transfer pricing adjustments exceeded USD 25 million in 2009, in which the main issues rejected were tax deductions and the calculation of the arm's-length ranges. Other items reviewed by the Tax Authority within audits included financial segmented information, supports related to services, shut-down costs, restructuring expenses, idle capacity and selection criteria of comparable companies in the application of the transactional net margin method.

In 2010 the Tax Administration continued with audits process and made transfer pricing adjustments to companies in the food and automotive sectors.

In 2011 an important telecommunication company paid USD 45,052 to the Tax Administration after a transfer pricing audit process due to irregularities in the adjustment to the interest rates paid on loans carried out with its headquarter domiciled abroad in 2004.

Additionally, an important automotive company paid USD 1,404,790 to the Tax Administration due to omitted taxes which generated a penalty of 10% plus default interests.

In the last two years and especially in 2012, the tax administration has focused on the verification of formal duties, specifically it has audited those taxpayers, who according to their databases, may be subject to the regime, but have not reported or documented the transactions under such regime.

## *Burden of proof*

The burden of proof lies with the taxpayer. However, a challenge by the SENIAT would require adequate supporting evidence if such challenge is to be accepted by the tax courts.

Any transaction between a Venezuelan taxpayer and an entity located in a low-tax jurisdiction will automatically be presumed to be a transaction with a related party and will also be considered not to take place at arm's length. In such cases, the taxpayer has the burden of proof, and it will be necessary to demonstrate either of the following:

- The counterparty to the transaction was an independent third party.
- If the counterparty to the transaction is a related party, the transaction was carried out at arm's length.

## *Tax audit procedures*

The Master Tax Code (MTC) establishes specific rules for transfer pricing audits:

- When a tax objection is made by the SENIAT during a transfer pricing audit, the taxpayer may either accept the objection and settle with the Tax Administration, or start summary proceedings to defend its position. The taxpayer has more time to submit the defence documents and collect proof than in a regular summary proceeding: five months as opposed to 25 days.
- Within the first 15 days of the summary proceeding, the taxpayer may designate a maximum of two representatives to evaluate the information gathered by SENIAT regarding related party transactions. Such representatives may be replaced once.
- The period for furnishing proof is the same granted to a regular proceeding with SENIAT: a maximum of 30 days. SENIAT has a two-year period to make a decision about the transfer pricing audit once the period of negotiations and information exchange is over.

## *Tax penalties*

The MTC specifies three types of situations where penalties might arise:

- Various noncompliance issues relating to filing and documentation requirements; the most relevant penalty relates to the non-application of the transfer pricing methodology set up in the Venezuelan Income Tax Law.
- The illegitimate reduction of the taxable income because of action or omission of the taxpayer. The penalty ranges from 25% to 200% of the tax omitted.
- Fraud on the part of the taxpayer. This is subject to a jail sentence ranging from six months to seven years. The penalties established on the MTC are summarised in the table opposite.

## *Use and availability of comparable information*

Comparable information is required to support the arm's-length nature of related party transactions and should be included in the taxpayer's transfer pricing documentation.

However, there is lack of reliable public financial information available about Venezuelan companies. Therefore, reliance is placed on foreign comparables.

The SENIAT has the power to use third-party confidential information. The taxpayer has limited access to this data through its two appointed representatives, who are then personally liable and subject to criminal prosecution if the data is disclosed.

## *Risk transactions or industries*

No substantial basis yet exists to identify any particular industrial sector or type of transaction especially sensitive to risk. Nevertheless, the SENIAT is conducting investigations on some taxpayers in sectors that show high profitability or growth such as energy, oilfield services, automotive, pharmaceuticals, consumption goods and financial services, among others.

## *Advance pricing agreements*

The MTC enables the Tax Administration to approve or reject APAs and establishes the formal rules governing the APA application procedure. This procedure includes a list of the various documents that must be provided along with a taxpayer's application.

The taxpayer should present a proposal to the SENIAT for the valuation of one or more transactions, providing evidence that such transactions comply with the arm's-length standard. The proposal should be prepared by the taxpayer and should be based on an accepted transfer pricing methodology. The SENIAT can determine the format of the documents to be provided by the taxpayer in the proposal. The APA proposal can be bilateral in cases involving the territories of tax treaty partners.

The APA process must be concluded by the end of the third year after the year of application. This period may be extended if the APA is being negotiated through a competent authority under a double tax treaty.

Either party may terminate the APA application process if commercial or operational changes occur in the assets, functions or risks of the relevant parties.

The SENIAT may terminate the APA if it concludes that fraud was committed or false information was provided in the APA proposal. The SENIAT may terminate an APA in the event of noncompliance with the agreed terms and conditions. If the SENIAT rejects an APA application, the taxpayer cannot seek any of the administrative solutions included in the MTC and other laws. The only course of action available is to initiate a new APA application.

## *OECD issues*

Although Venezuela is not a member of the OECD, Venezuelan tax authorities have adopted the arm's-length standard and the use of the methodologies endorsed by the OECD Guidelines.



## *Joint investigations*

Joint investigations with the tax authorities of tax treaty partners are possible. Currently, Venezuela has an important network of tax treaties with countries such as Spain, France, Italy, the UK, Germany, the Netherlands, Switzerland, Portugal, Sweden, the Czech Republic, Trinidad and Tobago, Norway, Mexico, and the US,

among others. Most of the Venezuelan tax treaties follow the OECD model and its Guidelines.

## *Thin capitalisation*

On 16 February 2007, the partial amendment of the Venezuelan Income Tax Law included Article 118 to introduce thin capitalisation rules. These rules state that the interest paid directly or indirectly to related parties will be tax-deductible only if the amount of the debts with the related parties (directly or indirectly received) plus the debts with independent parties does not exceed the amount of the taxpayer's equity. This debt-equity ratio of 1:1 is the strictest in Latin America, where most of the countries require a 3:1 ratio.

Moreover, to determine if a debt was received at arm's-length conditions, the tax authorities will consider (1) the level of debt of the taxpayer, (2) the possibility that the taxpayer could have obtained the loan from an independent party without the intervention of a related party, (3) the amount of debt that the taxpayer could have obtained from an independent party without the intervention of a related party, (4) the interest rate that the taxpayer would have obtained from an independent party without the intervention of a related party; and (5) the terms and conditions of the debt that the taxpayer would have obtained from an independent party without the intervention of a related party.