

Transfer Pricing in Latin America and the Caribbean

A General Overview based on CIAT Data's Transfer Pricing Information updated to November 2019



Inter-American Center of Tax Administrations

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German International Cooperation Agency (GIZ)

Inter-American Center of Tax Administrations (CIAT)

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Words from CIAT's Executive Secretariat

For more than a century¹, controlling the abusive manipulation of transfer prices has been one of the great challenges of tax authorities worldwide. Experts from all over the world have devoted considerable resources to discussing and investigating this matter. However, there are many barriers to overcome both in the regulatory and administrative fields. The “ideal” transfer pricing regime should have reasonable compliance and administration costs, generate certainty and be manageable by the tax administration while not presenting a barrier to international trade.

Thanks to the technical contributions of our member countries, it was possible to update our transfer pricing database² to reflect the regulatory and administrative aspects of transfer pricing in the Latin American and Caribbean countries. This has allowed us to know the current regional context and its main challenges. Thanks to this information, CIAT, along with the work of recognized international experts and members of our International Tax Network, recently published the proposal “A Cocktail of Measures for the Control of Abusive Transfer Pricing Manipulation, with a Contextual Focus on Low-Income and Developing Countries” which aims to address many of the challenges outlined above.

The current work makes use of the information published by CIAT Data, as well as some of the recommendations found in the ‘Cocktail’, to present a comparative analysis of the similarities and differences found in the transfer pricing regimes of more than 20 countries in the Latin American and Caribbean region. The comparison includes aspects related to efficient application techniques, highlighting good regulatory and administrative practices. This allows us to reflect on the degree of progress in the region, in both an individual and aggregated manner.

I am convinced that this book will be a useful tool for tax administrations, and the international tax community, to learn about the current regional landscape, to complement training efforts, to identify areas of improvement and development that may be deemed replicable through bilateral cooperation.

In the name of the Executive Secretariat of CIAT, I thank all of those who made this publication possible.



Marcio Verdi

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- 1 The first jurisdiction to promulgate an internal standard to combat transfer pricing manipulation was the United Kingdom, through its Law on Finances of 1915.
 - 2 Database available at www.ciat.org/transfer-pricing/?lang=en.

Content

Acknowledgments.....	v
Words from CIAT’s Executive Secretariat.....	vii
Abbreviations and Acronyms	17
1. Introduction to the General Aspects of the Region	19
1.1. Burden of Proof.....	25
2. Defining Related Parties that are Subject to the Transfer Pricing Regime.....	28
3. Formal Obligations.....	35
3.1. Transfer Pricing Return.....	36
3.2. Transfer Pricing Documentation Report	37
3.3. Other Aspects	41
3.3.1. Taxpayer Compliance Regarding Documentation Requirements ...	41
3.3.2. Transactions with Tax Exempt Entities	41
3.3.3. Mandatory Disclosure Rules of BEPS Action 12	42
4. Sanctioning Systems.....	43
5. The Comparability Analysis	48
5.1. The Use of Comparables.....	51
6. Information Sources for Transfer Pricing	53
6.1. Advantages and Disadvantages of Databases	56
7. Transfer Pricing Methods.....	58
7.1. Comparable Uncontrolled Price Method (CUP).....	59
7.2. Cost-Plus Method (CPM).....	59
7.3. Resale Price Method (RPM)	60
7.4. Transactional Net Margin Method (TNMM)	60
7.5. Profit-Split Method (PSM).....	60
7.6. The So-Called ‘Sixth Method’ (also known as the ‘Commodity Rule’).....	61
7.7. Methods Used Across the Latin American and Caribbean Regions	64
7.8. The Tested Party	66

8. Financial Indicators – Profit Level Indicators.....	67
9. Economic Sectors	70
10. Intra-Group Interest Rates	74
11. Transfer Pricing Adjustments	76
11.1. Comparability Adjustments	78
11.2. Primary and Corresponding Adjustments	79
11.3. Secondary Adjustments.....	80
12. Transfer Pricing Controls.....	81
13. Judicial Aspects.....	91
14. Organizational Structure	95
14.1. Resources for Strengthening the Tax Administration.....	102
15. Advanced Pricing Agreements (APA)	105
15.1. Controversies.....	112
16. Simplified Measures	114
16.1. Designing the Measures	115
17. Transfer Pricing in Relation to Double Taxation Agreements	121
17.1. The Varying Model Tax Conventions.....	123
17.2. Make Up of the Delegation.....	125
17.3. Application.....	127
18. Exchange of Information for Tax Purposes	128
18.1. Multilateral Convention on Administrative Assistance in Tax Matters (MAC)	128
18.2. The Exchange of Information Provision in Tax Treaties (Article 26 of the OECD and UN Model Tax Conventions)	129
18.3. Tax Information Exchange Agreements (TIEA).....	130
18.4. Beneficial Ownership	131
19. Anti-Abuse Rules.....	134
20. Aspects Related to Tax Havens	139
20.1. Tax Haven Abuse and BEPS	143
21. Aspects Related to the OECD’s BEPS Project.....	144

Annexes	147
Annex Chapter 1 – General Aspects	147
Annex Chapter 2 – Definition of Related Parties	148
Annex Chapter 3 – Formal Obligations.....	148
Annex Chapter 4 – Sanctioning Systems	150
Annex Chapter 6 – Public Information Sources for Transfer Pricing	151
Annex Chapter 7 – Transfer Pricing Methods	152
Annex Chapter 9 – Economic Sectors.....	155
Annex Chapter 11 – Adjustments.....	156
Annex Chapter 12 – Transfer Pricing Controls	157
Annex Chapter 14 – Organizational Structure	159
Annex Chapter 16 – Simplified Measures	160
Annex Chapter 21 – Aspects Related to BEPS.....	161
Annex – Paraguay’s Transfer Pricing Regime (2019).....	163

List of Charts

Chart 1.1: Date of adoption and entry into force of the transfer pricing rules, per country.	20
Chart 1.2: Time period (in years) between the adoption and effective operation of the transfer pricing regime (considering a sample size of 20).	22
Chart 1.3: Distribution of the participating countries according to their classification (considering a sample size of 23).....	24
Chart 1.4: Elements included in the transfer pricing rules of various countries (considering a sample size of 23).....	24
Chart 2.1: Most common criteria used to classify a relationship under the transfer pricing regime (considering a sample size of 19).	29
Chart 2.2: Level of capital participation (direct or indirect) which constitutes a relationship as per domestic transfer pricing rules (considering a sample size of 13).	33
Chart 2.3: Percentage of participation deemed as influential over the decision-making or control of the company (considering a sample size of 11).	34

Chart 3.1:	Information required in the transfer pricing report (considering a sample size of 16).	36
Chart 3.2:	Period during which taxpayers are required to maintain the transfer pricing return and related documentation report (considering a sample size of 18).	39
Chart 3.3:	Other documents which may be requested by the tax administration to verify the details of the related party transactions (considering a sample size of 18).	40
Chart 4.1:	Description of domestic sanctioning systems (considering a sample size of 19).	44
Chart 5.1:	Number of countries that carry out field inspections (considering a sample size of 22).	49
Chart 5.2:	Number of countries that regularly request information from other countries (considering a sample size of 18).	50
Chart 5.3:	Types of comparables provided for in the transfer pricing analysis (considering a sample size of 19).	52
Chart 6.1:	Type of databases used for transfer pricing control within the countries examined (considering a sample size of 20).	54
Chart 6.2:	Types of databases used for transfer pricing of commodities, interest and royalties (considering a sample size of 19).	55
Chart 7.1:	Allowable methods according to domestic legislations in 2016 (considering a sample size of 19). (For more detailed information see the annex of chapter 7).	65
Chart 7.2:	Determination of the tested party according to domestic legislation (considering a sample size of 19).	66
Chart 8.1:	Most common financial indicators as reported by countries in 2016 (considering a sample size of 16).	68
Chart 9.1:	Main economic sectors as reported by the participating CIAT member countries (considering a sample of 22).	70
Chart 9.2:	Sectors in which the most transfer pricing risks are perceived by the tax administrations of LAC CIAT member countries (considering a sample size of 21).	71
Chart 9.3:	Actual occurrences of transfer pricing manipulations per sector (considering a sample of 16).	72
Chart 9.4:	Performance of sector specific audits versus general audits (considering a sample size of 18).	73
Chart 10.1:	Methods used by the tax administration for control of the interest rates applied to related-party loans (considering a sample size of 15).	75
Chart 11.1:	Transfer pricing adjustments used by LAC CIAT member countries (considering a sample size of 12).	76

Chart 11.2: Which party the transfer pricing adjustments are applied to (considering a sample size of 17).	77
Chart 11.3: Reasons for rejecting the taxpayer’s adjustments.	79
Chart 12.1: Number of Transfer Pricing cases vs. Number of Specialized Officials in the Tax Administration in 2015.	83
Chart 12.2: Reported number of months to complete an audit (considering a sample of 14).	86
Chart 12.3: Main barriers reported by the tax administration when performing audits (considering a sample of 17).	89
Chart 13.1: Presence of a judicial court specialized in taxation cases (considering a sample of 18).	91
Chart 13.2: The existence of transfer pricing verdicts in the participating countries, as of 2018 (considering a sample of 16).	93
Chart 14.1: Main functions of the abovementioned units within the tax administration (considering a sample of 19).	97
Chart 14.2: Number of transfer pricing specialists in the tax administration in 2015.	98
Chart 14.3: Professional profiles that construct the transfer pricing team (considering a sample size of 18).	99
Chart 14.4: Number of information exchange officials available in the specialized unit at the tax administration as of 2017.	102
Chart 14.5: Availability of collaboration between the tax administration and other domestic or international entities for dealing with transfer pricing issues (considering a sample of 18).	103
Chart 15.1: Availability of MAP in the region as of 2018 (considering a sample of 17).	106
Chart 15.2: Use of the ‘secret’ information attained through APA applications for transfer pricing control purposes (considering a sample of 11).	109
Chart 15.3: Expected legal duration of an APA (considering a sample of 12).	110
Chart 16.1: Simplified measures present in the region (considering a sample of 12).	114
Chart 16.2: Belief that double taxation is likely to be generated by domestic or foreign simplified measures (considering a sample of 13).	116
Chart 16.3: The reduction or elimination of taxpayer compliance burdens according to the tax administration (considering a sample of 11).	117
Chart 16.4: Achievement of an arm’s length result through the implementation of the simplified measures, according to the tax administration (considering a sample size of 7).	118
Chart 16.5: The sixth method’s general achievement of results reflective of the market price (considering a sample of 13).	119

Chart 16.6: The sixth method's consistent achievement of results reflective of the market price (considering a sample of 12).	119
Chart 17.1: Models used for the negotiation of tax treaties (considering a sample of 21).....	124
Chart 17.2: Profile of the representatives that make up the delegation (considering a sample size of 21, it may be that representatives from multiple areas are chosen by the country).	125
Chart 17.3: Agency responsible for the interpretation of the treaties (considering a sample of 22).....	126
Chart 17.4: Agency responsible for the application of tax treaty provisions (considering a sample of 22).....	127
Chart 18.1: Number of tax treaties containing a clause for the exchange of information, per country as of December 2018 (estimated).	130
Chart 19.1: Timeline for the entry into force of GAAR's per country.	134
Chart 19.2: Anti-Abuse regulations present in the analyzed countries (considering a sample of 18).	135
Chart 19.3: Countries with thin-capitalization rules (considering a sample 20).....	136
Chart 19.4: Year of entry into force of thin-capitalization rules.....	137
Chart 19.5: Countries with rules meant to curb the use of tax havens (considering a sample of 21).....	137
Chart 20.1: Common forms of evasion through tax havens (considering a sample of 15).....	143

List of Figures

Figure 5.1: Aspects of the functional analysis.....	48
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List of Tables

Table 1.1: Date of adoption and entry into force of the transfer pricing regime.....	19
Table 1.2: Allocation of the burden of proof per country.....	27
Table 2.1: Taxpayers who fall subject to the transfer pricing regime.	29
Table 2.2: Some examples of criteria which constitute a deemed relationship.....	31

Table 2.3:	Relationship criteria for subjecting taxpayers to the transfer pricing regime.	32
Table 2.4:	Proportion of transactions required to establish a relationship.....	33
Table 3.1:	Documentation requirements per country.....	35
Table 3.2:	Differences between the deadlines to submit the transfer pricing return and/or report versus the income tax return.....	38
Table 4.1:	Sanctions imposed on taxpayers who commit material infractions.	45
Table 4.2:	Sanctions imposed on taxpayers for various formal infractions.	45
Table 5.1:	Transfer pricing experience and the request of information (descending order).	51
Table 6.1:	Various database options.	53
Table 6.2:	Internal sources of domestic market information (public databases used for transfer pricing analysis) (considering a sample size of 22).	56
Table 7.1:	Procedure for taxpayers to choose the transfer pricing method, according to domestic legislation.....	59
Table 7.2:	Variations on the so-called 'sixth method' application.	63
Table 7.3:	Per country report of the most used transfer pricing method.....	64
Table 9.1:	Most used method in each sector as reported by the countries.....	73
Table 12.1:	Average number of cases per year (descending order).	82
Table 12.2:	Average Yearly Revenue Collection from 2010-2015.	84
Table 12.3:	Estimated time for the tax administration to conclude a transfer pricing audit.	85
Table 12.4:	Performance of sophisticated audits.....	88
Table 13.1:	Countries with jurisprudence of taxation cases as of 2016.	92
Table 13.2:	Number of transfer pricing cases in dispute as of 2016 (descending order).....	92
Table 13.3:	Tax related cases from 2009-2016 resulting in favor or against the tax administration.	93
Table 14.1:	Specialized unit within the tax administration for international tax and transfer pricing issues.	95
Table 14.2:	Change in the quantity of transfer pricing experts in the specialized units.	98
Table 14.3:	Estimated gross salary per country for managerial/supervisory positions in 2015 (USD).....	100
Table 14.4:	Estimated gross salary per country for analyst/specialist positions in 2015.	101
Table 14.5:	Estimated gross salary per country for auditor positions in 2015.....	101
Table 15.1:	Availability and types of APA's in Latin America and the Caribbean (considering a sample of 23).	105
Table 15.2:	Tax administration's expected response time for an APA request as of 2018 (in descending order).....	107
Table 15.3:	Regulations relating to the requirements of APA applications.	108
Table 15.4:	Documentation and details to be included in the APA application (considering a sample of 13).	109
Table 15.5:	Selected economic sectors for the elaboration of APA's.....	112
Table 16.1:	Number of taxpayers who benefitted from the simplified measures. ...	120

Table 16.2: Formalities and other obligations brought about by the application of the simplified measures.	120
Table 17.1: Number of double tax treaties signed as of 2016 per country.	122
Table 18.1: Country ‘Beneficial Ownership’ (BO) definitions.	131
Table 20.1: Domestic legislation giving legal effect to the ‘blacklist’.	140
Table 20.2: Rates that may constitute a tax haven, according to the countries examined.	141
Table 20.3: Exchange of information circumstances that may constitute a tax haven, according to the countries examined.	141
Table 20.4: External source criteria to assist in defining a tax haven, according to the countries examined.	142
Table 21.1: Overview of the actions being implemented by some of the LAC CIAT member countries as of June 2019.	145

Abbreviations and Acronyms

ATAD 1	– European Union Council Directive 2016/1164 of 12 July 2016.
BEPS	– Base Erosion and Profit Shifting.
BO	– Beneficial Owner.
CbC	– Country by Country Report.
CFC	– Controlled Foreign Company.
CIAT	– Inter-American Center of Tax Administrations.
CIAT-GIZ Transfer Pricing Cocktail	– “A Cocktail of Measures for the Control of Abusive Transfer Pricing Manipulation, with a Contextual Focus on Low-Income and Developing Countries” document published by CIAT in 2019.
CRS	– Common Reporting Standard.
DTC	– Double Tax Convention.
EBITDA	– Earnings before Interest, Taxes, Depreciation and Amortization.
EU	– European Union.
G20	– ‘Group of Twenty’ International Forum.
GAAR	– General Anti-Abuse Rule.
GDP	– Gross Domestic Product.
Global Forum	– Global Forum on Tax Transparency and Exchange of Information.
Inclusive Framework	– OECD/G20 Inclusive Framework on BEPS.
IMF	– International Monetary Fund.
LAC	– Latin America and the Caribbean.
LOB	– Limitation on Benefits.
MAC	– Multilateral Convention on Administrative Assistance in Tax Matters.
MCAA	– Multilateral Competent Authority Agreement.
MLI	– Multilateral Instrument.
OECD	– Organization for Economic Cooperation and Development.
OECD Global Forum	– Global Forum on Transparency and Exchange of Information for Tax Purposes.
OECD Model Tax Convention	– OECD Model Tax Convention on Income and on Capital (2017).
Parent/Subsidiary Directive	– European Union Council Directive 2011/96/EU of 30 November 2011.
PPT	– Principal Purpose Test.
SAAR	– Specific Anti-Abuse Rule.
TIEA	– Tax Information Exchange Agreement.
UN	– United Nations.
UN Manual on Transfer Pricing	– United Nations Practical Manual on Transfer Pricing for Developing Countries (2017).
UN Model Tax Convention	– United Nations Model Double Taxation Convention between Developed and Developing Countries (2017).
USD	– United States Dollars.

1. Introduction to the General Aspects of the Region

In recent years, the risks posed by transfer pricing have demanded increasing attention from the tax administrations of Latin American and the Caribbean countries. This attention might be the result of various developments such as the convergence process through which transfer pricing rules have been disseminated (especially after the issuance of the Report on Action 13 of the Base Erosion and Profit Shifting (BEPS) project), or, due to the tax compliance risk that this issue represents for the economic sectors in the region. For example, the asymmetries in the tax burden (Tax Paid/GDP) between Latin American and Caribbean countries of approximately 10% to more than 30%, generate an environment that promotes profit shifting within the region. The experiences and knowledge acquired by tax administrations has been facilitating the progress and further development of this field in the region. However, the data presented in this book shows a notorious difference in the transfer pricing achievements between Latin American countries and the Caribbean countries. This is logical considering that the transfer pricing control rules have been in force for more than two decades in Latin America while only for a few years in some Caribbean countries. As will be exemplified throughout this document, the transfer pricing rules in question vary greatly from one country to the next; some tailored to meet specific characteristics while others are more aligned with the ‘Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations’ by the Organization for Economic Cooperation and Development (OECD), hereafter known as the ‘OECD Transfer Pricing Guidelines’.

The following table shows the year in which the transfer pricing control rules were introduced in the analysed Latin American and Caribbean countries, as well as, the period elapsed between the adoption of such rules and their entry into force.

Table 1.1: Date of adoption and entry into force of the transfer pricing regime.

Country	Year of Approval of the Legislation	Year of Entry into Force	Years elapsed (between approval and implementation)
Argentina	1998	1998	0
Bolivia	2014	2014	0
Brazil	1996	1997	1
Chile	1997	1997	0
Colombia	2003	2004	1
Costa Rica	2003	2003	0
Ecuador /1	1999	2005	6
El Salvador	2009	2010	1
Guatemala	2012	2013	1
Honduras	2011	2014	3
Jamaica	2015	2015	0
Mexico	1992	1992	0
Nicaragua /2	2013	2017	4
Panama	2010	2011	1
Paraguay /3	2013	2014	1
Peru	2000	2001	1

Country	Year of Approval of the Legislation	Year of Entry into Force	Years elapsed (between approval and implementation)
Dominican Republic /4	1992	2011	19
Suriname	1992	1992	0
Uruguay	2006	2007	1
Venezuela	1999	1999	0

1/ In Ecuador, a reform to the Tax Code was introduced in 1999 that empowered the Tax Administration to regulate transfer prices. However, the complete regime, with basic elements such as the arm's length principle, comparability criteria, etc. were introduced in 2004, coming into force in 2005.

2/ The case of Nicaragua is somewhat atypical. The transfer pricing regime in chapter V, is still pending application (Law 822 - Tax Law Arrangements)

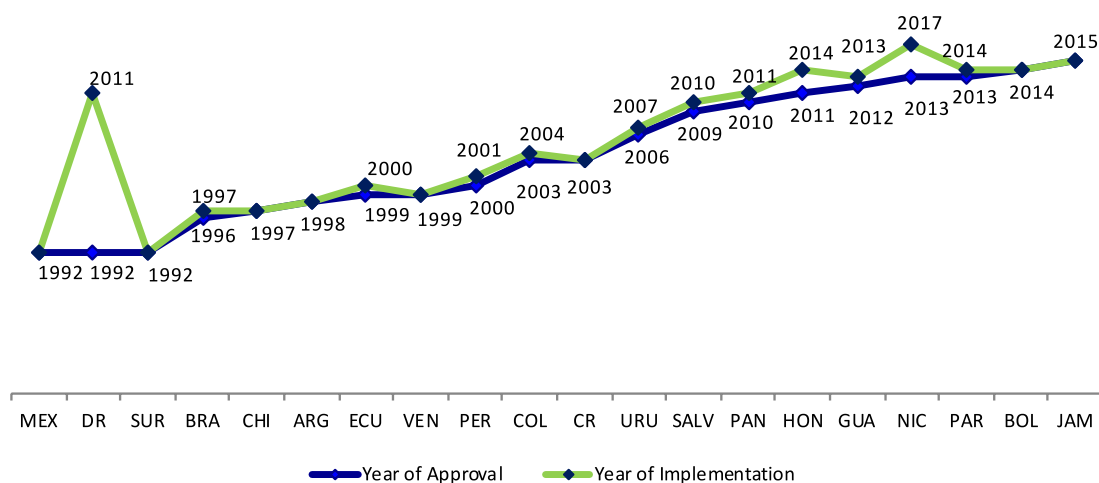
3/ In Paraguay there is a formulary price adjustment rule, which applies to agricultural exports of soy products and its derivatives. However, the country is in the process of reforming its transfer pricing regime, these new regulations, in-force as of January 1, 2020, are further detailed in the Annex - Paraguay

4/ In 1992, Art. 281 of the Tax Code introduced the arm's length principle; "The legal contracts concluded between a local company of foreign capital and a legal entity domiciled abroad which directly or indirectly controls it, will be considered made between independent parties when its provisions are in line with the normal market practices of unrelated entities." Over the years, changes were made to Article 281; linking elements were included (Law 139-98, 1998), the concept of transfer pricing and advance pricing agreements (Law 495-06, 2006) is introduced and in 2011 the valuation methodology rules and other elements in line with the OECD Transfer Pricing Guidelines were included. For this reason, the transfer pricing rules have been applicable since 1992, although the adaptation to the OECD methodology was effective as of 2011.

Source: Transfer Pricing Database, Section 1, General Aspects. Accessed through CIAT Data, 2019.

The graphical representation below highlights in chronological order the number of years that elapsed between the adoption of domestic transfer pricing rules and their implementation.

Chart 1.1: Date of adoption and entry into force of the transfer pricing rules, per country.



Source: Transfer Pricing Database, Section 1, General Aspects. Accessed through CIAT Data, 2019.

The aforementioned lag is a strategic and necessary factor when implementing a transfer pricing regime as time is needed to organize resources and effectively implement the rules. For example, it is expected that when a country incorporates transfer pricing control standards for the first time, it needs to create information systems, study the economic sector characteristics, develop human resources capable of analyzing the information, identify risks, and, if necessary, carry out audits. It is also important to

inform the business community and develop legal infrastructure and training for the judiciary system. For these reasons, among others, many of the countries under analysis required several years to develop an acceptable level of maturity related to the field before the entry into force of their transfer pricing rules. Almost half of the countries (45%) present a gap of one to three years between the adoption and the enforcement of these rules.

Furthermore, 20% of the countries with adopted standards, enacted them more than twenty years ago; 30% of them did so between twenty and ten years ago; the next 20% did so in the last five to ten years, and the remaining 30% have enacted their rules within the last five years. Considering this information, a marked difference exists in relation to countries that have enacted rules between the last ten and twenty years and those that have done so in the last five years (both groups combined represent 60% of the sample).

Jamaica was the last country in the region to adopt transfer pricing rules in 2015, while Nicaragua was the last country to have enforced them in 2017.³ Meanwhile, Mexico, the Dominican Republic, and Suriname were pioneers at the regional level, implementing the ‘Arm’s Length Principle’⁴ in their domestic rules as of 1992. Shortly after, in 1996 Brazil adopted the use of fix margins, representing a global exception to the traditional methods contained in the OECD Transfer Pricing Guidelines (CUP, CPM, and RPM). Paradoxically, the Dominican Republic was a pioneer in adopting the arm’s length principle into its tax code in 1992, however, other required elements such as specific valuation methods and documentation obligations weren’t implemented until 19 years later, in 2011. Nevertheless, the Dominican tax administration was able to perform audits and apply transfer pricing adjustments to taxpayers in the all-inclusive hotel sector as early as 2006 (thanks to the passing of a tax reform in that year).

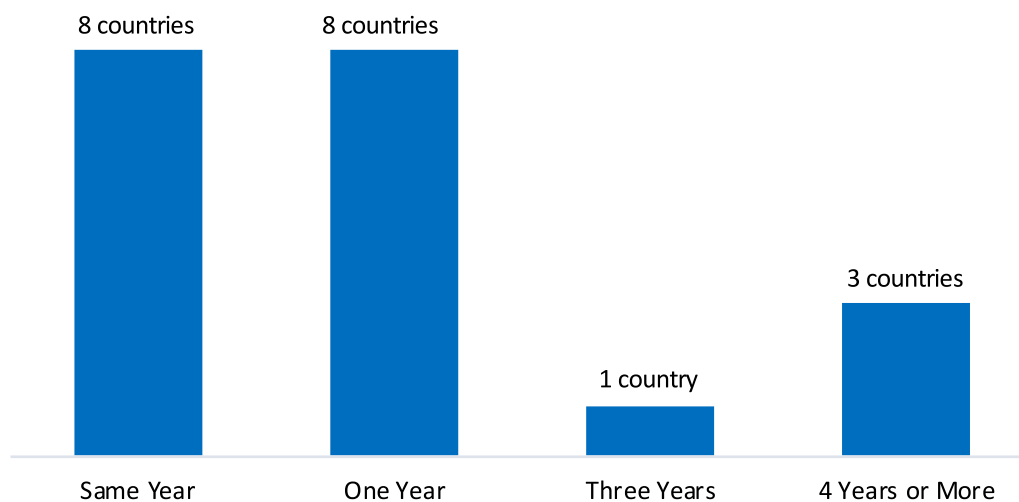
The following chart depicts the most common period of time elapsed between the sanctioning and the entry into force of the transfer pricing rules in the countries under analysis. In the following chart, it can be observed that many countries did not consider the implementation gap that is required for making the transfer pricing information system and control procedures operational.⁵

3 The regulations in Nicaragua, although in-force, have not been applied yet.

4 According to the OECD Transfer Pricing Guidelines, this international principle is used to determine a ‘fair’ transfer price for tax purposes. This principle is encompassed in Article 9 (1) of the OECD and UN Model Tax Conventions. See Annex 1 for the exact definition.

5 Despite regulatory schedules, practical observations concluded that many of the countries surveyed took well over a year to effectively implement the standards for the control of transfer pricing.

Chart 1.2: Time period (in years) between the adoption and effective operation of the transfer pricing regime (considering a sample size of 20).



Source: Author elaboration using information from the Transfer Pricing Database, Section 1, General Aspects. Accessed through CIAT Data, 2019.

Against this background, it is important to highlight that the experience attained by these countries is not necessarily proportional to the date of adoption or implementation of the rules. There are other factors that significantly influence the countries' development. These factors include, amongst others, the knowledge and experience of tax officials, the level of availability and access to information, training activities, priority level subject to the tax administration, etc. Case-in-point; Uruguay which, despite being among the last eight countries in the region to adopt transfer pricing rules, has been very successful and even became a regional point of reference for other countries. Similarly, the level of knowledge in some tax administrations has fluctuated over time due to the rotation of key personnel or changes in state-specific circumstances that generate unique setbacks or advances.

Many Latin American countries have been innovative in their aim of meeting precise risks with the resources available (e.g. the so-called Sixth Method in Argentina, the price adjustment method for exporters of agricultural commodities in Paraguay, the sector specific APA's of the Dominican Republic, the fixed margin regime of Brazil, the Mexican special regime for the 'maquila' industry, etc.). In a more global context, the OECD's BEPS Reports have encouraged innovation that ensures transfer pricing results fall in line with the value creation process, specifically in Actions 8, 9 and 10 of the BEPS Action Plan, as well as other related Actions. Furthermore, BEPS Action 13, dedicated to re-examining the documentation for transfer pricing purposes, has significantly influenced the requirements and procedures of the countries in the region that have chosen to join the BEPS Inclusive Framework.

With regards to transfer pricing rules, said global initiative may help countries to sustain the legitimacy of their taxation rights over the profits of a multinational group or enterprise according to the income and expenditure of each territory, thus, preventing situations of double taxation.

Furthermore, tax administrations in the region have interpreted transfer pricing rules as being merely for the collection of taxes, despite the recommendations of the OECD Transfer Pricing Guidelines,

and despite the provisions found in Article 9 of both the OECD Model Tax Convention on Income and on Capital, and the United Nations Model Double Taxation Convention between Developed and Developing Countries (hereafter called the ‘OECD Model Tax Convention’ and the ‘UN Model Tax Convention’, respectively). This is not without reason; for the tax administrations of developing countries, the application of transfer pricing rules implicates considerable efforts that consume valuable resources, thus requiring the implementation of such rules to be well justified and substantiated. In this respect, Actions 8 to 10 of the BEPS Action Plan may help tax administrations attain their fiscal collection targets. In addition, since most tax administrations have yet to reach an optimum level of maturity in the field, many distortions in prices have taken place as a result of premeditated strategies by taxpayers who do not perceive there to be a potential risk of being audited and who seek unjustified tax advantages.

In accordance with the policy tools adopted by the countries analyzed, the following classification is proposed:

Group A: Countries without standards to control transfer pricing, but with rules that might be applicable to cases involving transfer pricing issues (e.g. general anti-abuse rules (GAAR) relating to market prices, economic reality, fictitious transactions, etc.) Within this classification are Barbados, Guyana and Trinidad and Tobago.

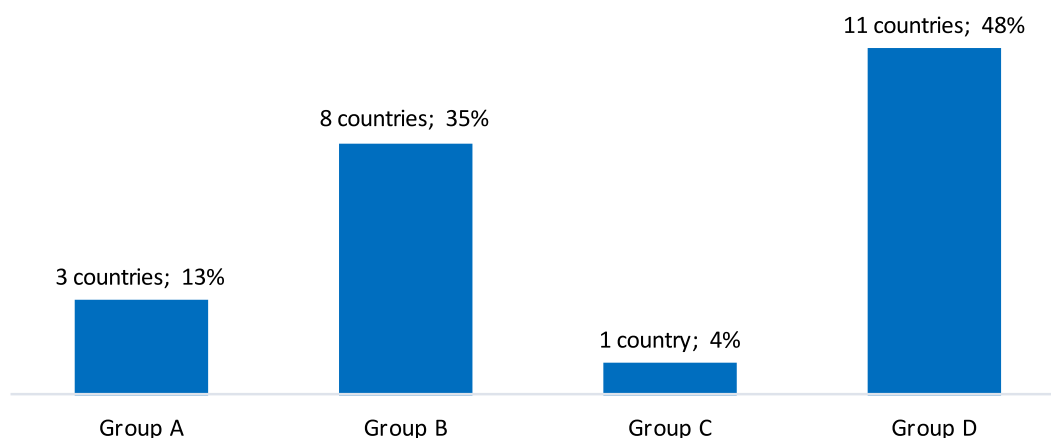
Group B: Countries with general rules for the control of transfer pricing, meaning rules that partially or completely follow the OECD Transfer Pricing Guidelines. We might call these standards orthodox, given their wide global acceptance. Within this classification are Chile, Colombia, El Salvador, Jamaica, Nicaragua, Panama, Suriname, and Venezuela.

Group C: Countries that only have specific rules for the control of transfer pricing, meaning those designed for a specific sector or type of operation (e.g. methodologies for the export or import of commodities). These standards are heterodox, and do not necessarily encompass the arm’s length principle as it is proposed in the OECD Transfer Pricing Guidelines. In this category is Paraguay, which, in addition to a GAAR, considers some aspects similar to the so-called ‘Sixth Method’ for the export of commodities by establishing the implementation of price adjustments in the export operations of goods whose prices are quoted on transparent markets, stock exchanges or the like.⁶

Group D: Countries with both, general and specific rules for controlling transfer pricing. In this category are Argentina, Bolivia, Brazil, Costa Rica, the Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Peru and Uruguay. In addition to its transfer pricing control rules based on the OECD Transfer Pricing Guidelines, Mexico has a specific ‘safe harbour’ provision for the “maquila” industry. This provision states that those companies who carry out assembly operations are assumed to comply with the arm’s length principle, provided that their taxable income is determined based on either 6.9% of the value of fixed assets used in their domestic operations or 6.5% of the total amount of costs and operating expenses incurred by the resident company in Mexico.

⁶ Paraguay is in the process of reforming its transfer pricing regime. These changes, expected to be in-force as of January 1, 2020, are further detailed in the Paraguay section of the Annex.

Chart 1.3: Distribution of the participating countries according to their classification (considering a sample size of 23).

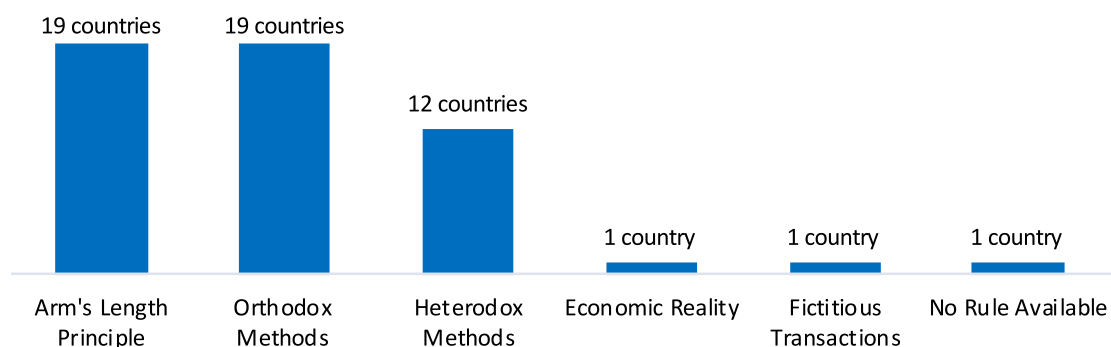


Source: Transfer Pricing Database, Section 1, General Aspects. Accessed through CIAT Data, 2019.

As seen in the chart above, most countries fall within groups B and D, which have adopted the arm's length principle (although Group D also includes specific transfer pricing rules that are not based on the OECD Transfer Pricing Guidelines).

The following chart examines which subjective elements have been included in the transfer pricing legislations implemented by the countries in the region.

Chart 1.4: Elements included in the transfer pricing rules of various countries (considering a sample size of 23)⁷



Source: Transfer Pricing Database, Section 1, General Aspects. Accessed through CIAT Data, 2019.

Following the global standard, 83% of the countries analyzed have adopted the arm's length principle. This principle has and continues to receive criticism due to its inappropriateness in circumstances where operations are exceedingly intertwined, and because it is especially difficult to apply in

⁷ Although not included in this chart, Cuba also has the arm's length principle in their legislation.

developing economies due to the lack of information. Nevertheless, the arm's length principle has been validated under the BEPS Action Plan as the most practical option.⁸ Its widespread adoption indicates a mutual convergence process within the region. Even in the unique transfer pricing regime of Brazil, this principle is partially applied through the modified application of the CUP method (although the other methods adopted by Brazil do not follow the same fate, their employment reflects the Cost-Plus Method and the Resale Price Method but with fixed profit margins that are calculated according to the economic sector).

Most countries that have introduced regulations to control transfer pricing have done so via income tax legislation. Other countries, like El Salvador, Panama and the Dominican Republic have introduced them in their respective tax codes. In the case of Paraguay, the standard has been implemented through the 'Price Adjustment Method' found in Law N° 5061/2013. This regime for agricultural commodity exports could also be interpreted as a specific rule to prevent transfer pricing abusive manipulation (also known as transfer mispricing).

With a few exceptions, most countries forming part of the Caribbean do not have regulations to control transfer pricing. One exception being Jamaica that adopted the arm's length principle into its tax code in 2015, introducing rules based on the OECD Transfer Pricing Guidelines. In a minority of cases across the region, transfer pricing rules that are not based on the arm's length principle are applied. Therefore, situations that generate double taxation may arise. Furthermore, a few countries adopted general control principles that may be applicable in transfer pricing cases. For example, Trinidad and Tobago has a rule dealing with artificial transactions in Section 67 of its Income Tax Law that allows transactions to be reclassified if necessary. Guyana has an anti-abuse rule based on economic reality (also known as 'substance over form'). Lastly, Barbados introduced the 'Business Companies (Economic Substance) Act 2018-41' that came into effect on January 1, 2019. According to the provisions of this Act, a resident company satisfies the economic substance test when the company is directed, managed and controlled in Barbados, when an adequate number of employees are physically present in Barbados, when adequate expenditure is incurred in Barbados, when there are adequate physical assets in Barbados, and when the company conducts its core-income generating activities in Barbados. If the economic substance test is not met, the 'Director of International Business' may fine the company up to United States Dollars (USD) 150,000 every year of non-compliance until the appropriate substance level is attained.⁹

1.1. Burden of Proof

Domestic regimes take distinct approaches regarding the party that has the obligation and responsibility to propose, prepare and present evidence. When the burden of proof rests on the tax authorities, they must provide evidence for calculating the taxable income if the taxpayer did not act in good faith. In contrast, when the taxpayer bears the burden of proof, it must produce the necessary evidence or be subject to a penalty.

8 The other commonly discussed option is the 'Global Formulary Apportionment' which brings about its own set of practical application problems as well. For more information on this proposed attribution principle, see chapter 1, sections C.1-C.2 of the OECD's Transfer Pricing Guidelines.

9 Barbados 'Business Companies (Economic Substance) Act, 2018-41', Articles 6-10. Available at: [https://www.investbarbados.org/docs/Business%20Companies%20\(Economic%20Substance\)%20Act,%202018-41.pdf](https://www.investbarbados.org/docs/Business%20Companies%20(Economic%20Substance)%20Act,%202018-41.pdf)

For the submission of transfer pricing documentation, it is generally understood that the burden of proof lies on the taxpayers. However, it can be reversed if the tax authorities wish to counter the taxpayer's position by presenting arguments and evidence demonstrating the determined prices are incompliant with the arm's length principle (or whichever domestic standard governs the control of transfer pricing).

For the evaluation of transfer prices, the burden of proof generally falls on the tax administration; however, this does not exempt the taxpayer from having to provide documentation to facilitate the inspection. In most countries, taxpayers are legally required to be fully cooperative during transfer pricing assessments.

It is important that domestic regulations determine where the burden of proof lies to avoid the adverse consequences that stem from legal uncertainty. When the burden of proof falls on the tax administration, their conclusions may rely on indexes or economic indicators which can be influenced by other government entities. Therefore, it is important that the regulations are unbiased, and that strict controls are followed. In this regard, the OECD Transfer Pricing Guidelines raise a valid point; when the burden of proof falls either on the tax administration or the taxpayer, it must be shown that the prices have been valued according to the arm's length principle;

“4.16 In practice, neither countries nor taxpayers should misuse the burden of proof in the manner described above. Because of the difficulties with transfer pricing analyses, it would be appropriate for both taxpayers and tax administrations to take special care and to use restraint in relying on the burden of proof in the course of the examination of a transfer pricing case. More particularly, as a matter of good practice, the burden of proof should not be misused by tax administrations or taxpayers as a justification for making groundless or unverifiable assertions about transfer pricing. A tax administration should be prepared to make a good faith showing that its determination of transfer pricing is consistent with the arm's length principle even where the burden of proof is on the taxpayer, and taxpayers similarly should be prepared to make a good faith showing that their transfer pricing is consistent with the arm's length principle, regardless of where the burden of proof lies.”

- OECD Transfer Pricing Guidelines, section B.2, paragraph 4.16, 2017.

In sixteen of the countries analyzed under this study, the burden of proof lies on the taxpayer; while in three countries (Brazil, Chile and Uruguay) it lies on the tax administration. The following table shows the distribution of the party on which the burden of proof lies.

Table 1.2: Allocation of the burden of proof per country.

Tax Administration	Taxpayer
Brazil	Argentina
Chile	Bolivia
Uruguay	Colombia
	Costa Rica
	Dominican Republic
	Ecuador
	El Salvador
	Guatemala
	Honduras
	Jamaica
	Mexico
	Nicaragua
	Panama
	Paraguay
	Peru
	Venezuela

Source: Transfer Pricing Database, Section 1, General Aspects. Accessed through CIAT Data, 2019.

2. Defining Related Parties that are Subject to the Transfer Pricing Regime

The term “related parties” has many connotations beyond that of taxation such as its economic, legal, accounting, and financial definitions. Economically, a related party would be defined by the business relations that exist between two subjects. For example, a company acting as an exclusive distributor of a brand, maintains an increased level of connection when compared to another company that sells only a small portion of the products offered by that brand. These types of business circumstances generate a special relationship between entities. Furthermore, variables such as exclusivity, availability, and timeliness can define relationships between suppliers and consumers. For example, providing an exclusive distribution license to only one company could create exclusivity and raise the demand of that product. Thus, the distributor may assert certain influence over the prices and the relationship with consumers. Very different is the situation of a company that does not have such particularity, like a distributor with a low or moderate market share.

Usually, there is a domestic definition in civil or corporate legislations as to what should be understood as related parties. Furthermore, the International Accounting Standards (IAS) provides an internationally accepted and extensive definition of related parties that considers consanguinity, key management personnel, subsidiaries, parent companies and reporting entities as related.¹⁰ A definition is also found in Article 9 (1) of the OECD and UN Model Tax Conventions, both of which are included in the annex of chapter 1.

Given the limited capacity of tax administrations to process information and perform audits, it is convenient to clearly define the obligations that taxpayers must meet and the standard for creating a relationship. When said standard is less strict, it will cause more taxpayers to fall within the transfer pricing regime. For this reason, and by virtue of its ability to control potential risks, the ‘related party’ criterion encompasses part of the tax strategy adopted by the country. Within the transfer pricing regime, it may be convenient to consider exclusion thresholds based on income level, value of business assets or the amount of total transactions. This would allow focusing the resources on taxpayers that present a higher tax risk and would provide a simplified procedure for smaller taxpayers.

The following table provides information of the various criteria that defines when taxpayers fall within the scope of the transfer pricing regime in the countries analyzed.

¹⁰ For the detailed definition of what constitutes a related party go to the IAS website at: www.iasplus.com/en/standards/ias/ias24

Table 2.1: Taxpayers who fall subject to the transfer pricing regime.

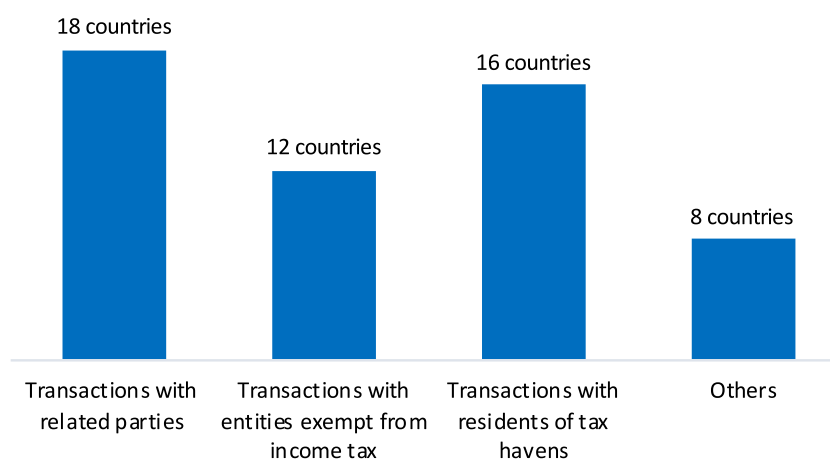
Country	Perform transactions with related parties	Perform transactions with tax exempt entities	Perform transactions with tax havens residents	Others
Argentina	X	X	X	X
Bolivia	X	X	X	
Brazil	X		X	X
Chile	X	X	X	X
Colombia	X	X	X	
Costa Rica	X	X	X	
Ecuador	X		X	
El Salvador	X	X	X	
Guatemala	X			X
Honduras	X	X	X	X
Jamaica	X	X	X	
Mexico	X		X	
Nicaragua	X	X	X	X
Panama	X			
Paraguay*	N/A	N/A		X
Peru	X	X	X	X
Dominican Republic	X		X	
Uruguay	X	X	X	
Venezuela	X	X	X	

*In Paraguay, the criterion applies to agricultural exports only. This will change once the transfer pricing reforms are in place as of January 1, 2020 (see Paraguay section of Annex for more details).

Source: Selected tax administrations of LAC CIAT member countries.

The following chart shows the number of countries that use each of the previously mentioned criteria for subjecting taxpayers to the transfer pricing rules.

Chart 2.1: Most common criteria used to classify a relationship under the transfer pricing regime (considering a sample size of 19).



Source: Transfer Pricing Database, Section 1, General Aspects. Accessed through CIAT Data on 2019.

In 95% of the countries, taxpayers carrying out transactions with related parties fall within the transfer pricing regime. An additional 63% of the countries require taxpayers to report, under the transfer pricing regime, any transactions carried out with exempt entities (such as pension funds or non-profit organizations). Furthermore, 84% of the countries presume -without proof to the contrary- that there is a deemed relationship when entities are located in a tax haven. 42% of countries use additional criteria to define a related party. Some examples of this criteria, along with other information regarding deeming provisions and exceptions to the related party status are detailed below:

In Argentina, taxpayers who carry out operations with entities in countries, domains, jurisdictions, territories, associated states or under special tax regimes that establish a maximum effective tax rate on business income of less than 15%

In Brazil, taxpayers who form a joint venture, or, who operate with one another under a contract of exclusivity, will be considered related and their transactions will fall under the scope of the transfer pricing regime.

In Chile, when a party carries out one or more transactions with a third party that, in turn, carries out one or more transactions with a related party, and these secondary transactions are similar or identical to those carried out with the first party, then these will be considered related.

In Costa Rica, when a person or entity has its residence in an extraterritorial jurisdiction that does not provide for the exchange of information with the Costa Rican Tax Administration, the operations with this entity fall under the scope of the transfer pricing regime.

In Guatemala, when an intermediary intervenes in an export transaction between related parties, and that intermediary does not have substantial presence in its country of residence, it is considered to be related to the exporter.

In the case of Honduras, when a contract contains preferential clauses that would not be granted to third parties in similar circumstances, or, when one party is financially or economically dependent on the other, these will be considered related.

In Peru, Article 24 of the Income Tax Law regulations consider that a relationship exists under the following situations:

- ▶ An individual or legal entity owns more than thirty percent (30%) of the capital of another legal entity, directly or through a third party.
- ▶ More than thirty percent (30%) of the capital of two or more legal entities belongs to the same individual or legal entity, directly or through a third party.
- ▶ In any of the above cases, when the indicated proportion of the capital belongs to spouses or to individuals related up to the second degree of consanguinity or affinity.
- ▶ The capital of two or more legal entities belongs, in more than thirty percent (30%), to common partners.
- ▶ The legal entities or entities have one or more directors, administrators or other managers in common, who have decision-making power in the financial, operational and/or commercial agreements.
- ▶ Two or more individual or legal entities who consolidate their financial statements.
- ▶ In the case of a joint-venture with independent accounting, the contracting parties that participate, directly or through a third party, in more than thirty percent (30%) of the assets will be considered related. Or, when any of the contracting parties have decision-making power in the financial, commercial or operational agreements that are adopted for the development of the contract, in which case the contracting party exercising the power of decision will be bound by the contract.

- ▶ In the case of a joint venture without independent accounting, the relationship between each of the parties to the contract and the counterparty must be verified individually. A counterparty is defined as the individual or legal entity with whom the parties carry out an operation in order to achieve the purpose of the contract.
- ▶ There is a joint venture agreement in which one of the associates, directly or indirectly, holds more than thirty percent (30%) participation in the shares or profits of one or several businesses of another associate, in which case it will be considered that there is a link between these two associates. It will also be considered that there is a connection when one of the associates has decision-making power in the financial, commercial or operational aspects of one or several of the other associates' businesses.
- ▶ A non-domiciled company has one or more permanent establishments in the country, in which case there will be a link between the non-domiciled company and each of its permanent establishments and between all of them.
- ▶ Other additional criteria: a. A taxpayer resident in the country and a distributor or exclusive agent resident abroad, b. A taxpayer residing in the country and its permanent establishments abroad, c. A distributor or exclusive agent resident in the country of a foreign organization and the latter, d. A permanent establishment located in the country and its parent company residing abroad or another permanent establishment or person related to it.

As seen above, countries often use complementary criteria to assume or 'deem' the existence of a relationship. The following table gives some examples of situations in which taxpayers will be deemed related, as per the regulations of the following countries.

Table 2.2: Some examples of criteria which constitute a deemed relationship.

Criteria for a Deemed Relationship	Countries
Exclusive distributor or agent.	Argentina, Brazil, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Nicaragua, Uruguay
Liability for the losses or expenses of another party.	Argentina, Dominican Republic
The transactions account for 50% or more of total production.	Dominican Republic
Transactions are non-compliant with the arm's length principle.	Ecuador
Dutch legal definition.	Suriname
Transacting with residents in a jurisdiction without the Exchange of Information.	Argentina /1, Brazil, Costa Rica
Level of shareholdings, rights, or claims, contractual or not, so long as these provide influence over the decisions or activities of the subject.	Brazil, Uruguay

1/ Argentina considers any transaction with a resident of a non-cooperative jurisdiction subject to the transfer pricing regime. Non-cooperative jurisdictions are those that do not have an information exchange agreement, or, an agreement to avoid international double taxation with a broad clause for the exchange of information, or, one that has the agreement in force but does not effectively comply with it (incorporated as part of the reform provided by Law No. 27,430).

These examples are non-exhaustive, there are many types of regulations which work to define a related party across the selected tax administrations. For further elaboration see chart 2.4 below.

Source: Selected tax administrations of CIAT member countries

Furthermore, two of the countries provide for an auspicious approach; instead of defining when parties will be considered related, Guatemala specifies that any domestic transactions will be exempted from the risk of creating a relationship. In Mexico, there are exemptions to transfer pricing documentation requirements that cover taxpayers whose income from business activities and interests obtained does not exceed 13 million Mexican Pesos, or, whose income related to the provision of professional services does not exceed three million Mexican Pesos¹¹ as well as the ‘maquila’ transactions that fall within the safe harbor calculation.

The following table is a graphical summary of this information;

Table 2.3: Relationship criteria for subjecting taxpayers to the transfer pricing regime.

Criteria	ARG	BOL	BRA	CHI	COL	CR	ECU	SAL	GUA	HON	JAM	MEX	NIC	PAN	PER	RD	SUR	URU	VEN
Direct or indirect participation in management, administration, control or capital	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X		X	X
Same members, partners or shareholders on the governing boards	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X		X	X
Affiliated companies, subsidiaries and permanent establishments	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X		X	
Entities domiciled in tax havens or preferential regimes	X	X	X	X	X	X	X	X		X	X	X	X			X		X	X
Consanguinity between the directors or administrators	X	X	X	X	X	X	X	X	X	X	X	X	X			X			
Same key management personnel	X	X	X		X	X	X			X	X	X				X		X	
Proportion of transactions			X			X	X	X			X					X		X	
Distribution of profits					X		X				X		X			X			
Common rights in a trust	X						X			X		X							
Price mechanisms used between parties											X		X						
Other	X		X			X	X	X	X							X	X		

Source: Transfer Pricing Database, Section 1, Related Parties. Accessed through CIAT Data, 2019.

It can be observed from the above information that the most common criteria for considering that entities are ‘related parties’ is; i. having direct or indirect participation in the management, administration, control or capital of the other company, ii. both companies being part of the same group such as parents, subsidiaries and permanent establishments, and iii. having the same members, partners or shareholders participate on the board of directors of both companies.

In opposition, the least employed criteria include; i. the use of special pricing mechanisms, ii. holding common rights in a trust, and iii. using a threshold that measures the distribution of profits or the proportion of transactions. The latter is exemplified in the following table:

11 This exemption does not apply to taxpayers that perform activities in the oil and gas industry as contract or ‘assignment holders’ as defined by the Hydrocarbons Income Law of 2014.

Table 2.4: Proportion of transactions required to establish a relationship.

Countries	≥30%	≥50%
Brazil /1	-	-
Ecuador		X
El Salvador		X
Jamaica /2	-	-
Peru /3		X
Dominican Republic		X
Uruguay	X	

1/ Brazil did not specify a percentage but mentioned an ‘exclusive distribution licence’ as enough to establish a relationship.

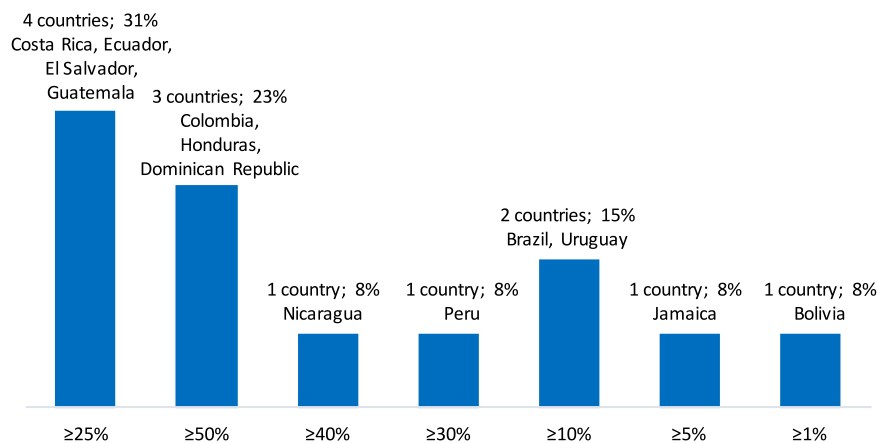
2/ Jamaica did not specify a percentage.

3/ In the case of Peru, more than 80% of sales by the provider must represent more than 30% of the purchases from the client in order to establish a relationship.

Source: Transfer Pricing Database, Section 1, Related Parties. Accessed through CIAT Data, 2019.

The different countries that have adopted this measure consider that having a substantial proportion of existing transactions (e.g. purchases, sales, etc.) will be enough to constitute a relationship. Moreover, the chart below presents the required level of direct or indirect participation in the capital of an enterprise that will cause such entity and its shareholder to be considered related.

Chart 2.2: Level of capital participation (direct or indirect) which constitutes a relationship as per domestic transfer pricing rules (considering a sample size of 13).

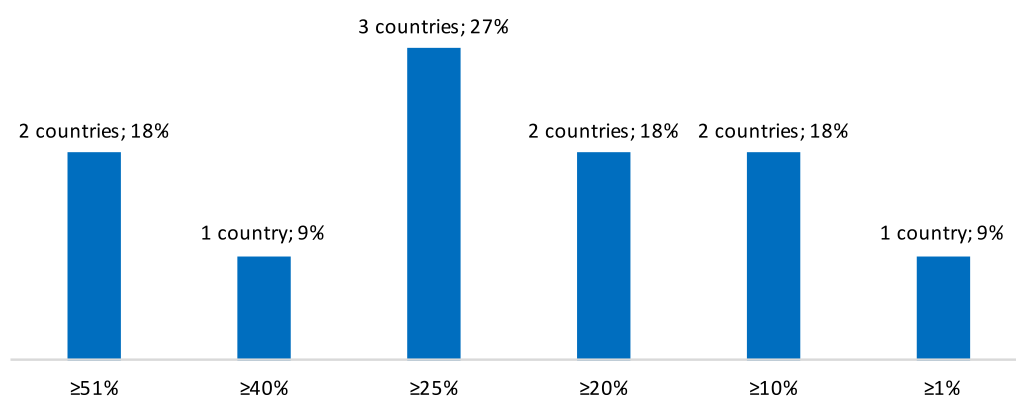


Source: Transfer Pricing Database, Section 1, Related Parties. Accessed through CIAT Data, 2019.

Thirteen countries reported information on the minimum required participation for related parties to comply with the transfer pricing regime, these are; Costa Rica, Ecuador, El Salvador and Guatemala which implemented a very strict linkage criterion that increases the number of subjects obliged to comply with the transfer pricing regime by setting a minimum participation of 25%. Followed by Peru with 30% and Nicaragua with 40%. Meanwhile, Colombia, Honduras and the Dominican Republic reported a threshold of 50%. On the other hand, Bolivia (1%), Jamaica (5%), Brazil and Uruguay (10%) have participation thresholds that are among the lowest/strictest in the world.

Lastly, the chart below shows the percentage of participation required to create a minimum level of influence on the decision-making process or the control of the entity.

Chart 2.3: Percentage of participation deemed as influential over the decision-making or control of the company (considering a sample size of 11).



Source: Transfer Pricing Database, Section 1, Related Parties. Accessed through CIAT Data, 2019.

Evidently, the level of participation that is considered as ‘influential’ varies greatly among the eleven countries under study (found in the chart above). The most tolerant are Colombia and Jamaica with a majority holding requirement of 51%. Contrarily, Bolivia is again one of the strictest in the world with a participation of as little as 1% considered influential. In order to compare these varying regional rates in an international context, we refer to the European Union’s (EU) Parent/Subsidiary Directive. This Directive applies to entities resident throughout the EU, it states that if one entity has a participation holding of 10% or more in another entity, the first will be attributed the status of a ‘parent company’ for taxation purposes.¹² Overall, nine of the eleven Latin American and Caribbean countries covered in this section, have legislations that are more lenient than the EU Directive.

¹² Council Directive 2011/96/EU is only applicable to companies, not individual persons.

3. Formal Obligations

“It is important that the documentation rules be broad enough to capture the reality of the related party transaction without being excessively burdensome on the mere chance that, though unlikely, a particular piece of information may be relevant.” - United Nations, Practical Manual on Transfer Pricing for Developing Countries (hereafter known as the ‘UN Manual on Transfer Pricing’), section C.2.3.5, page 407, 2017.

Formal obligations, such as documentation requirements, are indispensable to the control of transfer prices, especially when employing “orthodox” methods. The taxpayer’s information makes up the base in which risk assessment tools function, however, the predicament lies in limiting the amount of information required so as not to burden the taxpayer, meanwhile, providing the tax administration with the data that is necessary to carry out its functions. Although designing this system is never simple, it is necessary to define the information that will be required from taxpayers. As is pointed out in both the OECD Transfer Pricing Guidelines and the UN Manual on Transfer Pricing, documentation requirements have the following objectives: i. encouraging taxpayers to give appropriate consideration to the transfer pricing rules when establishing prices and reporting income from related transactions, ii. to provide the tax administration with the necessary information for assessments, and iii. to provide a part of the information necessary for conducting thorough audits.¹³

Table 3.1: Documentation requirements per country.

Master File, Local File and CbC Report	CbC Report
Argentina	Bermuda
Colombia	Brazil
Costa Rica	Chile
Mexico	
Peru	
Uruguay	

Source: Selected tax administrations of LAC CIAT member countries, 2018.

The BEPS Report on Action 13 is the latest development related to transfer pricing documentation, part of which became a minimum standard for the multilateral instrument. It consists of a three-tiered documentation approach: the Local file, the Master file and the Country-by-Country (CbC) report. The Local file includes a summary of the transactions effected by the domestic resident entity of the MNE group. The Master file contains general information about the entire group. And the CbC report, which is filed by the parent company of the group (or by a surrogate

company), contains information about the entire group’s activities. This includes the economic activity per jurisdiction, a summary of taxes paid in each country, the number of employees per country, and others.¹⁴ Additionally, the BEPS Report on Action 13 recommends that documentation requirements must be reviewed and updated annually to ensure accuracy and relevance.

13 OECD, 2017, Transfer Pricing Guidelines, Page 230, Section B.5.5. Also in the UN, 2017, Practical Manual on Transfer Pricing for Developing Countries, page 395, section C.2.1.1.

14 More can be found in the OECD, BEPS Action 13, 2015 Final Report, page 14.

3.1. Transfer Pricing Return

Generally, throughout Latin America and the Caribbean, taxpayers are responsible for submitting their transfer pricing returns. However, it could be that a third-party professional, such as an advisory firm, could also be held responsible for the reliability, veracity or content of the information submitted in the return, as is the case in Argentina.

Filing schedules can vary from annual, biannual, quarterly, or monthly. It cannot be said whether one filing option is better than the other as this depends on domestic information needs and administrative procedures. For example; due to the particularities of Paraguay's unique regime, taxpayers are required to calculate a self-adjustment of their tax balance on a monthly basis and to file the corresponding exportation contracts whenever these are signed or modified. These contracts cover the transactions of soy and soy by-products which are exported during the month, and consist of information indicating the selling price, quantities, international market price, the costs incurred, and, in some cases even attaching proof of the transactions. All of the countries with transfer pricing rules, except one, oblige their taxpayers to file the transfer pricing return annually.¹⁵ The exception is Nicaragua that does not require a transfer pricing return to be filed.

As for the main items to be included in the transfer pricing return, all of the countries require information as to the taxpayers' revenue and expense transactions. Additionally, most of those countries require an updated count of assets and liabilities. The three countries that did not require this information are Mexico, Uruguay and Venezuela.

Chart 3.1: Information required in the transfer pricing report (considering a sample size of 16).



1/ Argentina, Bolivia, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Panama, Peru, Uruguay, Venezuela.

2/ Argentina, Bolivia, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Panama, Peru, Uruguay, Venezuela.

3/ Argentina, Chile, Colombia, Ecuador, Honduras, Mexico, Uruguay. (See details related to this category below).

Source: Transfer Pricing Database, Section 1, Formal Obligations. Accessed through CIAT Data, 2019.

¹⁵ In Argentina, biannual filing was required for fiscal periods before 01/01/2018. However, for any subsequent period annual filing is now required thanks to Article 15 of Law No. 27.430.

The ‘Others’ category consists of the following country particularities

- ▶ Argentina requires the owner or licensee of any trademarks, patents or other intangible assets related with the transaction to be identified, even if these intangible assets are not being expressly remunerated (Article 21.9 of the Income Tax law). Furthermore, the details of any transaction where the local taxpayer is lacking in compensation should be included in the return (Article 21.11 of the Income Tax law).
- ▶ Chile requires financial transactions and refundable expenses to be included in the transfer pricing return.
- ▶ Colombia requires the declaration of transactions with tax havens, business restructurings, industrial or intangible contributions to foreign entities.
- ▶ Ecuador specifically mentions the requirement of any expenses associated with royalties and technical, administrative or consulting services. Furthermore, Ecuador has a list of transactions which are specifically exempted from the transfer pricing return:
 - ▷ Transactions that are not commercial or financial, provided they do not affect the income statement or involve a transfer price.
 - ▷ Those that take refuge in a safe harbor.
 - ▷ Air transportation of cargo or people.
 - ▷ Cash contributions in USD.
 - ▷ Compensation or reclassification of assets, liabilities or equity, provided they do not affect the accounting results.
 - ▷ Cash payments in USD of dividends or liabilities.
 - ▷ Operations with Ecuadorian public law entities or Ecuadorian public companies.
 - ▷ Those under the scope of the ‘single income tax’ that covers certain agricultural production, sale and export activities, such as bananas.
- ▶ Honduras requires financial transactions, administrative service transactions, business restructuring activities or royalty transactions to be included in the return.
- ▶ Mexico requires the declaration of ‘cumulative income’ and authorized deductions.
- ▶ Uruguay also requires the inclusion of revenues and expenses associated with royalties, know-how, interest, and insurance/reinsurance premiums.

3.2. Transfer Pricing Documentation Report

As for the report that describes the arm’s length determination of the related-party transactions (i.e. the transfer pricing analysis and supporting documentation); most of the countries require this to be submitted annually. However, four countries did not require their taxpayers to report the transfer pricing methodology, these are Chile, Costa Rica, Guatemala and Paraguay¹⁶. Although not requiring the direct submission of the methodology, these countries do require taxpayers to maintain records and to provide this information upon request by the tax administration. By doing so, the tax administration can reserve its administrative resources for other items, at the same time, lowering compliance costs for the taxpayer. In the case of any inconsistencies or concerns the information must be provided, for example, in 2016, Guatemala solicited the transfer pricing report from a chosen sample of taxpayers. The only exception is Chile that does not mandate the transfer pricing documentation report in either case.

16 Before Paraguay’s transfer pricing reform of 2020, the transfer pricing methodology report was not required as only one type of ‘method’ (the price adjustment formula) could be used.

This was a recent change for taxpayers in El Salvador who, as of 2019, are required to submit an online form relating to their transactions with related parties, highlighting the pricing method used. In Mexico, the transfer pricing documentation report is not submitted unless the taxpayer qualifies for the Local File submission (usually only large taxpayers are targeted).

As for the timing of the submission of the transfer pricing report, the countries vary greatly in their schedules. Some require filing on a specific month (i.e. July in Colombia), while other countries base their deadline on the taxpayer’s fiscal year end, such as ‘twelve months after closing’ in Argentina, ‘two months after closing’ in Ecuador, or ‘two and a half months after closing’ in Jamaica. In three of the countries under analysis (Bolivia, Brazil and Jamaica), the submission of the transfer pricing report aligns with the date of submission of the tax return. However, this is not always the case as can be seen in the following table

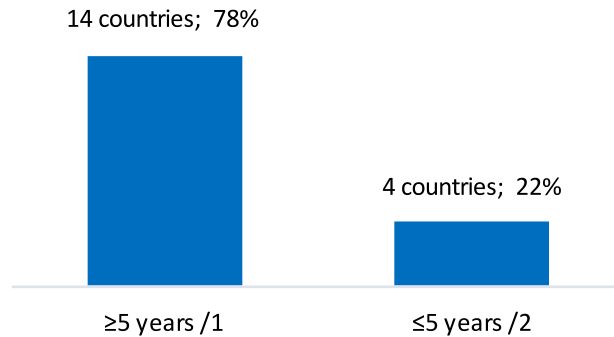
Table 3.2: Differences between the deadlines to submit the transfer pricing return and/or report versus the income tax return.

Argentina	Income Tax Return: twelve months after fiscal closing. Transfer Pricing Return and Report: twelve months after fiscal closing.
Chile	Income Tax Return: April. 'Transfer Pricing Statement': June. Transfer Pricing Report: submission not required.
Colombia	Income Tax Return: April. Transfer Pricing Return: July.
Dominican Republic	Income Tax Return: 120 days after the fiscal closing. 'Informative Declaration of Operations between Related Parties' (DIOR): 60 days after the income tax return is submitted.
El Salvador	Income Tax Return: 4 months following conclusion of the fiscal period. Transfer Pricing Report: 3 months following conclusion of the fiscal period.
Mexico	Income Tax Return: March. 'Transfer Pricing Informative Return' (covers only transactions with foreign-based related parties): March. Transfer Pricing Documentation Report: not submitted unless the taxpayer qualifies for the Local File obligation.
Panama	Income Tax Return: 3 months following conclusion of the fiscal period. Transfer Pricing Report: 6 months following conclusion of the fiscal period.
Paraguay	Income Tax Return: April. 'Report on Price Adjustment': May.
Uruguay	Income Tax Return: within the following four months after the close of the fiscal year. Transfer Pricing Return: during the ninth month following the closing of the fiscal year.

Source: Selected tax administrations of CIAT member countries.

Another aspect that influences the weight of transfer pricing obligations on the taxpayers is the period during which the documentation related to the transfer pricing analysis must be kept. This period is generally around five years as can be seen in the chart below.

Chart 3.2: Period during which taxpayers are required to maintain the transfer pricing return and related documentation report (considering a sample size of 18).



1/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Jamaica, Mexico, Paraguay, Venezuela
2/ Guatemala, Nicaragua, Panama, Peru

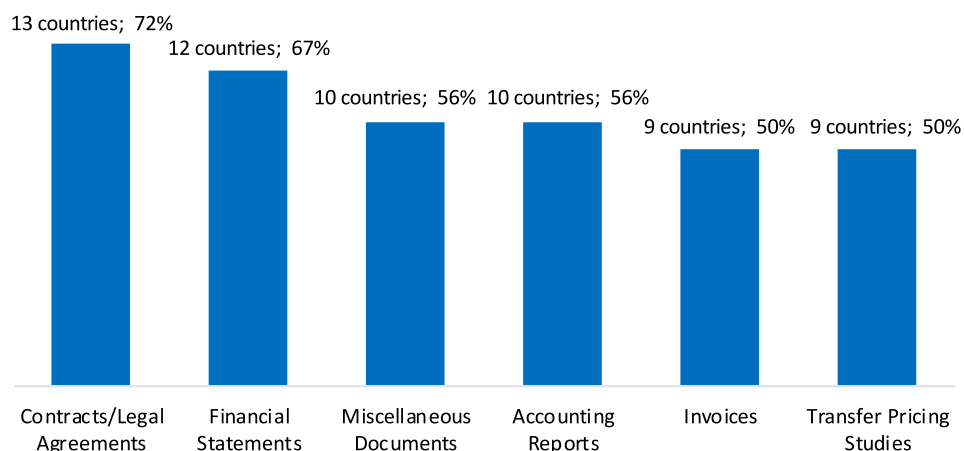
Source: Transfer Pricing Database, Section 1, Formal Obligations. Accessed through CIAT Data, 2019.

Uruguay is not included in the previous chart; it takes a different approach by requiring the documents to be kept for the same period as the statute of limitations.

Regarding digitalization, in 2016 Venezuela was the only country that did not allow for online document submission (i.e. requiring physical files instead). El Salvador most recently adopted digitalization processes in 2019, accepting the transfer pricing report to be submitted online. For developing countries with limited resources to process and store information, it may be opportunistic to shift a portion of the storage burden to the taxpayer by having them only submit the key content and requiring them to keep any backup documents in their records for a specific period, to be made available upon request by the tax administration (as previously discussed).

The following chart describes other documents that may be requested at the discretion of the tax administration to assist in verifying the details of the relevant related party transactions.

Chart 3.3: Other documents which may be requested by the tax administration to verify the details of the related party transactions (considering a sample size of 18).



For more information as to the specific documents that may be requested, and for a list of the countries in each category, see the detailed chart in the annex of chapter 3.

Source: Transfer Pricing Database, Section 1, Formal Obligations. Accessed through CIAT Data, 2019.

The transfer pricing documentation report is used along with any working papers, research or information sources to defend the transfer price as well as the selection of comparables. Presenting contracts, agreements or conventions entered into by the taxpayer with its related parties may show the conditions that influenced the transactions being examined.

The financial statements that may be requested are the balance sheet, profit and loss statement, net worth statement, financial situation statement and cash flow statement. Likewise, accounting reports to compare depreciation, assets, inventory, etc. may also be used by the tax administration to evaluate the entities in question.¹⁷

Under the category of ‘Miscellaneous Documents’ there exist two patterns. The first consists of three countries that mention tax-related documents in their response. These are: Honduras may request a statement declaring shareholder’s equity; Nicaragua requests documentation related to any advanced pricing agreements (sometimes more information is requested if it is deemed necessary); and Mexico request a quarterly report covering the relevant transactions. The second pattern consists of a blanket clause to cover all potentially relevant information. It is adopted by the Dominican Republic, Ecuador, El Salvador, Panama and Uruguay that specified their tax administration may request whatever information is necessary to evidence transactions between the related parties.

¹⁷ Financial statements have proven to be more useful for transfer pricing analysis if segmented by type of operation/transaction.

3.3. Other Aspects

3.3.1. Taxpayer Compliance Regarding Documentation Requirements

For those countries where documentation compliance is low, there is the possibility of designing penalty systems that effectively make non-compliance costlier than compliance. Another option is to offer incentive programs that motivate taxpayers to fulfil their documentation requirements. For example, by shifting the burden of proof to the tax administration's side when the taxpayer has successfully delivered all documentation. Or, exempting the taxpayer from potential penalties (or applying a lower penalty rate), when the documentation requirements have been met.¹⁸ Similarly, the tax administration could offer a lower tax rate to taxpayers who submit their documents prior to the deadline. On the flip side, penalties may be imposed for every missing document that hasn't been filed. Finally, the tax administration could issue a 'suspicious transactions warning' to certain taxpayers, giving them notice that their actions will be watched vigilantly with the possibility of demanding additional data.

3.3.2. Transactions with Tax Exempt Entities

In some countries, taxpayers who are exempt from taxation (such as charities, non-governmental organizations or pension funds¹⁹) may not be considered 'residents' since they are not liable to comprehensive taxation in that country, as per the provisions of Article 4(1) of the OECD Model Tax Convention.²⁰ This poses the question as to whether these non-resident taxpayers must file tax returns or transfer pricing reports for their international transactions.

The 2017 commentary on Article 4, at paragraph 8.11, tries to clarify this issue by presenting the idea that a person may be considered liable to comprehensive taxation even if the country does not factually impose the tax.

The advantages that exempt taxpayers would obtain if they had lesser, or no, filing requirements may incentivize other companies to begin operating under a similar 'international organization' structure. Also, pension funds, and other similar organizations, have such a tremendous international reach that affording them opacity in their global endeavours could potentially lend them to abusive situations. Therefore, it may be advisable to require the same filing obligations to all taxpayers, including exempt taxpayers, thereby increasing control and transparency in these sectors. Considering that countries have differing standards, if an organization already has the systems in place to collect the information required by one country, it could be easier for them to create a template for these documents to be handed-in to the other countries where they are active. Furthermore, thanks to the advances in the exchange of information, countries have the opportunity to compare these reports as they are received.

18 BEPS Action 13, page 19, Section D.7.40 and D.7.43

19 A 'recognized pension fund of the state' is expressly included in the definition of resident in Article 4(1) of the 2017 version of the OECD Model Tax Convention. However, pension funds are not included in Article 4(1) of the previous versions of the OECD Model Tax Convention. Therefore, they are not included as part of the definition of 'resident' found in many treaties signed before 2017.

20 Article 4(1) OECD Model Tax Convention reads: "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature..." Paragraphs 8.2 and 8.3 of the commentary on Article 4 further clarify that this refers to 'comprehensive' tax liability. Since exempt taxpayers are not 'liable to tax', they do not meet the definition and could be considered not residents of that state for the purposes of the Convention.

This brings us to the situation of transfer pricing in a domestic context (e.g. in federal countries like Argentina, Colombia and Mexico), where individual states have their own tax competence. By requiring both, domestic intra-state transactions, and exempt taxpayers, to be subjected under the transfer pricing regime, the country retains the most control over the operations carried out in their jurisdiction.

3.3.3. *Mandatory Disclosure Rules of BEPS Action 12*

“The lack of timely, comprehensive and relevant information on aggressive tax planning strategies is one of the main challenges faced by tax authorities worldwide. Early access to such information provides the opportunity to quickly respond to tax risks through informed risk assessment, audits or changes to legislation or regulations.” –Final Report on BEPS Action 12, OECD, executive summary, page 9, 2015.

Another requirement that may be imposed on taxpayers (and on tax professionals) is the obligation to disclose any information related to aggressive tax planning schemes. This requires the tax administration to have processes through which taxpayers can disclose said information, and, the infrastructure to receive this information. As of 2018, the only countries in our study to have implemented the recommendations from the BEPS Report on Action 12 are Chile, Ecuador and Mexico. Although, in Chile the disclosure of the information is not an obligatory requirement but a voluntary mechanism, while in Ecuador there is a legal provision that requires the ‘creation, use or ownership’ of entities in tax havens to be declared (although, as of mid-2019 this law is has not yet been enforced).

Mexico has employed one of the strictest declaration requirements in the region, which is found in Article 25, section 1 of their Federal Income Tax Law (2019).²¹ It states that taxpayers must submit information for the following types of transactions:

- ▶ Financial transactions (for example; transactions involving financial assets, title transfers for moveable and immovable property, derivative transactions, etc.).
- ▶ Transactions with related parties.
- ▶ Changes in the tax residency.
- ▶ Reorganizations and corporate restructurings.
- ▶ Operations with taxpayer’s resident in a territorial taxation system.
- ▶ Tax losses, capital refunds and dividend payments.

This information must be submitted quarterly (within sixty days from the end of the quarter in question). The formats to submit such information are called “Relevant Transactions Information Report” and “Information on Relevant Operations Report”. If the information presented is incomplete, or with errors, a thirty-day period is granted to complement or correct the information. Furthermore, if a public accountant prepares the taxpayer’s tax statements it will be relieved from declaring any operations whose cumulative amount in the tax year is lower than 60,000,000 Mexican Pesos (around 3.13 million USD).²²

21 Legislation available at: http://omawww.sat.gob.mx/informacion_fiscal/Paginas/formato_76.aspx

22 Exchange rate of 19.18 Pesos per 1.00 USD. From www.xe.com/currencyconverter, on May 2019.

4. Sanctioning Systems

“The Committee on Fiscal Affairs has recognised that promoting compliance should be the primary objective of civil tax penalties” - OECD Transfer Pricing Guidelines, par. 4.18, section B.3, 2017.

In 2003, the Inter-American Center of Tax Administrations (CIAT) prepared an Examination Handbook in collaboration with the International Bureau of Fiscal Documentation (IBFD) titled ‘Strengthening the Examination Function in the Tax Administrations of Latin America and the Caribbean.’²³ This document outlined some basic obligations of the tax administration such as; having transparency in their operations, assisting citizens with the opportunity to object and appeal against decisions of the tax administration and the obligation to make laws known to the taxpayers through various means (paper, fiscal code, computerization, online websites, etc.). The Examination Handbook also outlined the following taxpayer rights:

- ▶ the right of equality before the law;
- ▶ the right to be represented;
- ▶ the right of legal security (taxes only levied under prior legal regulations, decisions implemented within a reasonable period of time, opportunity to lodge an objection or an appeal to an impartial body);
- ▶ the right to be respected (both from the attitude of tax officers and by rendering support to taxpayers with regard to their fiscal problems);
- ▶ the right of privacy and confidentiality (ensuring all sensitive personal data is treated with care);

Source: Examination Handbook, Strengthening the Examination Function in the Tax Administrations of Latin America and the Caribbean, pages 8-10, CIAT, IBFD, 2003.

Similarly, the OECD’s Committee of Fiscal Affairs published a Practice Note titled ‘Taxpayers’ Rights and Obligations’ which outlines some taxpayer obligations, such as: to be honest, to be co-operative, to provide accurate information and documents on time, to keep records and to pay taxes on time.²⁴

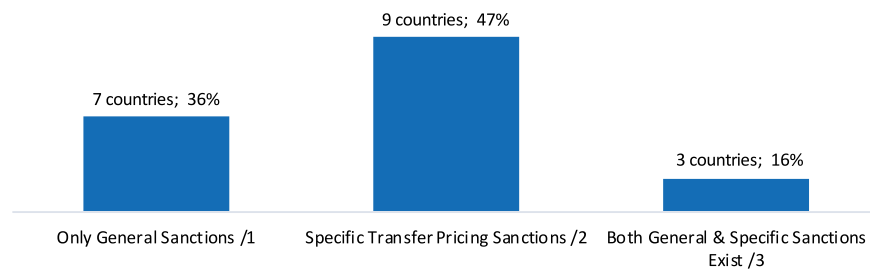
In order to maintain balance within the tax system, it is necessary to verify that these rights and obligations are being respected. Moreover, countries need to have formal evaluation procedures (risk assessment systems, audits, or similar tools) to ascertain if taxpayers are complying with the transfer pricing regime and whether any manipulations are occurring (*an extensive list detailing the distinct procedures followed by each country is provided in the annex of chapter 4*). When taxpayers are found incompliant, sanctions may be imposed to penalize the wrongful behaviour and deter it from happening again. However, the tax administration must be careful that the penalty system is proportionate and applied in an unbiased consistent manner. As explained in paragraph 4.28 of section B.3 of the OECD Transfer Pricing Guidelines (2017): “It would be inappropriate to impose a transfer pricing penalty on a taxpayer for failing to consider data to which it did not have access, or for failure to apply a transfer pricing method that would have required data that was not available to the taxpayer”. However, this is a thin line, regulations must be practical, applicable and prescriptive to clearly define the responsibilities of the taxpayers (otherwise the lack of information could potentially be used as an excuse for not applying an unfavorable method).

23 The Examination Handbook is available at: https://www.ciat.org/Biblioteca/DocumentosTecnicos/Ingles/2003_examination_handbook.pdf

24 The Practice Note is available at: http://www.oecd.org/ctp/administration/Taxpayers'_Rights_and_Obligations-Practice_Note.pdf

In general, having a sanctioning system encourages an attitude of compliance amongst taxpayers. Moreover, having specific sanctions that relate to the transfer pricing regime may be advisable, considering the size of the taxpayers involved and the abundance of transfer pricing cases in the country. The majority of countries covered in this study have specific sanctions, while six countries (Bolivia, Brazil, Costa Rica, Guatemala, Jamaica and Nicaragua) maintain a general sanctioning system without distinguishing between the different areas of taxation. And three countries, Argentina, the Dominican Republic and Uruguay, can choose to apply either specific or general sanctions depending on the circumstances involved.

Chart 4.1: Description of domestic sanctioning systems (considering a sample size of 19).



1/ Bolivia, Brazil, Costa Rica, Guatemala, Jamaica and Nicaragua, Paraguay.

2/ Chile, Colombia, Ecuador, El Salvador, Honduras, Mexico, Panama, Peru and Venezuela.

3/ Argentina, Dominican Republic and Uruguay.

Source: Transfer Pricing Database, Section 1, Sanctioning System. Accessed through CIAT Data, 2019.

There are two categories of infractions which carry distinct corresponding sanctions. The first category covers those known as ‘material’, ‘substantive’ or ‘criminal’ offenses, which include negligence, fraud, misrepresentations, conspiracy and tax evasion. These are considered more serious and often involve punitive damages as can be seen in the following table;

Table 4.1: Sanctions imposed on taxpayers who commit material infractions.

Country	Penalties for substantive violations
Argentina	In the case of omission: up to 200% of the tax omitted. For grave infractions with no reasonable excuse, fine of 200% to 1000% of the amount of tax evaded.
Bolivia	In the case of omission: 100% omitted tax.
Brazil	In the case of omission: 75% to 150% of tax that was omitted.
Chile	Tax payable plus additional fine of 5% of the difference.
Colombia	In the case of omission of assets or inclusion of liabilities: 200% of tax omitted (Article 647-1 and 648 of the Tax Bylaws).
El Salvador	Erroneous amounts declared: 25%-50% fine over the tax payable.
Jamaica	Non-submission of documentation, non/insufficient certification or fraudulent behaviour are considered serious violation and subject to fines/imprisonment in accordance with S17. 1 (5); S17.1
Honduras	Withholding the transfer pricing report during an audit will result in a fine. Similarly, declaring a lower taxable base than the reality of the transaction will result in a 30% fine calculated on the amount of the adjustment made by the Tax Administration (Articles 18 and 19, paragraph 2 Transfer Pricing Regulatory Law).
Mexico	Depending on the infraction, between Mexican Pesos 61,000 - 122,010 (USD 3180 and 6361 ²⁵). If the transfer pricing documents were submitted, the fine relating to an adjustment is reduced by 50%.
Paraguay	In the case of omission: 50% of the omitted tax. In the case of fraud: 100-300% fine on the amount of the tax fraud.
Peru	In the case of omission: 50% of the omitted tax.
Venezuela	In the case of omission: 100% to 300% of the omitted tax.

Source: Transfer Pricing Database, Section 1, Sanctioning System. Accessed through CIAT Data, 2019.

The second category covers those known as ‘administrative’, ‘civil’ or ‘formal’ infractions related to procedural errors such as untimely filing, documentation mistakes, submission errors, exclusion of certifications, amongst others. In general, these infractions often carry with them lower monetary penalties which may be a predetermined amount, calculated on a percentage of the tax due and correlated with the time limit of noncompliance (i.e. 5% for each late month), or, it could involve a shift in the burden of proof.

Practical examples of the formal sanctions imposed by countries are shown in the following table. As it can be seen, the applicable sanctions change given the seriousness of the infraction.

Table 4.2: Sanctions imposed on taxpayers for various formal infractions.

Country	Failure to File the Transfer Pricing return or the analysis	Incorrect filing or omission of information in the Transfer Pricing return or the analysis	Non-compliance with domestic information standards or failure to maintain documents
Argentina ²⁶	Specific penalties ranging between Argentine Pesos 600,000 to 900,000 (USD 13,350 to 20,022) as dictated by Article 39 of Law No. 11.683	Specific penalties ranging between Argentine Pesos 600,000 to 900,000 (USD 13,350 to 20,022) as dictated by Article 39 of Law No. 11.683	Specific penalties ranging between Argentine Pesos 600,000 to 900,000 (USD 13,350 to 20,022) as dictated by Article 39 of Law No. 11.683

25 Exchange rate used for calculations was 19.18 Mexican Pesos per 1.00 USD. From www.xe.com/currencyconverter, on May 2019.

26 Exchange rate used for calculations was 44.95 Argentine Pesos per 1.00 USD. From www.xe.com/currencyconverter, on May 2019.

Country	Failure to File the Transfer Pricing return or the analysis	Incorrect filing or omission of information in the Transfer Pricing return or the analysis	Non-compliance with domestic information standards or failure to maintain documents
Bolivia (in 2016, one Tax Unit was equal to Bolivianos 2.16)	5,000 Tax Units	2,500 Tax Units	2,500 Tax Units
Brazil	3% of omitted or incorrect amount		0.25% to 10% per month of delay
Chile (in 2016, one Tax Unit was equal to Chilean Pesos 521,988)	10 to 50 Tax Units	10 to 50 Tax Units	10 to 50 Tax Units
Colombia (Supporting Documents)	4%-6% on the value of undocumented transactions.	1%-4% of omitted or incorrect amount.	0.05%-0.2% per month on the value of operations
Colombia (Information Return)	4% on the value of the operations subject to the Transfer Pricing regime	0.6% on the value of the operation for which the inconsistent information was supplied. 1.3% of the value of the omitted operation	0.02%-0.1% per month on the value of operations
Dominican Republic	Up to twice the amount of the tax omitted. If the amount of tax evaded is indeterminable, the fine is between 10 and 50 minimum salaries, as provided in Article 281 of the same Law.	Up to 3 times the sanctions described in Article 257 of Law 11-92 of the Dominican Tax Code, as provided in Article 281 of the same Law. From 5 to 30 minimum salaries and 0.25% of gross revenue in cases of missing information.	Up to 3 times the sanctions described in Article 257 of Law 11-92 of the Dominican Tax Code. From 5 to 30 of minimum salaries, as provided in Article 281 of the same Law.
Ecuador	Up to USD 15,000		
El Salvador	0.5% of net worth or accounting capital, less surplus for reassessment of unrealized assets		2% of net worth or accounting capital, less surplus for reassessment of unrealized assets
Honduras	USD 10,000 for each omission	USD 10,000	Progressive penalties as per Article 160 of the Tax Code.
Jamaica ²⁷	Jamaican Dollars 5,000 for each month late (USD 36)		
Mexico ²⁸	Mexican Pesos 1,380 to 4,150 for every unidentified transaction (USD 72 - 216)	Mexican Pesos 61,000 to 122,010 (USD 3180 - 6361)	Mexican Pesos 140,540 to 200,090 for not presenting the Master, Local or Country by Country Reports (USD 7,327-10,432)
Panama	1% of total gross amount of transactions carried out with related parties up to USD 1,000,000		Information non-compliance USD 1,000 to 5,000 the first time or USD 5,000 to 10,000 if repeated and temporary closing of establishment.

27 Exchange rate used for calculations was 135.88 Jamaican Dollars per 1.00 USD. From www.xe.com/currencyconverter, on May 2019

28 Exchange rate used for calculations was 19.18 Mexican Pesos per 1.00 USD. From www.xe.com/currencyconverter, on May 2019.

Country	Failure to File the Transfer Pricing return or the analysis	Incorrect filing or omission of information in the Transfer Pricing return or the analysis	Non-compliance with domestic information standards or failure to maintain documents
Peru (in 2015, one Tax Unit was equivalent to Peruvian Sols 3,950)	0.6% of the company's Net Revenues. Limit: minimum 10% of Tax Units and maximum 25 Tax Units		0.6% of the company's Net Revenues. Limit: minimum 10% of Tax Units and maximum 25 Tax Units.
Venezuela (in 2016, one Tax Unit was equivalent to Venezuelan Bolivars 150)	150 Tax Units and closing of establishment for 10 days.		1000 Tax Units and closing of establishment for 10 days. For non-filing it is 50 Tax Units.

Source: Transfer Pricing Database, Section 1, Sanctioning System. Accessed through CIAT Data, 2019.

The variation between the penalties imposed on the same infraction stem from the degree of culpability (e.g. higher rates may be imposed when it is proven that the taxpayer had a wilful intent to evade taxation). Failure to file the transfer pricing return, or, failure to comply with the domestic documentation requirements will usually result in the highest sanctions. Whereas, incorrect filing of the return or omission of information in the transfer pricing analysis generally result in minor sanctions.

There are proposals on how to design a sanctioning regimes, in particular for transfer pricing obligations, in the document titled “A Cocktail of Measures for the Control of Abusive Transfer Pricing Manipulation, with a Contextual Focus on Low-Income and Developing Countries” published in 2019 by CIAT in collaboration with GIZ the German Society for International Cooperation (hereafter, known as the ‘CIAT-GIZ Transfer Pricing Cocktail’).

5. The Comparability Analysis

The starting point for any transfer pricing procedure is to perform a functional and factual analysis to gain a detailed understanding of the transactions that are being evaluated. As the OECD pointed out in the BEPS Reports on Actions 8-10, it is essential that remuneration follow the value creation process or what's colloquially referred to as 'the real deal'. By understanding where the value is added to the product or service, we can determine a fair distribution of the tax base amongst each of the countries involved.

To further enhance the delineation of the transaction, there are five comparability factors found in the OECD's Transfer Pricing Guidelines:²⁹ 1. Contractual terms of the transaction; 2. Functional analysis; 3. Characteristics of the products or services; 4. Economic circumstances; and, 5. Business strategies. The consideration of these five factors is not meant to be in any specific order. They are equally essential when trying to understand the transaction, and when searching for information on potentially comparable transactions with which to calculate the arm's length transfer price.

Especially relevant for identifying the specifics of a transaction is the functional analysis, which consists in ascertaining the functions performed, assets used, and risks assumed by the parties involved. Examples of these aspects are outlined in the figure below.

Figure 5.1: Aspects of the functional analysis.



Source: Chart made using information from the OECD Transfer Pricing Guidelines, Chapter 1, Section D.1.2 (2017).

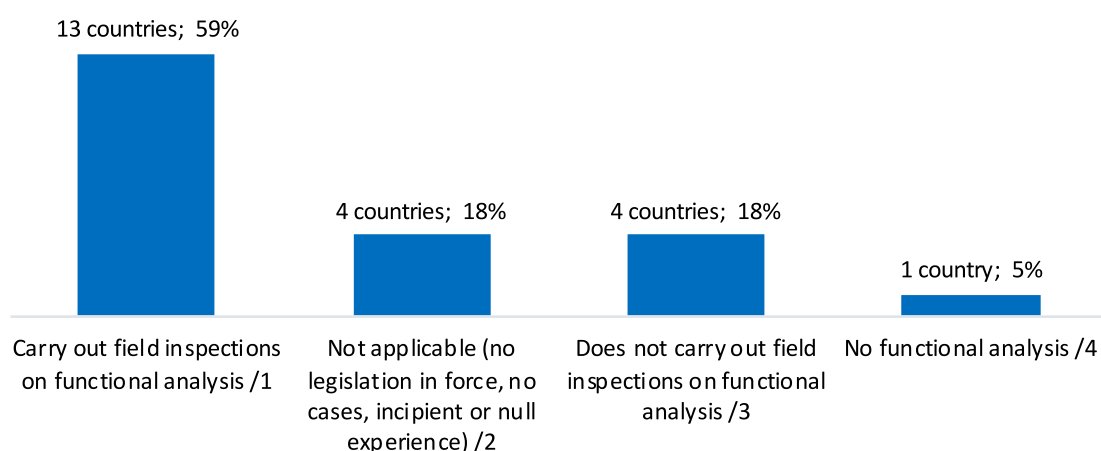
Within the framework of this functional analysis, the assumption of risk triggers the most deliberation, as it is difficult to measure or distribute. The complications surrounding risk allocation inspired Action 9 of the OECD's BEPS project which attempts to further define how and where risk is held. The focus is on who controls the risk, who has the decision-making power to mitigate the risk and who has the financial capacity to bear the risk if it materializes.

A difference in the risk between two transactions is often enough to render the whole comparison unreliable. In Latin America & the Caribbean there exist a myriad of countries with divergent geographic traits, some have large economies which foster foreign investments and others are small

²⁹ OECD Transfer Pricing Guidelines, chapter 1, part D (2017).

countries just beginning to expand and strengthen their financial capacities. This leads to disparate risk levels across the region. There are exceptional situations within Latin America where a functional analysis may not be required for the transfer pricing process. For example, countries that implement safe harbours specifically tailored to domestic standards, or, when Brazil's fixed margins are applied in the determination of transfer prices.³⁰ Although in most circumstances, the functional analysis plays a big role in determining the arm's length remuneration. Therefore, it is important that tax administrations have the resources to check the details of the functional analysis as reported by the taxpayer. A taxpayer could potentially try to shift profits by allocating functions or risks to an entity with little substance, for this, the ability to carry out field inspections could prove useful. The following chart shows the number of countries that utilize the functional analysis, and, the field inspections that are carried out.

Chart 5.1: Number of countries that carry out field inspections (considering a sample size of 22).



1/ Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Jamaica, Panama, Peru, Uruguay, Venezuela.

2/ Barbados, Guyana, Suriname, Trinidad and Tobago.

3/ Dominican Republic, Mexico, Nicaragua, Paraguay.

4/ Brazil

Source: Transfer Pricing Database, Section 1, Functional Analysis. Accessed through CIAT Data, 2019.

Out of the countries examined, thirteen of them indicated that they carry out field inspections for verifying the functional analysis. Mexico indicated that the tax administration carries out desk inspections to verify the functional analysis however, it is in the process of switching to field inspections. As mentioned previously, when dealing with the fixed margin regime, Brazil doesn't need to perform these inspection as its system doesn't require a functional analysis (fixed margins generally apply to all methods except for the modified CUP method). Nevertheless, the tax auditor is able to perform field inspections to examine other aspects related to the taxpayers and their transactions. The remaining countries are either without vigilant transfer pricing legislation or have too little experience in transfer pricing to perform these inspections effectively.

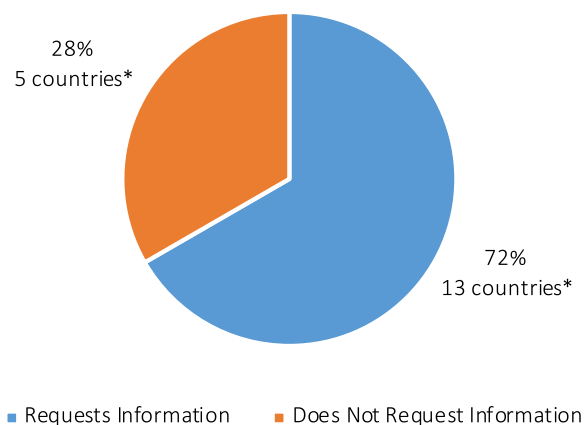
Although having the ability to verify the information in the taxpayers' statements is helpful, field inspections are resource intensive and time consuming. Generally, risk assessment tools are used to select taxpayers for investigation and the human resources required to effectively carry out such an investigation.

30 Safe Harbours and the processes used by Brazil are further discussed in chapter 16 on simplified measures.

Another criterion, which may be helpful to the tax administration for determining the veracity of the functional analysis, is the ability to solicit and process information from other tax administrations. This information may then be crosschecked with previous tax returns and transfer pricing reports to help paint a clearer picture of the taxpayers' transactions. The tax administration may add this information to its databases for future reference, however, the use of it may be restricted due to privacy laws and data security regulations. The OECD broadly encourages countries to exchange information by providing a model 'Competent Authority Agreement' to help overcome such legislative restrictions.

The following chart depicts the countries that have a tendency to request information from the ministries, treasuries or tax administrations of other countries (depending on the type of information needed and the body in charge of dealing with that information request).

Chart 5.2: Number of countries that regularly request information from other countries (considering a sample size of 18).



*These countries are identified in the chart below.

Source: Transfer Pricing Database, Section 1, Functional Analysis. Accessed through CIAT Data, 2019.

Expanding the network of available information will increase reliability, understanding, and allow the tax administration to better assess the effects of special conditions between the related parties. Also, attaining foreign information helps to coordinate and substantiate the findings of joint audit procedures.

The following table lists the country's availability to request information versus the years elapsed since the transfer pricing legislation has been vigilant (experience).

Table 5.1: Transfer pricing experience and the request of information (descending order).

Requests Information		Does Not Request Information	
Country	Years of Experience	Country	Years of Experience
México	25	Venezuela	18
Chile	20	Dominican Republic	6
Argentina	20	Guatemala	4
Ecuador	17	Paraguay	3
Peru	16	Nicaragua	0
Costa Rica	14		
Colombia	13		
Uruguay	10		
El Salvador	7		
Panamá	6		
Bolivia	3		
Honduras	3		
Jamaica	2		

Source: Author elaboration.

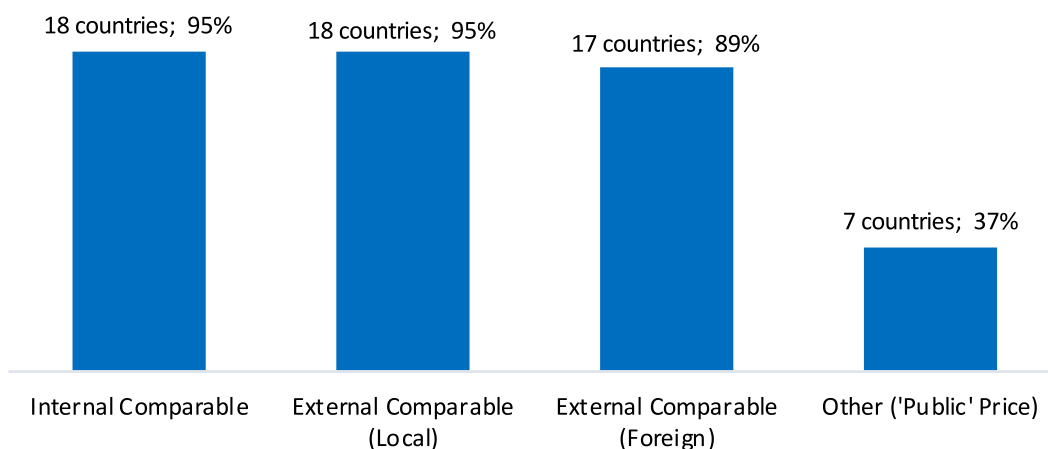
Evidently, many of the countries that reported making regular requests for information are also those who have more years of experience with transfer pricing rules. Although there are some exceptions, such as Venezuela or the Dominican Republic, which specified that it has been overly time consuming to obtain the level of detail demanded from the information requests. This challenge is being confronted by the OECD's work on Action 13 of the BEPS project, more specifically, the Country-by-Country (CbC) report where multinational enterprises are required to harmonize the submission of their reports and recount the transactions realized in each tax jurisdiction in which they do business. This allows tax administrations to exchange and trace information more efficiently. It also proves useful as an anti-avoidance tool, since there is a visualization of the global dealings of the enterprise.³¹

5.1. The Use of Comparables

When performing a transfer pricing analysis, taxpayers and tax administrations must ensure the most reliable comparables are utilized (generally meaning the ones with most similarities). These can be either internal comparables (a transaction of similar products or services sold between the entity in question and an unrelated party), or external comparables (transactions between two external unrelated entities). The use of an external comparable may be more reliable if it is from transactions performed by entities under similar conditions in the local market. However, finding sufficiently comparable transactions might be difficult and may necessitate searching in foreign markets. As shown in the following chart, countries across the region allow the use of both internal and external comparables. The only exception is Peru that does not allow the use of external comparables found in foreign markets.

³¹ For further analysis on the exchange of information and Action 13, see chapter 18 on the Exchange of Information for Tax Purposes.

Chart 5.3: Types of comparables provided for in the transfer pricing analysis (considering a sample size of 19).



Source: Transfer Pricing Database, Section 2, Comparables. Accessed through CIAT Data, 2019.

Argentina, Bolivia, Chile, Dominican Republic, Ecuador, Guatemala and Paraguay use foreign external comparables even further by having a unique system for calculating the transfer price of certain transactions through the use of 'public' prices such as those of comparable products found in international markets and stock exchanges. The use of comparables is not yet necessary in countries without such transfer pricing requirements in force like Barbados, Guyana and Trinidad and Tobago. Furthermore, in Brazil, taxpayers are allowed to use comparables when utilizing the modified CUP method.

The tax administration has copious amounts of private information made available to them. Either internal data obtained through the submission of tax returns and the like, or, external data such as that obtained through exchange of information requests. This allows them greater opportunity for analysing the details in a taxpayer's transfer pricing report. However, a question of morality arises: is it fair for the tax administration to use this private information (also known as 'secret comparables') in their assessment of a taxpayer who did not have the benefit of accessing the same information? In the region, the response to this question is uncertain as six countries allow this practice (Argentina, El Salvador, Honduras, Mexico, Peru, and Uruguay), while eleven countries disallow it (Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Guatemala, Jamaica, Nicaragua, Panama and Venezuela).

Furthermore, Argentina, Ecuador, Paraguay and Peru, seem to search for a middle ground: In Argentina, the internally sourced information is presented to the taxpayer so that they may verify it (insofar as to maintain financial secrecy regulations). In Ecuador, the use of secret comparables is only allowed for risk analysis and not to be used in the determination of transfer pricing adjustments. Contrarily, in Paraguay the internal information of the tax administration (and information from third parties) is used only for the calculation of the price adjustment method. In Peru, Paragraph 18 of Article 62 of the Peruvian Tax Code states that the tax administration may use secret comparables, but only so far as they do not include information protected by special laws such as industrial secrets, patents, intellectual property, etc.

6. Information Sources for Transfer Pricing

In the area of transfer pricing, the availability and quality of the information used is key to attaining arm's length results that resemble a transaction between independent enterprises. For this, information on comparable transactions between similar independent enterprises, operating under similar circumstances is required. This includes financial data, local market data, business plans, and so on. Unfortunately, this type of information is often considered by businesses to be confidential, hence, the rising importance of databases in transfer pricing.

In certain regions, the search for information on comparable transactions is made easier due to domestic regulations. For example, in the United States, the Securities and Exchange Commission (SEC) implemented financial reporting regulations, requiring companies listed on the stock exchange to make detailed financial reports publicly available.³² Regularly, these reports contain relevant information which can be used for transfer pricing purposes. One example would be by checking the assets and liabilities on the balance sheet to determine how fiscally comparable this entity is to the tested party. Information begot from these and other sources is often collected and put into commercial databases, which are then licensed to be used for varying business purposes, including the transfer pricing needs of both tax administrations and taxpayers.

Table 6.1: Various database options.

Moody's Analytics - Bureau van Dijk	Standard & Poor's
Osiris	Compustat
Orbis	Global Vantage
TP Catalyst	Royalty Range
KT Mine	Royalties, interests and service fees
Pathfinder	

Source: Author elaboration.

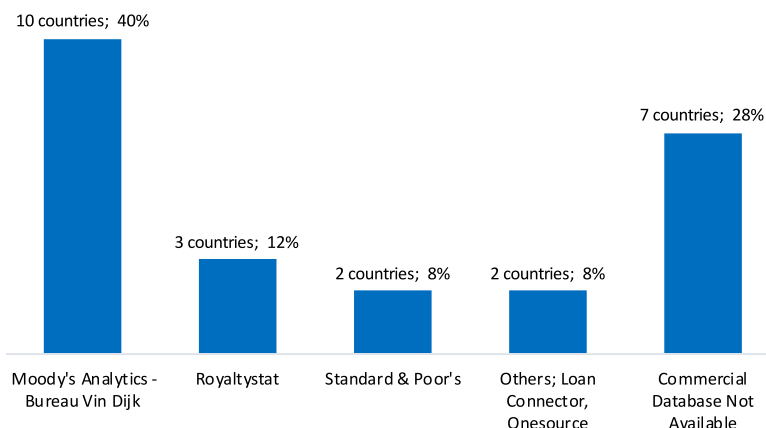
The level of information needed in these databases is staggering, therefore, there are only a handful of analytics companies in the world, who offer these services. The most popular being Bureau van Dijk (subsidiary of Moody's Analytics) and Standard & Poor's.³³ The different databases may have a specialized focus such as commodities or intangibles. For example, Royalty Range operates three databases relating to intangibles: i. royalty rates, ii. loan interest rates and, iii. service fees.

These databases can also be used as a risk analysis tool for tax officials, for example, by calculating internal price ranges for comparison with the prices being reported in the tax return by taxpayers. If certain taxpayers' prices are above or below the price range calculated by the tax administration, then they will be flagged for further investigation. The following chart presents the databases that are most commonly used by officials in the examined countries.

32 This was done in response to the Sarbanes-Oxley Act of 2002. For more information on regulations see <https://www.congress.gov/bill/107th-congress/house-bill/3763>

33 Examples of the different database options offered by these companies are provided in Table 6.1.

Chart 6.1: Type of databases used for transfer pricing control within the countries examined (considering a sample size of 20).



Source: Transfer Pricing Database, Section 1, Data Sources. Accessed through CIAT Data, 2019.

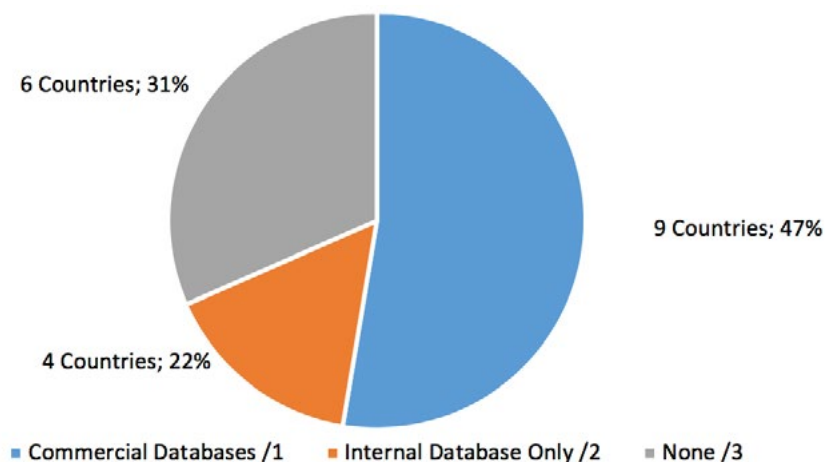
Generally, the tax administrations set the standard trend as to what databases are being used in their country. For example, when the tax authorities in Costa Rica acquired Osiris, then it became more probable for the tax professionals and accounting firms in Costa Rica to also acquire Osiris as the likelihood of rejection of the transfer price is lowered due to a consistency in the information used for the calculations. However, access to these databases can be a substantial expense for both the private sector and developing country administrations, further impairing their possibility of acquisition.

The two countries that have invested heavily in these databases are Colombia and Mexico. Colombia counts on all of the databases offered by Bureau van Dijk, Refinitiv, and uses the KT Mine database specifically for intangible transactions and Eikon for financial transactions, bonds and commodities. Mexico counts on seven databases, the two offered by Standard & Poor's, as well as Osiris, Orbis, and the Amadeus database especially for European markets. For commodities, intangibles, interests and royalties Mexico uses Royaltystat and Loan Connector. In contrast, the tax administration of Brazil responded that it does not use external databases as the onus is on the taxpayer to present a list of comparables to the tax administration, who will then judge their validity.³⁴ Furthermore, Peru has recently changed from Osiris to OneSource in 2017, so far the only analyzed country to have chosen this new database.

The following chart shows the types of databases used specifically for transactions involving commodities or interests and royalties. For the complete list of databases used in each country, refer to the annex of chapter 6.

³⁴ Although the onus is on the taxpayer, as a general rule, the tax authorities have the obligation to provide evidence that supports their tax assessments.

Chart 6.2: Types of databases used for transfer pricing of commodities, interest and royalties (considering a sample size of 19).



1/ Chile, Colombia, Dominican Republic, Ecuador, Honduras, Mexico, Panama, Peru and Uruguay.

2/ Argentina, Bolivia, Brazil and Paraguay.

3/ Costa Rica, El Salvador, Guatemala, Jamaica, Nicaragua and Venezuela.

Source: Transfer Pricing Database, Section 2, Sources of Information for Transfer Pricing Control. Accessed through CIAT Data, 2019.

Often, commercial databases are not created with a transfer pricing objective, therefore, they don't reflect all the relevant factors of a transaction and the information received from them can be convoluted or mislaid. One way to make the use of databases more reliable is by performing adjustments on their results. In theory, their use is recommended only when no other sources of comparable data are available, however, in practice, the use of databases is widespread for the control of transfer pricing and the search for comparables. This is partly because of the ease with which information is attained, and the rising popularity of the TNMM.

Another tool to cultivate data for transfer pricing purposes is through public databases that have been created using local information from domestic sources, such as insurance agencies, the securities market or the central bank. Examples of these can be seen in the table below.

Table 6.2: Internal sources of domestic market information (public databases used for transfer pricing analysis) (considering a sample size of 22).

Country	Database
Bolivia	Financial System Supervisory Authority - FSSA (www.asfi.gob.bo) and Bolivian Stock Exchange (www.bbv.com.bo)
Colombia	SIREM – www.supersociedades.gov.co
Dominican Republic	Central Bank – https://www.bancentral.gov.do/
El Salvador	Central Bank from El Salvador http://www.bcr.gob.sv/bcrsite/?cdr=60 , for interest rates
Jamaica	Information from Regulatory bodies and Jamaica Stock Exchange
Mexico	Mexican Stock Exchange
Panama	Panama Stock Exchange, Bank Superintendence and Insurance and Reinsurance Superintendence.
Peru	Information from the Bank Superintendence, Insurance and AFP and Stock Exchange Superintendence, Lima Stock Exchange
Uruguay	National Internal Auditing Office

Source: Transfer Pricing Database, Section 1, Information Sources for Transfer Pricing Control. Accessed through CIAT Data, 2019.

Lastly, public databases exist, such as the United States Securities and Exchange Commission’s ‘Electronic Data Gathering, Analysis, and Retrieval’ system (EDGAR) which is used by Bolivia, Ecuador, El Salvador, Guatemala and Honduras.

6.1. Advantages and Disadvantages of Databases

Frequently, finding comparable transactions is extremely difficult as companies are rarely in sufficiently similar circumstances or the information necessary is not made public. Therefore, the most reliable sources of information are external and internal databases. CIAT asked its participating member countries to describe the advantages and disadvantages that arise from the use of these distinct databases.

Internal databases are created by culminating information attained through tax returns, customs reports and other domestic means. The advantages of these databases are overwhelmingly related to reliability and ease of access as the information is available at a moment’s notice. Internal databases allow for the crosschecking of data with audit results, tax returns and other financial statements. There are no costs or payments incurred for its use, and the data input is managed in-house which allows for accommodation of the design to the administrations’ needs. Lastly, similarities in the macro-economic and geographical circumstances are more probable.

Disadvantages of internal databases include the lack completeness (a comparability analysis might require more information that must be attained via other sources). Similarly, the quantity of local enterprise transactions may not be enough to find a suitable comparable. There could also be a lack of consistency in the accounting processes between local entities. This would make it difficult to make adjustments without the tools offered by the commercial databases. Lastly, domestic legislation could disallow the use of information attained in a private setting (i.e. ‘secret comparables’).

For those countries who invest in external commercial databases, the advantages include the access to foreign data on multinational operations and other entrepreneurial groups. Speed, reliability, and ease when searching for comparables are other mentioned advantages. The database companies usually offer immediate access to client support systems. Different tools are available to combine, integrate and adjust information, thereby facilitating its use and increasing comparability. Lastly, there are specialized modules targeting different transactions such as those involving royalties, interest rates or even the ‘DEMPE’ functions of intangible property.³⁵

The disadvantages of external databases are that they often focus on the quantity instead of focusing on the quality of the information. The information is global and aggregated; therefore, finding transactions relating to one specific country might be difficult. As with internal databases, they need to be complimented with additional information relating to the macro-economic circumstances of the transactions. Lastly, it may be difficult to ascertain the effect on comparability that is caused by corporate differences in accounting and financial reporting procedures.

35 According to the OECD Transfer Pricing Guidelines, chapter 6, section B; ‘DEMPE’ is the Development, Enhancement, Maintenance, Protection and Exploitation of intangible property (2017).

7. Transfer Pricing Methods

(This chapter gives a general overview of the transfer pricing methods most used in Latin America and the Caribbean. For a detailed explanation of these methods see either the OECD Transfer Pricing Guidelines and/or the UN Practical Manual on Transfer Pricing.)

There exist a number of traditional or transactional, unilateral or bilateral methods to consider when calculating transfer prices. Choosing between these methods depends on the specific circumstances of the transaction being tested. Some guidance is provided in the OECD Transfer Pricing Guidelines and the UN Manual on Transfer Pricing, including the following characteristics that are used to determine the most appropriate method: i. the relative strengths and weaknesses of each method; ii. the nature of the transaction as determined by the functional analysis; iii. the availability of comparables, their degree of comparability, and the reliability of adjustments to eliminate potential differences; iv. the quantity and quality of reliable information for both the controlled and the uncontrolled transactions; and v. the domestic law preference of the countries involved (i.e. a hierarchy or the ‘best method rule’).

If a chosen method results in financial or economic inconsistencies, it may be necessary to repeat the analysis with other methods in the hopes of attaining results better aligned with reality. Furthermore, if the transaction being tested is complicated, it may require multiple methods to be used in combination.³⁶ For these and many other reasons, taxpayers often find it confusing to choose the best method, one suggestion for overcoming this problem is found in the CIAT-GIZ Transfer Pricing Cocktail where a ‘how-to’ guide is presented based on the availability of information and the characteristics of the transaction (i.e. which entity supplied unique and valuable contributions).³⁷

The OECD Transfer Pricing Guidelines do not require all the methods to be tested, just the one that is deemed most appropriate given the circumstances, this is often referred to as the ‘best method rule’, or the ‘rule of best fit’.³⁸ Nevertheless, five of the countries in the region employ a hierarchy, giving a preference to certain methods. Taxpayers are obliged to analyze the respective methods as identified within the domestic legislation, if necessary, they must indicate why the top methods are not appropriate and explain why the method chosen is considered to be the most appropriate.

36 OECD Transfer Pricing Guidelines, page 100, paragraph 2.12 (2017).

37 CIAT-GIZ Transfer Pricing Cocktail, chapter 1, sections 1.2, 1.3 and 1.4 (2019).

38 OECD Transfer Pricing Guidelines, page 99, paragraph 2.8 (2017).

Table 7.1: Procedure for taxpayers to choose the transfer pricing method, according to domestic legislation.

Procedure for choosing the transfer pricing method:	Country
Hierarchy of methods	Dominican Republic /1, Jamaica, Mexico, Panama, and Venezuela /2
'Best method rule'	Argentina /3, Bolivia, Chile, Colombia /4, Costa Rica, Dominican Republic /1, Ecuador, Guatemala, Honduras /5, Nicaragua, Peru and Uruguay
No specification; use domestic regulations as well as the OECD Transfer Pricing Guidelines to make an informed choice.	Brazil /6, El Salvador

1/ The legislation dictates a preference for the traditional methods (CUP, RPM, and CPM) over any others. However, complex transactions or a lack of information may render these methods unusable. In these situations, the 'best method rule' is employed.

2/ The CUP method should be analyzed first, if that one is deemed inappropriate, then another method may be chosen.

3/ Taxpayers should justify why they discarded or accepted certain methods. Furthermore, when pricing internationally traded goods the CUP method is considered most appropriate (Art. 21.6 of the income tax law). For imports/exports of non-commodity transactions in which an international intermediary intervenes the sixth paragraph of Article 15 of the Income Tax Law must be followed (so called 'sixth method').

4/ According to Article 107 of Law 1819 from December 29, 2016 the CUP method is mandatory for commodity transactions. Other methods may only be used with proof of valid economical, technical or financial reasons.

5/ Hierarchy: 1. CUP, 2. RPM, 3. CPM, 4. PSM, 5. TNMM. However, consideration is also given to the circumstances of transaction in determining which method is the best fit. The tax administration will also evaluate the appropriateness of the method based on such circumstances.

6/ In Brazil there is no hierarchy of the methods. The taxpayer is free to choose any of the methods provided for in the legislation (except when dealing with commodity transactions, then the PCI method for imports and the PECEX method for exports should be used)

Source: Transfer Pricing Database, Section 1, Methods. Accessed through CIAT Data, 2019.

7.1. Comparable Uncontrolled Price Method (CUP)

The Comparable Uncontrolled Price method (CUP) establishes the transfer price by comparison to an uncontrolled transaction of similar goods or services, sold between similar entities, in similar conditions. Unfortunately, if the conditions are not sufficiently similar, this can have an influence on the prices being compared, and the CUP will be deemed unusable. This influence can come from dissimilarities between the business strategies or economic circumstances of the entities, the currency or geographical location of the transaction, the utility or branding of the product, etc. The OECD maintains that the CUP method is preferable over all other methods, it allows the taxpayer to avoid choosing a tested party, and that it is the 'most direct and reliable way to apply the arm's length principle'.³⁹ From a conceptual standpoint, this method is easy to understand and quick to use, however, in practice, it is the hardest to apply as acquiring the necessary level of comparability might be challenging. The CUP is most recommended when pricing commodity products or financial transactions for which comparables can be found in transparent markets.

7.2. Cost-Plus Method (CPM)

The Cost-Plus Method (CPM) establishes the appropriate transfer price by using the cost of goods sold or the cost of manufacturing plus an appropriate markup. This markup is based on a benchmark such as the profit margin of comparable entities or the industry average. The CPM is recommended in situations where the manufacturer has simple functions that are easy to identify and compare, or, when

39 OECD Transfer Pricing Guidelines, page 101, paragraph 2.15 (2017).

the manufacturer adds little value to the products, such as a ‘contract’ or a ‘toll’ manufacturer. It may also be used to remunerate commission agents as long as they are performing low value-added services.

A major advantage of the CPM is that it uses readily available internal information for the cost analysis. However, this method is based on gross profits and therefore any differences between comparables in the calculations of operating expenses or cost of goods sold will distort the results.

7.3. Resale Price Method (RPM)

The Resale Price Method (RPM) calculates the transfer price by subtracting an appropriate markup from the sales price. This markup is equal to that which would have been earned by another distributor performing the same functions. The RPM is more reliable when the transactions being priced involve products with an inelastic demand. It is also recommended when the manufacturer adds most of the value, while the distributor has functions that are simple and easy to compare. In general, this method tends to allocate more profits to the country where the manufacturer is located, however, as with the CPM, the RPM is based on gross profits, thus, not taking operating losses into account and being distorted by accounting differences in the comparables. Similarly, the addition of any marketing or brand value by the seller will deem this method unusable.

7.4. Transactional Net Margin Method (TNMM)

The Transactional Net Margin Method (TNMM) arrives at the transfer price by analyzing profit level indicators such as the Return on Sales, Return on Assets, or the Berry Ratio. Choosing the most appropriate indicator will depend on the functional analysis and the nature of the transaction (e.g. using the ‘Return on Capital Employed’ for capital intensive projects). Like the previous two methods, the TNMM is appropriate when there is a ‘least complex’ party that does not add substantial value or perform key functions. The TNMM is also recommended to situations where the comparables are slightly different in their functions and accounting processes because net margins are less affected by transactional and functional differences than the gross margins. Also, the TNMM is recommended when there is lack of information in the comparability analysis (e.g. it is commonly used in countries where the domestic financial reporting regulations do not require multinational companies to release financial reports, as this leads to deficiencies in comparable financial data).

The TNMM is a ‘unilateral’ method, meaning that it is applied to only one of the parties involved in the transaction: the tested party. This allows its use even when there are intangible assets for which comparable returns cannot be determined.

7.5. Profit-Split Method (PSM)

Applying the profit split method might be challenging, however, the method is gaining in popularity as technological advances and the use of intangibles are making transactions more complex. This method is recommendable when all the entities involved in the transaction have valuable contributions and unique functions, which are highly integrated and therefore not comparable to the functions of other entities. This method is also recommended, when the parties involved create synergy and economies of scale (e.g. if the transaction derives significant value from the employment of intangible assets which work together to form a consumer benefit). There are three common ways to apply the profit split method: the ‘Residual PSM’, the ‘Contribution PSM’, and the ‘Comparable PSM’.

The ‘Residual PSM’ first separates the routine functions performed by the entities and remunerates them using one of the four previously presented transfer pricing methods. The ‘residual’ leftover profit is then allocated based on the relative value of each entity’s unique contributions (e.g. the value of the intangibles assets employed). The ‘Comparable PSM’ and the ‘Contribution PSM’ are similar in the remuneration of each function, however they divide the combined profit according to profit data from independent enterprises that perform similar activities.

Nevertheless, taxpayers and the tax administration may find it challenging to calculate the transfer price using the PSM. There may be difficulties in obtaining the financial information necessary from the related party, or, if the information was obtained, the subsequent splitting of the combined revenues, costs and operating expenses for all of the associated enterprises involved is a complex procedure.

7.6. The So-Called ‘Sixth Method’ (also known as the ‘Commodity Rule’)

There is much controversy regarding the so-called sixth method. It could be considered a simplified measure, a safe harbor, a specific anti-abuse rule (SAAR), a way to apply the CUP, or, another transfer pricing method in itself. Mainly, the difference stems from the preservation of the arm’s length principle and the allowance of adjustments to be used (further discussed below). There is no single interpretation of this method as it is modified and manipulated to fit distinct needs depending on: the reason for its use, the context of the country, the types of commodities or raw materials involved, the capacity of the tax administration, etc. Due to the asymmetrical nature of this method, some recommendations were made in the CIAT-GIZ Transfer Pricing Cocktail to have countries offer parallel options when utilizing this method, for example, by giving taxpayers the possibility to apply for an advanced pricing agreement (APA) or by providing an escape clause from the sixth method’s scope.⁴⁰

The sixth method attracted attention for the first time in 2003 when it was adopted into Article 15 of the Argentinian Profit Tax Law. Taxpayers and tax administrations avoid the complex techniques of commodity valuations by choosing to look at the quoted price on international markets instead. However, one of the problems that arises is the variety of financial instruments and markets which can relate to the same product, achieving congruency as to which market price will be used for the valuation of one specific commodity can prove difficult. Also, problems arise due to volatility, by choosing a specific date or time the taxpayer can arrange the price to be more beneficial (further explained below). Until recently, Argentina considered the sixth method as being its own separate method, best suited for transactions dealing with primary commodities such as raw materials. Bolivia reiterated this view within its regulations. Likewise, the United Nations discusses this method within a separate section, on par with the other methods in their UN Manual on Transfer Pricing.⁴¹ Nevertheless, the changes to the Argentinian legislation adopted in December 2017 (Law 27.430 in force as of January 1, 2018) provide for a contradictory position as the ‘sixth method’ has been absorbed under the umbrella of the CUP method. Furthermore, Argentina now requires taxpayers to register the contracts of transactions that fall under this scope; those being commodity transactions in which an intermediary is present (commodity or not). Any variation between the agreed upon price and the market price at the time of delivery might be defensible with proof of the comparability adjustments that led to the difference. The tax authority also introduced a revenue threshold below which transfer pricing requirements are no longer be applicable. These changes exemplify a regional trend to bring the sixth method closer to the CUP method. Further supported by Brazil that explicitly declares that it regards the sixth method as

40 CIAT-GIZ Transfer Pricing Cocktail, chapter 3, section 3.4 (2019).

41 UN Manual on Transfer Pricing, section B.3.4, page 213 (2017).

being a modified version of the CUP. Similarly, the OECD embeds the discussion on the sixth method within the CUP section of the OECD Transfer Pricing Guidelines.⁴²

When the sixth method is employed as a specific anti-abuse rule, it can help curb the triangulation of transactions through tax havens. Accomplishing this task usually involves a substance requirement for the intermediary company at the other end of the transaction. However, considering that many of these intermediaries reside in uncooperative tax jurisdictions, it may be difficult for the tax administrations to obtain the information necessary to prove that there is insufficient substance in the intermediary, or that a relationship exists between the intermediary and the domestic entity.⁴³

The abovementioned differences to approach this method stem from concern over whether the arm's length principle is being upheld. Generally, if the sixth method is applied without allowing for comparability adjustments, or, allowing for only a few specific adjustments, then it won't reflect the specific circumstances of that transaction or the arm's length price. In other words, if adjustments are disallowed, the fundamental principles of transfer pricing are dismissed, reducing its alignment with the CUP method. Even when the arm's length principle is upheld through adjustments for quality, volume, insurance, freight costs, country risk, etc., this may not be enough to offset the fundamental circumstantial differences between the quoted price (which is reflective of all these variables combined) and the transfer price (which should reflect the comparability factors of the companies involved). Effectively, companies are forced to absorb the difference between their costs and those reflected in the market price. Furthermore, the price of commodities is often influenced by market speculation of the product's future value, therefore, the price can drastically fluctuate depending on portfolio strategies, ratings, derivatives, interest rates, inflation, and other financial market traits. In addition, there exist differing strategies to calculate the price of stocks and bonds: the Constant Dividend Growth Model, the Discounted Cash Flow Method, and the Capital Asset Pricing Model, amongst others. These models may influence the commodity's price in the market but will also not be reflective of the arm's length principle.

Tax administrations face many challenges when dealing with commodity transactions such as the complexity of valuation, the shifting of profits through associated intermediaries, or the manipulation of the transaction date on the invoice. In some countries the sixth method is only applied when related intermediaries without economic substance are involved in the transaction. In such a case, the definition of 'intermediary' should be clarified and taxpayers should be allowed to present evidence that their intermediaries have legitimate substantial activity to be exempted from the rule. It is also important to clarify which products will be subject to the sixth method and how the date of the transaction will be determined. These aspects are manipulated by each country to create the version of the method which best suits their tax administration's capacities (for additional details and examples of the country's variations see the chart in the annex of chapter 7⁴⁴). The table below shows a summary of the various details implemented by the countries in the region.

42 OECD Transfer Pricing Guidelines, section 2.18-2.22, page 102-104 (2017).

43 Further discussion of the 'sixth method' being utilized as a simplified measure can be found in chapter 16.

44 The chart in the annex to chapter 7 is from section 3.4 of the CIAT-GIZ Transfer Pricing Cocktail, where more information can be found regarding the sixth method.

Table 7.2: Variations on the so-called 'sixth method' application.

Countries	Applies to Exports	Applies to Imports	Applies to commodities	Requires Intermediary	Date of Shipment	Date of Unloading
Argentina	X	X	X/1	X	X	
Bolivia	X	X			X	X
Brazil	X	X	X		X/2	
Costa Rica	X	X	X			
Dominican Republic	X	X	X		X	X
Ecuador	X		X			
Guatemala	X	X	X	X	X	X
Paraguay	X		X			
Peru	X	X				
Uruguay	X	X				

1/ As of January 1, 2018 the 'sixth method' has been absorbed by the CUP. These valuation factors apply to the exportation of commodities when an intermediary is present, as well as the import and export of non-commodity goods when an intermediary is present.

2/ If it is not possible to identify the transaction date, the date of shipment should be used.

Source: Transfer Pricing Database, Section 3, Sixth Method. Accessed through CIAT Data, 2019.

Thankfully, the Mutual Agreement Procedure contained in Article 25 of most bilateral tax treaties might help to soothe the potential conflicts that arise from the different ways to apply this method. Furthermore, CIAT is in a unique position to foster international congruency, perhaps by creating a forum for cooperative discussion with the countries in the region (potentially inviting feedback from the private sector). This forum would benefit from the encounters of countries that have not experienced success with this method, such as Ecuador and Peru. The sixth method was introduced in 2013 in the Peruvian legislation through Decree No. 1120 as a way to apply the CUP method. However, this provision never came into effect. In Ecuador, the sixth method was introduced in 2016, requiring taxpayers dealing in crude oil, metals or bananas to use market prices calculated for tax purposes. However, this law was quickly repealed from the Ecuadorian legislation as rules regarding the use of quoted prices were already in existence via previous regulations (for the oil sector since the 1980's, for metals since 2013, for bananas since 2015). Therefore, the main conflict with the sixth method was the coexistence of two domestic standards that had the same objective. In 2017, Ecuador re-introduced a specific anti-abuse rule based on the suggestions found in the CIAT-GIZ Transfer Pricing Cocktail to apply for the exportation of crude oil, metals, or bananas. It includes specified measures for intermediaries, the use of known quoted prices calculated based on dates according to the individual sector (for metals the contract date is considered, if this is not available, then the month after the one of shipment; for crude oil the month before that of exportation is used; for bananas an annual indexed price is calculated using information from the IMF, World Bank, and the USA Department of Agriculture).

7.7. Methods Used Across the Latin American and Caribbean Regions

There is a strong connection between fully understanding the nature of the transaction being priced and choosing the correct method via a thorough functional and factual analysis. Having knowledge as to the circumstances under which each method will be applied is a determinant factor in choosing the appropriate method. Despite this, there is complacent consistency across the region in regard to the methods most used.

Table 7.3: Per country report of the most used transfer pricing method.

Country /1	Most Used Method
Bolivia	TNMM
Brazil	PRL (Modified RPM) /2
Chile	TNMM
Colombia	TNMM
Costa Rica	TNMM
Dominican Republic	TNMM
Ecuador	TNMM
El Salvador	TNMM
Guatemala	TNMM
Honduras	TNMM
Jamaica	CPM
Mexico	TNMM
Panama	TNMM
Paraguay /3	Price Adjustment Method
Peru	TNMM
Uruguay	TNMM
Venezuela	TNMM

1/ The information was not available from Argentina.

2/ Brazil uses a modified version of the RPM to align with their fixed margin regime (further explained below).

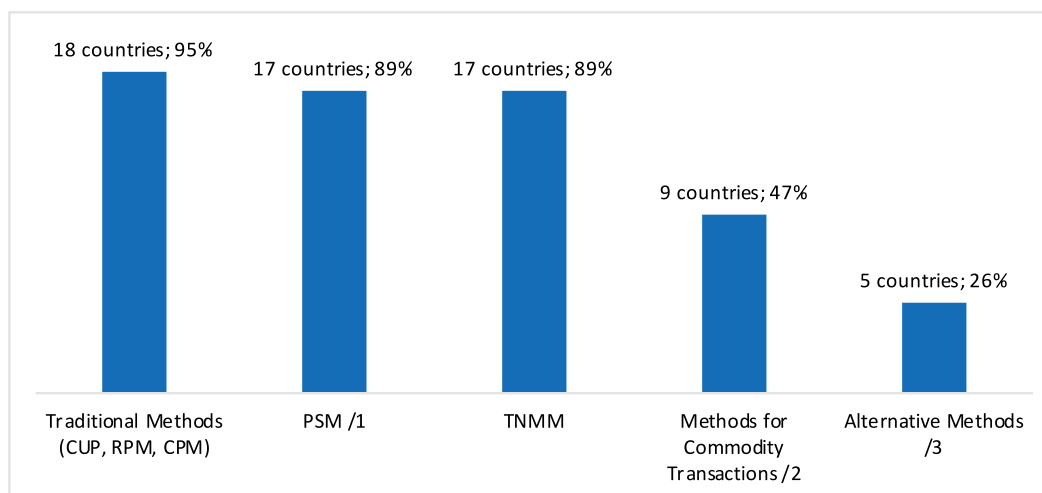
3/ At the time of writing, Paraguay was in the process of designing a reform to their tax regime which proposes to adopt the five transfer pricing methods recommended by the OECD.

Source: Transfer Pricing Database, Section 1, Methods. Accessed through CIAT Data, 2019.

All of the countries listed above (except for Paraguay) apply the arm's length principle through unilateral methods, mostly the TNMM, but also a modified version of the RPM in Brazil and the CPM in Jamaica. Unilateral methods restrict the analysis to only one side of the transaction: the tested party. Therefore, this practice of applying unilaterally focused methods more frequently than any other method, may cause distortions. As pointed out in the previously mentioned CIAT-GIZ Transfer Pricing Cocktail, this might result in two main problems: “(1) the impulsive exclusion of other methods which could be more appropriate for that particular case, and (2) the application of a method which is not appropriate nor acceptable for the specific situation.” – CIAT-GIZ Transfer Pricing Cocktail, chapter 1, section 1.2 (2019).⁴⁵

⁴⁵ For a further discussion and potential solutions to approach this issue, see chapter 1 of the CIAT-GIZ Transfer Pricing Cocktail (2019).

Chart 7.1: Allowable methods according to domestic legislations in 2016 (considering a sample size of 19). (For more detailed information see the annex of chapter 7).



1/ The PSM can be further divided into two categories; the contribution/comparable PSM (17 countries) and the residual PSM (9 countries).

2/ The term 'commodity transactions' refers to primary or raw materials.

3/ In 2018, Argentina introduced a norm that allowed taxpayers to use alternative methods when pricing transactions involving valuable and unique intangibles or certain financial assets as defined in Decree 1170/2018.

Source: Selected tax administrations of CIAT member countries.

Eighteen of the countries analyzed, all except Paraguay, allow for the use of the traditional OECD methods: the CUP, RPM, and CPM (although Brazil modifies their application). As for the transactional methods: the TNMM and PSM, all of the countries except for Brazil and Paraguay approve the 'contribution' or 'comparable' PSM calculations, whereas only nine of them approve the 'residual' PSM calculation. The countries that allow for the use of alternative methods are Brazil, Chile, Honduras, Jamaica and Paraguay.

In Brazil, the situation is quite unique; the traditional methods are altered to provide fixed margins that are meant to further simplify the transfer pricing process and may often remove the need for a comparability analysis. These margins are established by law, deriving from industry practices and intended to be in line with the arm's length principle. Brazil will demand for adjustments to be made in the case of exports when the agreed upon price is lower than the 'parameter price' set by the tax administration. Similarly, for imports, adjustments are demanded when the agreed upon price is higher than the parameter price.

Generally, Brazil allows the taxpayer to select any method, with one exception: commodity transactions must be priced according to the PCI method for imports and the PECEX method for exports. Both methods, the PCI and the PECEX, work similarly to the 'sixth method' using the average quoted price on the international commodity market as the arm's length price. They also allow for certain adjustments to be made for differences in quality and terms of payment. As a last resort, if there is no price available on the commodity market, then the arm's length price may be obtained using an internationally recognized database. In this sense, Brazil seems to be finding a middle ground between the OECD's CUP recommendations and the so-called 'sixth method'.

In the above chart, the category ‘Methods for Commodity Transactions’ includes the so-called ‘sixth method’, however, some of the countries choose not to utilize this name because they do not consider it to be its own method.

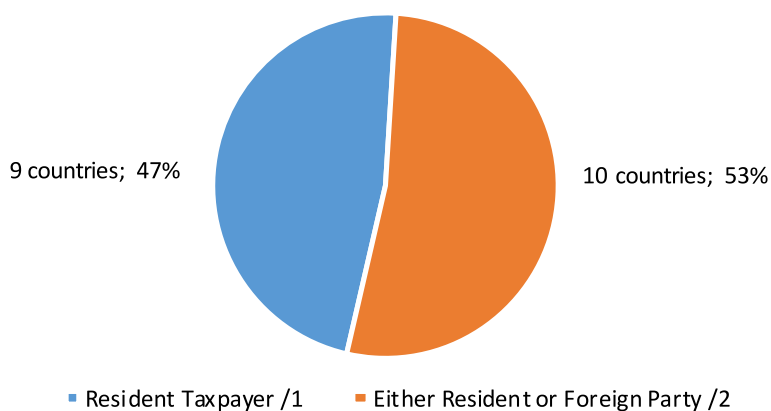
Furthermore, Paraguay does not yet have the traditional or transactional transfer pricing methods in place, nevertheless, there is the Price Adjustment method for commodity transactions is used (i.e.: agricultural exports).

The remaining three countries that allow the use of alternative methods do so via a determination by the taxpayer. These are; Chile, Honduras and Jamaica (in the case of Jamaica, also by the General Commissioner). This possibility is also contained in paragraph 2.9 of the OECD Transfer Pricing Guidelines that endorse the “freedom to apply methods not described in these Guidelines...to establish prices provided those prices satisfy the arm’s length principle”⁴⁶

7.8. The Tested Party

The application of one-side methods requires the selection of a tested party that will act as the basis for the comparison. The tested party must be the least complex entity of the transaction, this allows for maximum similarity with the comparables. Often the tested party is the resident taxpayer, however, the tax administration may also accept the foreign party as the tested party, as long as this achieves the best results. Such is the case in ten of the countries in the region which allow either the resident taxpayer or the foreign entity to be chosen as the tested party. Meanwhile nine countries insist on exclusively using the resident taxpayer entity as the tested party.

Chart 7.2: Determination of the tested party according to domestic legislation (considering a sample size of 19).



1/ Argentina, Brazil, El Salvador, Jamaica, Nicaragua, Panama, Paraguay, Peru and Venezuela.

2/ Bolivia, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Mexico and Uruguay.

Source: Transfer Pricing Database, Section 2, Tested Party. Accessed through CIAT Data, 2019.

⁴⁶ OECD Transfer Pricing Guidelines, paragraph 2.9, page 99 (2017).

8. Financial Indicators – Profit Level Indicators

In the context of transfer pricing, financial indicators are tools that support the comparative analysis to evaluate the accuracy of a chosen method, or, to apply the transactional net margin method in the case of profit level indicators. Likewise, tax administrations may use financial indicators for risk assessment by analyzing whether the transactions under the scope of the transfer pricing regime (i.e. operations performed with related parties or tax havens) have similar levels of financial ratios (costs and profits) as transactions performed at arm's length.

Deciding the financial indicator to be used can be quite challenging, as each of them are affected by several factors (e.g. comparing price ratios might be influenced by differences in the characteristics of the products while comparing gross margins might be affected by functional differences). Likewise, net profit margins might be less sensitive than gross margins to differences in the functions of the entity and the level of risks assumed. However, they are affected by the absorption of indirect fixed costs and therefore can be more sensitive to differences in the capacity utilization.⁴⁷

The use of financial indicators requires careful consideration as many factors that are indirectly related to transfer pricing might affect the results, such as competitive position, market share, management efficiency, individual business strategies, differences in cost of capital, etc. Also, it could be that the tested transactions are mixed with aspects from unrelated transactions (e.g. if the profits attributable to the controlled transaction are not segmented). In countries with a lack of public data and absence of clarity regarding the expenses that have been classified as operating or direct expenses, it is difficult to compare margins.

The Berry ratio compares a company's gross profit to its operating expenses. This ratio is used as an indicator of a company's profit over a given time period. However, the comparison may be distorted due to its high sensitivity for differences in the calculation of operating expenses of each entity.

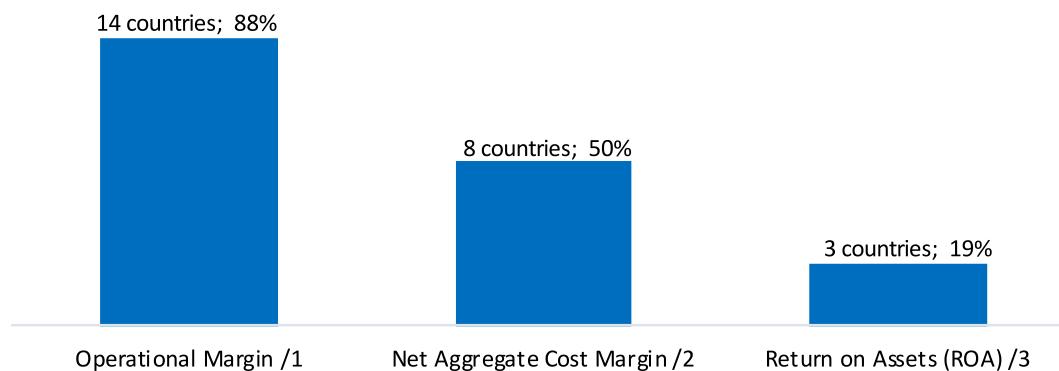
The 'operating margin', also known as the return on sales (ROS) ratio, measures how much profit a company makes on a dollar of sales after paying for all other costs except for interests and taxes. It is a good indicator of management efficiency and risk (more variance in this ratio equals more risk).

Return on assets (ROA) indicates the profitability of a company relative to its total assets. It measures how efficiently a company uses its assets to generate earnings. However, comparing ROA is difficult as it can vary greatly depending on the type of industry.

The following chart shows the financial indicators that are most commonly used by the tax administrations when comparing the results of related party transactions with and independent ones;

47 Explained in more detail in the OECD Transfer Pricing Guidelines, annex 1 to chapter 2, pages 425-430 (2017).

Chart 8.1: Most common financial indicators as reported by countries in 2016 (considering a sample size of 16).



1/ Bolivia, Brazil, Chile, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Jamaica, Mexico, Panama, Peru, Uruguay and Venezuela.

2/ Chile, Colombia, Dominican Republic, El Salvador, Honduras, Jamaica, Mexico and Peru.

3/ Argentina, Jamaica and Uruguay.

Source: Selected tax administrations of CIAT member countries.

Net margin indicators such as the ‘Net Aggregate Cost Margin’, account for direct costs, but also for indirect or ‘operational’ costs. In opposition, only three of the countries in the region, Argentina, Jamaica and Uruguay, use the ROA ratio. This is a gross measure corresponding to the percentage of profit or loss for every dollar invested (without accounting for indirect costs). Surprisingly, none of the countries reported the use of the Berry Ratio, which tends to go hand in hand with the TNMM method. This might be explained by the fact that the method is applied on the taxpayer’s side and therefore the tax administrations did not report its use.

Many types of indicators could be used for comparison purposes (e.g. Jamaica takes into consideration financial restructuring and loan information to better understand the financial positions of the companies being compared). However, as previously mentioned, drawing any conclusion from these financial indicators might be challenging since small details could indirectly influence the costs or prices used in the calculation, such as the effectiveness of management and logistics, marketing and demand, performance of long-term assets and investments, etc.

To increase accuracy and representation of the comparables, a price range can be constructed by calculating the interquartile range using financial information from the comparables. Generally, price ranges result when multiple methods are utilized or when more than one comparable exists. However, ranges do not in themselves help to increase reliability. The appropriateness of the range, relative to the arm’s length price, is determined by the quality of the information used.

Using the middle two quarters of the interquartile range helps to narrow the range of potential prices and to increase accuracy by eliminating outliers. Similarly, the mean will help determine central tendency. These concepts can be intertwined, or, further added to. For example, in Argentina, if the transfer price is outside the mid-quartile range (lower than the first quartile or greater than the third quartile) then the median is respectively reduced or increased by 5%. Also, in Bolivia if the price falls outside the range, and this causes a decrease in the taxable base, then the price must be adjusted based on a formula contained in Article 10 of Regulatory Decree 10-0008-15.

Almost all the countries in the study allow the use of price ranges, either the average mean or the interquartile range to arrive at the appropriate transfer price. The three outlier countries are Brazil, Chile and Paraguay. In Chile, neither the legislation nor the administrative regulations, specify the acceptance of the interquartile range. Nevertheless, it is used as an international best practice. Paraguay has not adopted a traditional transfer pricing regime yet, but establishes the price for export transactions according to a formula, taking the referential price obtained from transparent markets and deducting the necessary expenses for comparability. In Brazil, price ranges are not used, however, it is considered legally acceptable to have a 5% (3% in the case of commodities) divergence between the average price agreed-upon by the taxpayers and the average 'parameter price'.

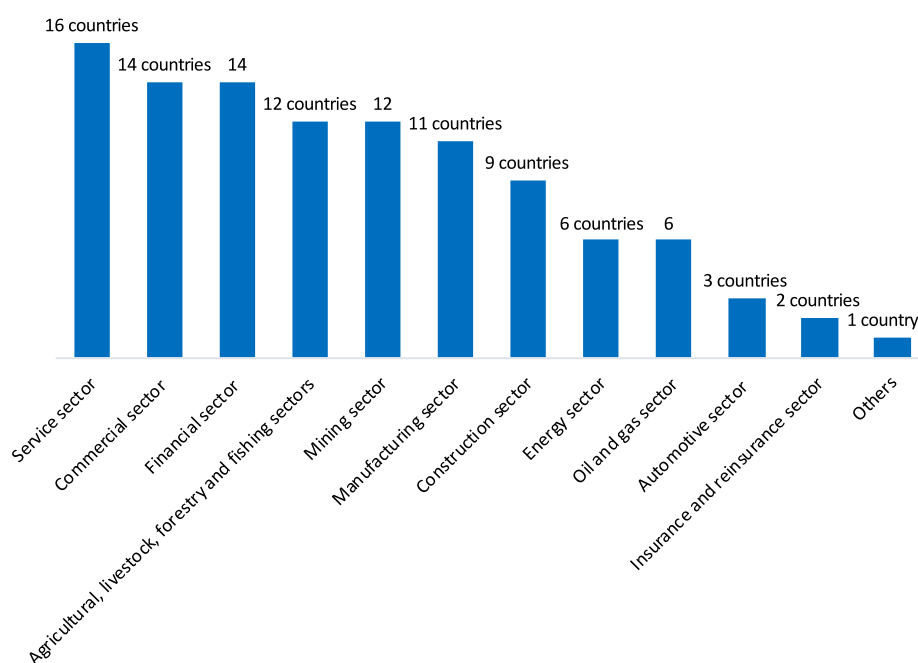
9. Economic Sectors

Identifying in an aggregated manner the interaction between the transfer pricing controls that are imposed by the tax administrations and the key economic sectors of the analyzed countries could help to reduce biases or incoherency in the imposition of transfer pricing controls. This information is essential for transfer pricing professionals, both in the public and private sectors, especially for transactions in developing economies like those found in parts of Latin America and the Caribbean. For these economies, taxation has a heavy impact on the income of the few large economic players that represent the most significant weight in the collection of taxes.

The study of economic sectors involves analyzing the business characteristics and value chains, the historical collective attitude towards taxation in both domestic and foreign contexts, the analysis of financial data and other relevant factors that allow for better understanding. Given this information, the tax administration can develop customized strategies for defining more effective control mechanisms based on the perceived risks of the industry and mechanisms to facilitate tax compliance. Doing so, will improve the tax administration's relationship with the most vital economic sectors of the country, generating higher certainty for taxpayers, decreasing compliance costs and imposing restrictions only in those cases where the level of risk requires so.

Providing the context for this topic, the key economic sectors for twenty-two countries in Latin America and the Caribbean are presented below in an aggregated manner.

Chart 9.1: Main economic sectors as reported by the participating CIAT member countries (considering a sample of 22).



Others: Pharmaceutical sector.

Source: Transfer Pricing Database, Section 2, Economic Sectors. Accessed through CIAT Data, 2019. (For a complete description of which countries reported certain sectors, see the annex of chapter 9).

Following global trends, the services sector has the most expanded market share, continually growing its financial capacity. This sector was mentioned as one of the top five economic sectors by sixteen countries (73%).⁴⁸ It may be expected as the category in itself casts a wide net, encompassing the (often quite large) insurance, reinsurance and financial services industries. Other industries mentioned in this category were transportation and storage services in Bolivia, restaurants and hotels in El Salvador, telecommunications and tourism in Jamaica, educational services in Mexico, and telecommunications, hotels, bars and restaurants in the Dominican Republic.

Diving even further, the economic sectors that are perceived to have the highest risk of transfer mispricing according to the tax administration are shown in the following chart.

Chart 9.2: Sectors in which the most transfer pricing risks are perceived by the tax administrations of LAC CIAT member countries (considering a sample size of 21).

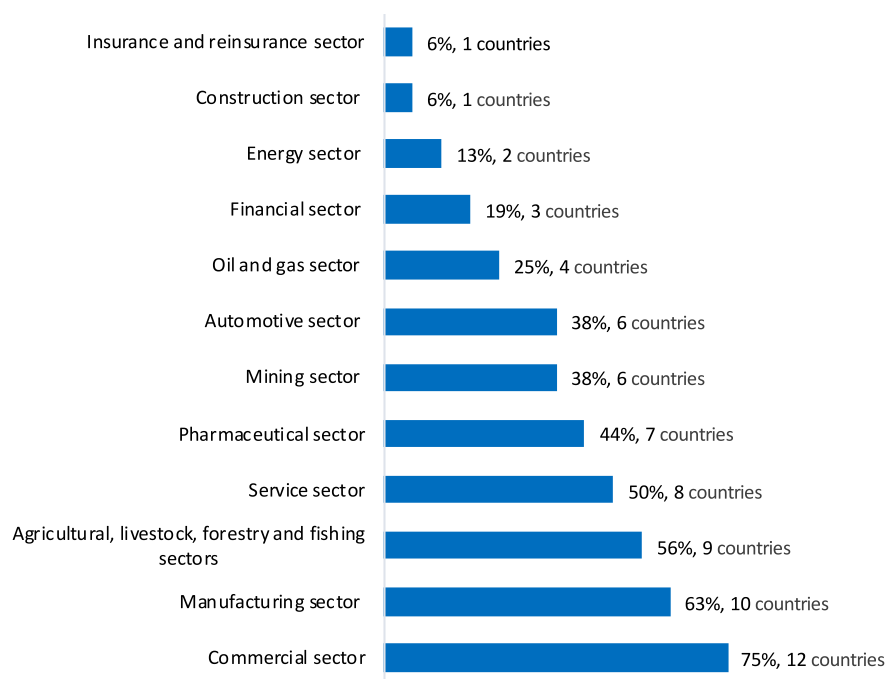


Source: Transfer Pricing Database, Section 2, Economic Sectors. Accessed through CIAT Data, 2019.

The above chart is only an estimated prediction of risk by the tax administrations according to the various factors that help to delineate targets for their control mechanisms. It can be useful to compare these sectors predicted as ‘risky’ with the actual occurrence of abuse by taxpayers. The chart below outlines the sectors in which transfer pricing manipulations have been detected by the tax administrations of the countries analyzed.

⁴⁸ These sixteen countries are: Bolivia, Barbados, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago and Uruguay.

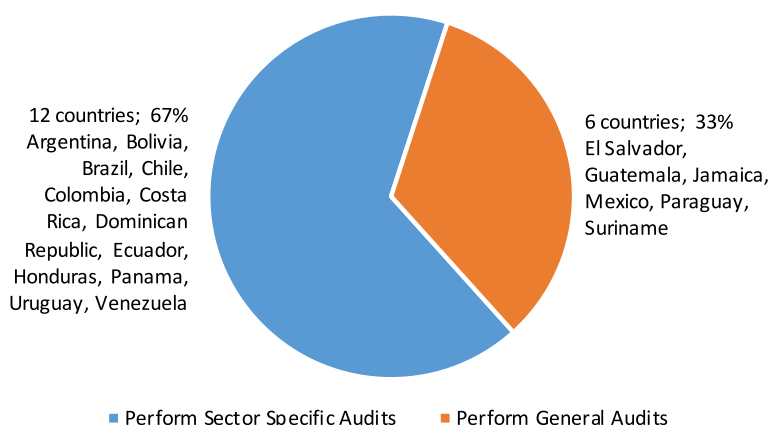
Chart 9.3: Actual occurrences of transfer pricing manipulations per sector (considering a sample of 16).



Source: Transfer Pricing Database, Section 2, Economic Sectors. Accessed through CIAT Data, 2019.

In general terms, the similarity between the two charts is encouraging for the tax administrations, whose risk perceptions lead them to predictions that are sufficiently accurate. Where the tax administrations predict that there may be a risk, is where abusive transactions are being discovered. Although this could be a 'chicken-and-egg' situation, the similarities allow tax administrations to justify implementing more focused controls in these areas. Furthermore, the evidential accuracy of predicting abusive sectors could serve as an argument for tax officials to have enhanced liberty in their auditing and control procedures, such as being able to choose whether to audit certain industries over others. In fact, the tax officials of twelve countries are able to take the aforementioned data and use it for the purposes of performing more targeted, 'sector-specific' audits. This innovative option is exhibited in the following chart.

Chart 9.4: Performance of sector specific audits versus general audits (considering a sample size of 18).



Source: Transfer Pricing Database, Section 2, Economic Sectors. Accessed through CIAT Data, 2019.

The following analysis shows the transfer pricing methods most used in each of the abovementioned sectors.⁴⁹

Table 9.1: Most used method in each sector as reported by the countries.

Agricultural, livestock, forestry and fishing sectors	CUP
Mining sector	CUP
Construction sector	TNMM
Oil and gas sector	TNMM
Manufacturing sector	TNMM
Service sector	TNMM
Commercial sector	TNMM
Financial sector	TNMM
Automotive sector	TNMM
Pharmaceutical sector	TNMM
Others	TNMM

Source: Transfer Pricing Database, Section 2, Economic Sectors. Accessed through CIAT Data, 2019.

The previous chart presents an aggregated view of the most used method in each sector. It was created using combined information from the tax administrations of the region.⁵⁰ The RPM was mentioned as the second-most used method in the commercial activities sector. In the manufacturing activities sector, the CPM was the second-most used method. And, as expected, the sixth method was only mentioned in the Agriculture, Livestock, Forestry and Fishing sectors, as well as in the Oil and Gas sectors.

⁴⁹ Countries without transfer pricing regimes are missing from the analysis, along with Brazil that employs fixed margins.

⁵⁰ The segregated information of the individual methods that were highlighted by each country per sector can be found in the 'Economic Sectors' tab of the Transfer Pricing Database in CIAT Data.

10. Intra-Group Interest Rates

A lack of consensus and general inexperience regarding the treatment of intra-group loans is a problem that plagues transfer pricing professionals, not just in Latin America and the Caribbean, but in a global context. The complexities surrounding this topic are exacerbated by the use of hybrid financing instruments that have characteristics of both, debt and equity. Although the research and mainstream publications relating to this issue have only begun to emerge in the last few years, the importance of this particular subject should not be underestimated as multinational enterprises are increasingly consolidating their international accounts and creating entities such as in-house banks to centralize group financing needs for better management and control.

The definition of what constitutes ‘interest’ payments and their subsequent treatment is usually defined in each country’s domestic legislation which potentially leads to regional inconsistencies. In an international context, however, the taxation of interest is governed by Article eleven of the Model Tax Conventions (UN and OECD Models) that provide a three-part definition:

“The term “interest” as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.” - Art. 11 (3) of both the 2017 model tax conventions by the OECD and the UN.

Different approaches exist for pricing intra-group loans and determining the appropriate (arm’s length) interest rate. As is usually the case when pricing any related party transaction, outlining the characteristics of the transaction is important to designate the correct method. The OECD generally prefers the CUP method, as long as it is in line with the functional analysis of the transaction.⁵¹ The arm’s length interest rate should be determined with regard to the terms and conditions of the loan, the credit rating of the borrower, and other comparability factors such as the maturity date, collateral, guarantees, repayment conditions, the availability to recall the loan, covenants or restrictions, etc.

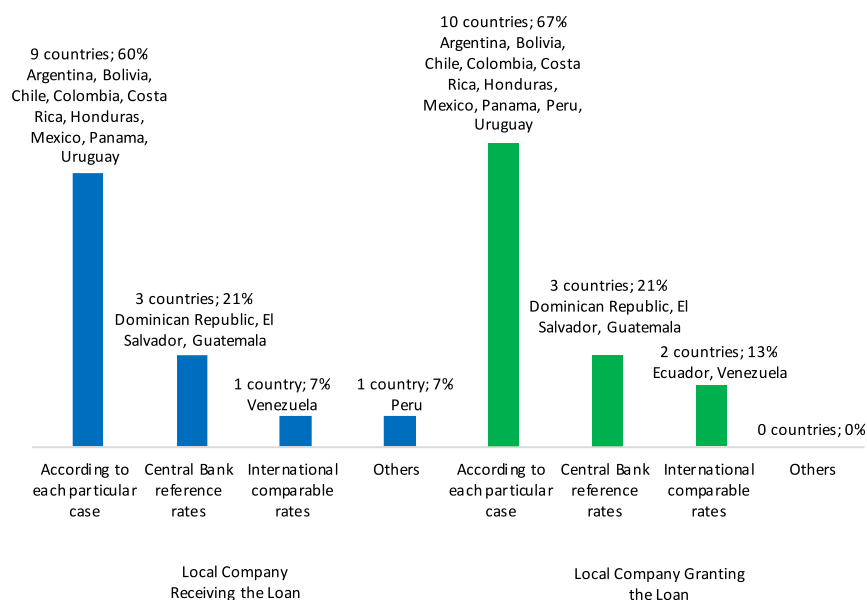
Across the Latin American and the Caribbean region, one is hard pressed to find any jurisprudence regarding this subject. As of 2018, none of the twenty analyzed countries had any judgments by a superior court of cases concerning the interest rate that should be used for financial transactions between related parties.⁵² Additionally, Bolivia, Brazil and Peru are the only countries to have legislation regarding the interest rate that should be used by their taxpayers when pricing related-party financing transactions. When taxpayers use this rate, they will be presumed to be in compliance with the arm’s length principle.

Generally, tax administrations will also have their own methods for calculating and comparing related-party financial transactions, in order to ascertain compliance with the arm’s length principle. The various methods for calculating the interest rate of an inter-group loan can be seen in the chart below.

⁵¹ Section C.1.7 of the OECD BEPS Actions 8-10 Public Discussion Draft released for comments in 2018.

⁵² These twenty countries are; Argentina, Bolivia, Barbados, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru, Dominican Republic, Suriname, Uruguay and Venezuela.

Chart 10.1: Methods used by the tax administration for control of the interest rates applied to related-party loans (considering a sample size of 15).



Source: Transfer Pricing Database, Section 2, Interest Rates. Accessed through CIAT Data, 2019.

In the ‘others’ category: the Dominican Republic uses domestic interest rates when the debtor is local and foreign interest rates when the debtor is abroad. Under special circumstances, there is also the option to calculate the interest rate depending on the solvency of the debtor or using international rates (e.g. using LIBOR rate). As for Peru, when the local company is receiving the loan, they use the rate for similar amounts provided by domestic commercial banks. No information was attained for situations when the company in Peru is granting the loan.

Furthermore, there are many differences amongst the application of the varying country’s legislations. For example, concerning the use of the central bank interest rate as a reference; In El Salvador, when the local company is receiving the loan, the Tax Code dictates that the interest rate should not exceed the rate published by the Central Reserve Bank plus four additional points (Article 29-A regulating thin-capitalization). Additionally, when the local company is granting the loan, the interest should not be lower than that provided by the Central Reserve Bank for a comparable type of credit being granted (Article 192-A regulating the deemed profit margin for loan services).

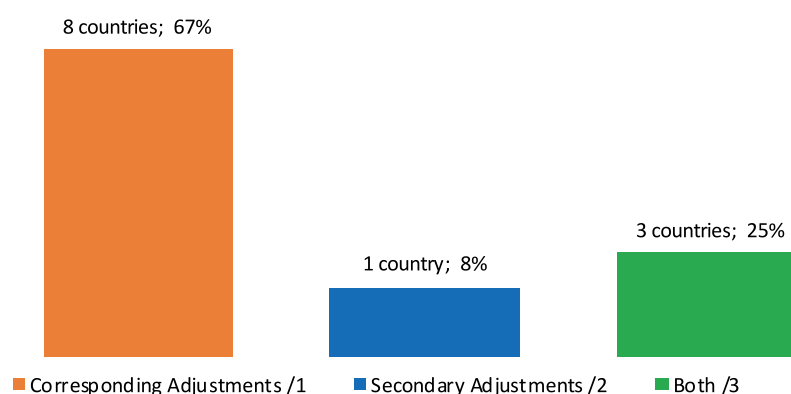
In Guatemala, when the local company is receiving the loan, Article 24 of Decree No. 10-2012 dictates that the interest rate on loans in foreign currencies should not exceed the annual maximum rate determined by the Monetary Board, minus the value of the exchange rate variation between the Guatemalan ‘Quetzal’ and the currency of the loan. Furthermore, when the local company is granting the loan, the interest rate cannot exceed the annual maximum simple rate determined by the Monetary Board, also, it cannot exceed the referred rate of interest multiplied by three times the average total net asset submitted by the taxpayer in their annual tax return.

11. Transfer Pricing Adjustments

The three general approaches used by countries for making transfer pricing adjustments are: comparability adjustments, primary or corresponding adjustments and secondary adjustments. The first and most commonly performed are the comparability adjustments, which are used by both, the taxpayer and the tax administration, to eliminate material differences and improve similarity between the transactions being compared. The higher the level of comparability, the more reliable the transfer price will be. These adjustments are followed by the primary and corresponding adjustments. The primary adjustment is made by the tax administration when examining the taxpayer's transfer pricing study and the return upon which the tax is calculated. The corresponding adjustment is the consequential adjustment done in response to the primary adjustment, by the tax administration of the country at the other end of the transaction. This corresponding adjustment is necessary to eliminate potential economic double taxation in the hands of the related entity. However, in practice, they are difficult to substantiate. A lack of international consensus and diverging regulations cause countries to hastily reject the foreign jurisdiction's primary adjustment. Further complications arise when countries attempt to reach an agreement as to the fair allocation of value creation for each of the jurisdictions involved. Lastly, transfer pricing legislation may allow the use of secondary adjustments. These adjustments are performed in a purely domestic context when a primary adjustment is made by the tax administration, it could trigger the need for a secondary adjustment, which captures the changes in account balances that arose as a consequence.

All the countries covered under this study that have transfer pricing regulations, may practice primary adjustments with their taxpayers. However, the foreign corresponding adjustments and the secondary adjustments are less frequent.

Chart 11.1: Transfer pricing adjustments used by LAC CIAT member countries (considering a sample size of 12).



1/Argentina, Chile, Colombia, Costa Rica, El Salvador, Honduras, Mexico and Panama.

2/ Venezuela.

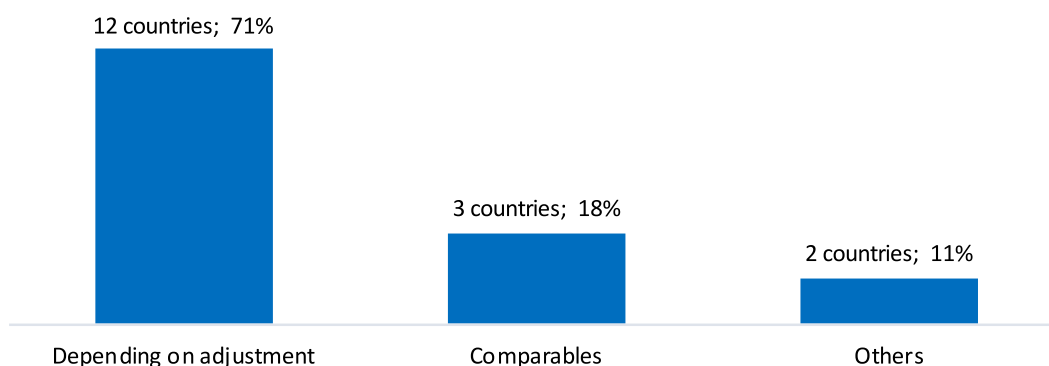
3/ Dominican Republic, Jamaica and Peru.

Source: Transfer Pricing Database, Section 1, Adjustments. Accessed through CIAT Data, 2019.

Overcoming the difficulty of substantiating the corresponding adjustments may be easier if a double tax convention is available. For example, in Uruguay there is no internal regulation which allows for corresponding adjustments to be effected, however, they may be carried out through the provisions of the double taxation convention. Similarly, the Ecuadorian tax administration accepts that the obligation to apply corresponding adjustments may arise from any of their double tax conventions (although, as of mid-2019, it has not yet happened).

Furthermore, depending on the applicable legislation, adjustments can be perpetrated upon the taxpayer's information and/or upon the information of the comparable entity. Out of the countries in our study, 71% (Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Jamaica, Panama, Peru, and Uruguay) were flexible in allowing the adjustment to be applied to either the taxpayer or the comparable, as required by the circumstances. However, the Dominican Republic, El Salvador and Mexico are more rigid, as they only allow adjustments to be performed on the comparables' information. Interestingly, none of the countries in our study restricted the application of the adjustment solely to the taxpayers' side (with the exception of Paraguay which is further explained below).

Chart 11.2: Which party the transfer pricing adjustments are applied to (considering a sample size of 17).



Source: Transfer Pricing Database, Section 1, Adjustments. Accessed through CIAT Data, 2019.

The two countries in the 'others' category are Paraguay and Brazil. For Paraguay, typical transfer pricing rules are not yet available, the measures in existence could be considered anti-abuse rules as taxpayers are obliged to perform self-adjustments, using a referential price formula to calculate the transfer price of their agricultural exports. In Brazil, adjustments are used in specific situations - for the PIC and PEVEX methods⁵³ comparability adjustments are allowed if they are grounded on the terms of payment, the quantity bought, guarantees given, promotional costs, publicity costs, intermediary costs, transport, insurance premiums, shipping, warehousing, and import/export duties. Furthermore, the PCI and PECEX methods⁵⁴ (mandatory when trading in commodities) also permit adjustments for: the costs that arise due to the fluctuation of the commodity price, for differences between the agreed upon contract price and the stock market price, and, for the premiums or discounts received by the seller due to the differences in the characteristics of the commodity in question and its counterpart on

53 The Brazilian PIC and PEVEX methods are a customization of the OECD's CUP method.

54 The Brazilian PCI and PECEX methods are a customization of the so called 'sixth method' used for commodity transactions.

the commodities market or the futures exchange market. The variables considered for the adjustments are: payment terms, quantity, climatic influences, unrelated intermediary costs, packaging, insurance, freight and terminal handling charges, internal transportation, warehousing fees and customs costs (including taxes and import duties). Through their use of fixed margins, Brazil intends to provide simplicity for the taxpayers; however, it may create potential difficulties when justifying an adjustment before a foreign jurisdiction as the transfer price is not based on a comparability analysis, thus potentially seeming less compliant with the arm's length principle.

11.1. Comparability Adjustments

Comparability adjustments are easier to understand, as they have a very specific purpose of removing any material differences between the transactions that are being priced and the comparables used to arrive at the arm's length price. In the OECD Transfer Pricing Guidelines, the OECD differentiates between three kinds of comparability adjustments: i. those that reduce differences in accounting practices between the two entities being compared, ii. those that segment financial data to eliminate a set of non-comparable transactions from the calculations or which make up for different values in inventory, accounts payable and receivable, interest rates or other similar aspects, and, iii. adjustments for differences in the circumstances of the two entities being compared, such as functions performed, assets used or risks assumed by the taxpayer versus those performed, used or assumed by the comparable (e.g. transport terms, insurance premiums, location savings, country risks, etc.).⁵⁵

According to the tax administrations analyzed in this study, the comparability adjustments more used by taxpayers are:

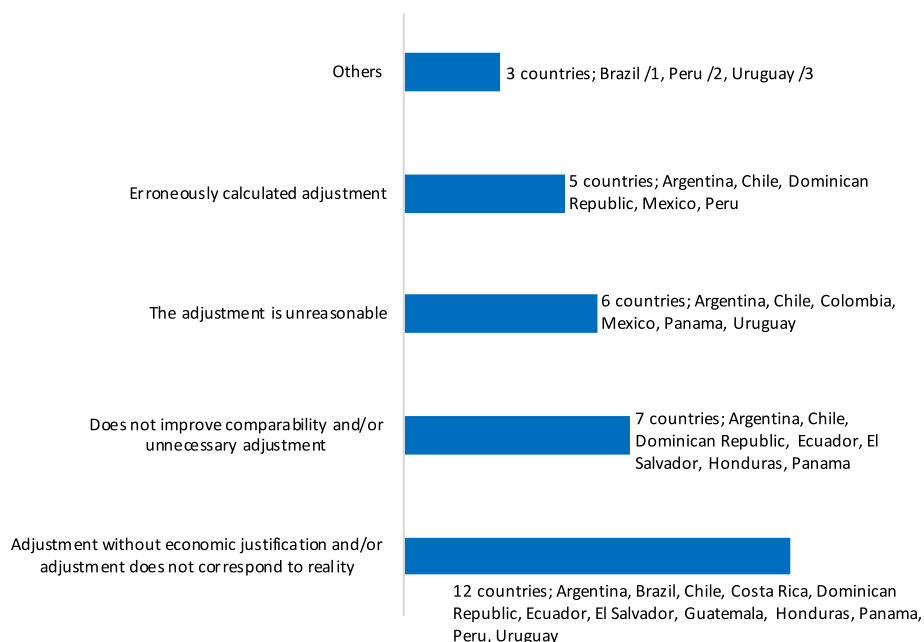
1.	Accounts receivable adjustments	13 countries
2.	Accounts payable adjustments	13 countries
3.	Inventory turnover adjustments	13 countries
4.	Adjustments for differing accounting practices	8 countries
5.	Adjustments for differing capacities and assets	6 countries

Some of the less common adjustments mentioned by the countries were for differences in capital and financing costs, ownership of plant and equipment, freight and insurance costs. Occasionally, the customs value (the import or export price) is used as a comparable when calculating the transfer price. In such a case, comparability adjustments are required to better align the customs valuation principles with the arm's length principle used in the context of transfer pricing. For a full list of adjustments reported by each country see the annex of chapter 11.

The complexity of transfer pricing adjustments can lend itself to confusion and potential abuse. There needs to be certainty that the comparable chosen by the taxpayer or the tax administration is sufficiently similar to the tested party (i.e. the related party being compared). The taxpayer may potentially try to use adjustments that result in the most convenient price range for them. Therefore, the tax administration occasionally denies the use of certain comparability adjustments made by the taxpayers. The following figure details the most common reasons given by the tax administrations to reject adjustments:

⁵⁵ OECD Transfer Pricing Guidelines, chapter 3, section A.6, paragraph 3.48 (2017).

Chart 11.3: Reasons for rejecting the taxpayer's adjustments.



1/ Adjustments for goods, rights or services that are insufficiently comparable. For example, comparing goods of companies residing in tax havens.

2/ Rejected when the taxpayer makes adjustments that are related to events that had a global impact, as if it had only affected them.

3/ Accounts payable adjustments rejected if the amounts payable are due to a related party.

Source: Transfer Pricing Database, Section 1, Adjustments. Accessed through CIAT Data, 2019.

11.2. Primary and Corresponding Adjustments

When the tax administration performs adjustments to edit the results of the transfer pricing report of the taxpayer, this is called the 'primary adjustment'. This adjustment is based on Article 9 (1) of the OECD and UN Model Tax Conventions. The primary adjustment is made when a jurisdiction increases⁵⁶ a company's taxable profits to reflect their given calculations. The tax administration may perform this adjustment if it considers the transfer price is unreflective of the arm's length price, or if it believes there has been transfer mispricing by the taxpayer.

Corresponding adjustments are generally grounded in the provisions of Article 9 (2) of the OECD and the UN Model Tax Conventions. They are a consequential downward⁵⁷ adjustment of the related company's tax liability in the state at the other end of the transaction. There are two ways in which a country can perform a corresponding adjustment⁵⁸: either by revising and recalculating the company's taxable income using the new transfer price. Or, by giving the company relief from the domestic tax payable which equates to the additional tax charged in the other state. This amalgamation is necessary to avoid economic double taxation of the same income in the hands of the taxpayer and the related party. However, to maintain fiscal sovereignty, the corresponding adjustment is not mandatory and calls only for the tax administrations to '*consult each other as necessary*'.

56 Primary adjustments could potentially decrease the company's taxable profits based on the jurisdiction's calculations; however, it would be rare for a country to voluntarily reduce their tax revenue in such a way.

57 An upward adjustment would only be effected if the other jurisdiction lowered their tax revenue as explained in the previous footnote above.

58 OECD, 2017, Transfer Pricing Guidelines, chapter 4, section C.2, paragraph 4.35.

Furthermore, complications arise with the application of corresponding adjustments when there is suspicion of transfer mispricing or fraud. For example, if the primary adjustment is made by a country, which gives the benefit of the doubt to the taxpayer, but the corresponding adjustment will take place in a jurisdiction that operates under the opposite criteria, controversy and potential double taxation could arise.

The transfer pricing rules of 52% of the countries analyzed: Argentina, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Honduras, Jamaica, Mexico, Panama, Peru and Uruguay, allow the performance of corresponding adjustments. However, as of 2018, experience in the region has been scarce, 23 of the countries examined responded that there have not yet been any corresponding adjustments carried out in practice.

Any transfer pricing adjustment, which increases a company's tax liability has the potential to cause double taxation if the corresponding relief is not provided by the country at the other end of the transaction. This conflict is generally solved via the Mutual Agreement Procedure (MAP) found in Article 25 (1) and (2).⁵⁹ However, the MAP is not without faults, often taxpayers are not involved in the process, there is no option to appeal, no rationale provided for the decisions and legal precedence is not used. Most importantly, reaching a solution under MAP is not obligatory, the contracting states may be unable to come to an agreement, in which case, Article 25 (5) calls for arbitration. Currently, arbitration is not mandatory, and, if no solution is reached either unilaterally or bilaterally, the taxpayer will find itself in an ill-fated position. Thanks to the minimum standard contained in the BEPS Report on Action 14, mandatory arbitration should become more prevalent with regards to transfer pricing cases. In the framework of treaty negotiation, countries should analyze their capacity to make adjustments, and the impact that these adjustments may have on their foreign related parties to avoid inconveniences for their taxpayers.

11.3. Secondary Adjustments

Secondary adjustments are also known as a 'constructive transaction.' This is a purely domestic concept executed by the same country which does the primary adjustment. It is meant to facilitate the registration of the additional deemed income that arose as a consequence of the primary adjustment (e.g. if the tax administration calculates a primary adjustment of USD 10, it could create a secondary transaction to include USD 10 as having been constructive dividends, or, constructive equity, constructive loan, etc.). Effectively, this acts as a mechanism to allow the tax administration to impose tax on the adjusted amount. There is little information on secondary adjustments in the 2017 OECD Transfer Pricing Guidelines; they could serve to prevent tax avoidance however, they are neither recommended nor condemned.⁶⁰ Only four of the countries in our study have regulations regarding the use of secondary adjustments: Dominican Republic, Jamaica, Peru and Venezuela. Furthermore, Peru reported the (rare) application of secondary adjustments in practice.

⁵⁹ OECD, 2017, Model Tax Convention, Article 25 commentary, paragraph 10.

⁶⁰ OECD, 2017, Transfer Pricing Guidelines, chapter 4, section C.5, paragraph 4.68.

12. Transfer Pricing Controls

The ability of the tax administration to successfully control transfer pricing operations is determined by a multitude of factors; the expertise of the personnel, access and availability of relevant information, the resources at their disposal (databases, technology, etc.), the administration's organizational structure and ethical standards, amongst others. Furthermore, the tax administration can measure the taxpayer's level of adherence to the transfer pricing regime by identifying potentially risky transactions. This is done using information from income tax returns, complementary transfer pricing information regimes, studies on businesses, databases and other domestic or international third-party sources;⁶¹ most notably the data begot from foreign tax administrations via [incoming] exchange of information provisions (automatic, spontaneous or on request). Parts of this information are processed through mass control examination tools that identify and segment risky transactions (e.g. finding that a company has a history of misstatements and errors may raise a red flag for the tax administration to look more closely at its transactions, or, possibly even at the entire industry). These high-risk transactions are further examined using specific controls: verifying the transfer pricing documentation, performing audits and calculating adjustments if deemed necessary. These specific controls are an exception to the rule, they are too costly and resource intensive to be used as a form of regulation since tax officials must take their time to individually audit taxpayers. Nevertheless, they are necessary for ingrained control. As of September 2018, all but five of the countries examined regularly performed these evaluations. The five countries which have not yet initiated specific control processes are: Nicaragua, Suriname, Barbados, Guyana, and Trinidad and Tobago. In the last three countries mentioned this is due to the inexistence of a transfer pricing regime.

Those tax administrations that do implement control procedures indicated the number of cases dealt with on an annual basis from 2011 to 2015. The following chart presents the average number of cases per country, in descending order. However, it must be noted that analysis of these absolute numbers is impractical; consideration must be given to the transfer pricing experience of the country, the quantity of tax audits started in previous years, the quantity of multinationals existing in the economy, the risk assessment tools available, amongst others. Therefore, the information in the table below is not enough to compare or draw conclusions as to the level of proficiency that exists in the countries.⁶²

61 Costa Rica is the only country who reported that they do not allow the information obtained from the transfer pricing study to be used for identifying compliance risks.

62 One potential option for attaining relative numbers would to divide the number of cases by the number of taxpayers subject to the regime. This could make for a more balanced comparison, although there are still many influential factors as mentioned in the paragraph above.

Table 12.1: Average number of cases per year (descending order).

Country	Yearly Average (2011-2015)
Colombia 1/	124
Mexico	70
Argentina 2/	56
Chile 3/	53
Brazil	52
Dominican Republic 4/	18
Peru 5/	18
Venezuela	15
El Salvador 6/	8
Uruguay	8
Panama 7/	7

1/ In 2015, these are only fundamental cases, not formalities.

2/ This number corresponds to the 'Large Taxpayers' department.

3/ No information from 2015.

4/ No information from 2011.

5/ Cases from 2011-2012 refer to the TNMM method, 2013 to other methods, 2014 and 2015 to scheduled cases. Furthermore, Peru reported new information for the years 2016 to 2018, averaging 43 cases per year. This information can be found in the annex to chapter 12.

6/ No information from 2011.

7/ No information from 2011-2013.

This table presents average numbers; see the annex to chapter 12 for a list of the specific number of cases per year, per country. Source: Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019

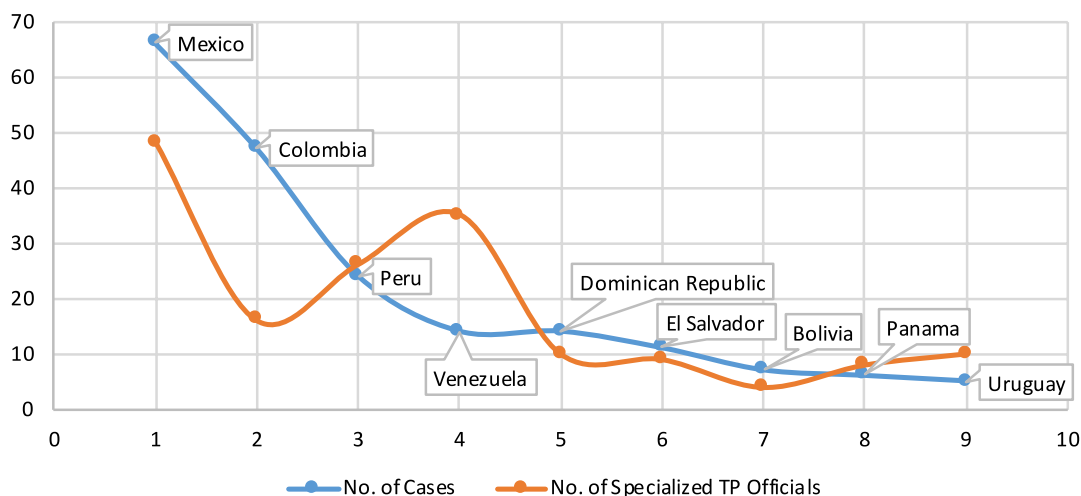
Source: : Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019.

Out of those examined, Colombia is the country with more reported cases overall, from 2011-2015, it had 618 audits. Mexico is in second place with a total of 348 audits, while Argentina and Brazil follow closely behind with a total of 279 and 259 audits, respectively.

As mentioned above, it is important to keep in mind that the quantity of audits does not in itself retain a positive or negative character; we must consider complementary information when evaluating the results of any control process. For example, having a low number of audits could be the result of highly efficient risk assessment tools that identify and prevent abusive transactions, and motivate taxpayers into compliance. Especially for developing countries, if there is a lack of resources in the tax administration, this emphasizes the importance of assessing, identifying and prioritizing risks. On the other hand, a country with a high quantity of multinational entities, may expect to have more audits considering the higher number of transactions under the scope of the regime. However, auditing is an expensive form of control, to be used as a last resort, not for replacing other risk assessment tools. For example, sometimes audits are used as a strategic policy by the tax administration to generate risk perception and scare certain taxpayers into compliance. If risk assessment tools are insufficient, this strategy will backfire on the tax administration, as taxpayers are quick to realize the hollow reasoning behind it.

For further examination, we observe the correlation between the number of audit cases and the number of transfer pricing experts working in the tax administration. Again, it is necessary to note that many factors can influence these results; in different countries officials will have varying responsibilities and job descriptions, some may work solely on transfer pricing while others may cover multiple areas, some may focus on auditing while others on planning or providing guidance, etc. Similarly, external factors such as; the quantity of high-risk taxpayers, the lack (or inefficiency) of risk assessment tools for transfer pricing, or, the prevalence of fraud within a specific sector that will demand multiple audits. Consideration must be given to the status of previous audits, whether they are completed, disputed at an administrative stage or in tribunal. Lastly, the effect of domestic rules must be accounted for, such as the fixed margin regime in Brazil which gives their officials the ability to solve transfer pricing cases faster as they don't need to do a comparative analysis.

Chart 12.1: Number of Transfer Pricing cases vs. Number of Specialized Officials in the Tax Administration in 2015.



This chart was made using average numbers; see the annex to chapter 12 for the specific number of cases.
Source: Selected tax administrations from LAC CIAT member countries.

Having more cases will not necessarily increase the amount of revenue that will be collected by the tax administration; however, more cases could work to motivate taxpayers to increase compliance. The following list quantifies the average revenue received from transfer pricing cases, calculated using information from 2010-2015. For comparison purposes, the local currency amounts have also been converted into USD.⁶³

63 Conversion made using the exchange rate as of December 2015, available at www.xe.com/currencyconverter, accessed on May, 2019.

Table 12.2: Average Yearly Revenue Collection from 2010-2015.

Country	Average Annual Revenue Collected in Local Currency	Average Revenue Collected in USD
Argentina	60,384,783	4,621,556
Brazil /1	3,920,539,229	1,014,369,788
Chile /2	198,509,281	280,698
Colombia	51,203,257,650	16,071,330
El Salvador /3	1,836,940	1,836,940
Mexico	2,516,085,077	145,809,288
Peru /4	7,500,000	2,207,830
Dominican Republic /5	1,633,020,083	36,288,529
Uruguay /6	307,331,999	10,330,487
Venezuela	33,424,851	5,319,040

1/ Information missing from 2015.

2/ Information missing from 2011 and 2015.

3/ Information missing from 2010-11.

4/ Information missing from 2010-13. Further information was provided by Peru for the years 2016-2018, averaging, this can be found in the annex to chapter 12.

5/ Information is missing from 2010-11 as the Dominican Republic didn't have their transfer pricing regime in place yet. Even so, from 2005-2010 the country reported auditing 33 taxpayers in the hotel industry, with a total collection of USD 83,441,775 (RD 3,754,879,893) using the exchange rate from 2015.

6/ Information missing from 2010.

The information used to calculate this chart is available in the annex to chapter 12.

Source: Author elaboration.

Unfortunately, comparing tax revenue is complex due to the fact that the countries calculate information in an asymmetrical manner. Factors that will influence tax revenue in relation to transfer pricing are the quantity of multinational companies present in the economy, the size of the transactions being examined, the quantity of adjustments, whether penalties are imposed for erroneous submissions, the flexibility of the tax administration in providing payment extensions, the taxpayers' ability to pay, the existence of previous agreements, amongst others. Most distortive to our analysis, is the fact that the revenue collected in one year, does not necessarily correspond to adjustments or cases from that same year. A taxpayer may have amounts in arrears, or, domestic law provisions may allow for payment extensions under certain conditions. Similarly, the tax administration could be taking tax due or assessment amounts into account when making their calculations. A more reliable observation could be to focus on the trends which form over the years as these may reflect the quality of risk assessment tools, cooperative compliance programs, the audit and tax collection process, etc.

In the Dominican Republic and Guatemala, domestic regulations impose different time limits between completing general audits versus transfer pricing audits. In Colombia, Nicaragua and Peru the time limits are determined depending on the applications of the transfer pricing regime. Bolivia and Chile do not differ in the period allocated to either type of audit, however, transfer pricing audits have the potential for a longer extension than general audits do. In Argentina, the difference is not between general and transfer pricing audits, it is between large taxpayers (12-24 months) and other taxpayers (under 12 months). In El Salvador there is no time limit, although, regard must be had to the statute of limitations for the years covered.

The next table highlights the projected number of months that a country may take to conclude a transfer pricing audit..

Table 12.3: Estimated time for the tax administration to conclude a transfer pricing audit.

Countries	8 to 10 months	11 to 13 months	18 months	24+ months
Argentina			X 1/	
Bolivia				X 2/
Brazil		X		
Chile			X	
Colombia		X		
Costa Rica	X			
Ecuador		X		
El Salvador		X		
Guatemala			X	
Honduras	X			
Jamaica				X
Mexico				X 3/
Peru		X		
Dominican Republic	X			
Uruguay	X			
Venezuela			X	

1/ Argentina: between 18 to 24 months

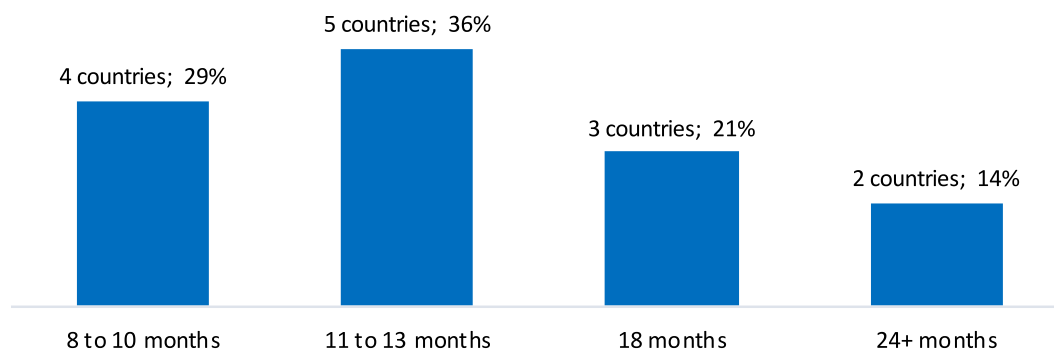
2/ According to the regulation, it should take 12 months, but can be expanded up to 24 months.

3/ Mexico: Thirty months

Source: Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019.

It is impractical to talk about an ‘ideal’ time frame as this is highly subjective, depending on legislation standards and the tax administrations’ capacities. However, we can use this information to better identify the regional trend, as shown below.

Chart 12.2: Reported number of months to complete an audit (considering a sample of 14).



Source: Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019.

Out of the countries examined in this study, Mexico reports taking the longest with an average of 30 months. Of course, these numbers represent the various countries' *ideal* time frames, deviations arise depending on the size and nature of the transactions in the scope, the complexity and size of the company, the number of tax officials assigned to the audit, etc.

As for the methodology used by tax officials to assess the risk level of taxpayers, the answers amongst the countries in our study are quite consistent. A taxpayer is more likely to be chosen for further examination based on the following criteria:

1. Evaluating the behaviour and trends of the taxpayer (16 countries)⁶⁴
2. Evaluating the amounts declared on transactions with related companies (16 countries)⁶⁵
3. Analyzing transactions with tax havens (14 countries)⁶⁶
4. Crosschecking information from financial accounts, tax reports, and customs declarations (13 countries)⁶⁷
5. Reviewing of yields inferior to the sector average (13 countries)⁶⁸
6. Identifying taxpayers with lower profit margins than the industry average (13 countries)⁶⁹
7. Specific control models designed by the tax administration (9 countries)⁷⁰
8. Identifying irregularities in the capital structure of the taxpayer (7 countries)⁷¹

Source: Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019.

64 Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Panama, Paraguay, Dominican Republic, Uruguay, Venezuela.

65 Argentina, Bolivia, Brazil, Chile, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Panama, Paraguay, Dominican Republic, Uruguay, Venezuela.

66 Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Paraguay, Dominican Republic.

67 Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Honduras, Jamaica, Mexico, Paraguay, Dominican Republic, Venezuela.

68 Argentina, Chile, Costa Rica, Ecuador, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru, Dominican Republic, Uruguay, Venezuela.

69 Argentina, Bolivia, Chile, Costa Rica, Ecuador, Guatemala, Honduras, Jamaica, Mexico, Panama, Dominican Republic, Uruguay, Venezuela.

70 Argentina, Bolivia, Chile, Colombia, Ecuador, Guatemala, Mexico, Paraguay, Uruguay.

71 Brazil, Ecuador, Guatemala, Honduras, Jamaica, Mexico, Paraguay.

Identifying a high-risk transaction by the taxpayer may lead to further examination and potential adjustments calculated. If these adjustments are justified by extensive research, a comparative analysis, documentation and sound reasoning on the part of the tax officials, then the taxpayer could accept it. However, the taxpayer may choose to dispute the adjustment, causing the matter to end up in tribunals that are expensive and time consuming for both sides.

One way to increase the accuracy and reliability of the transfer pricing audit would be to have either joint or simultaneous audits performed by the tax officials from two of the countries that the multinational company is operating in. This option could also increase taxpayer certainty and improve MAP relations, but tax administrations should realize that it is unlikely for both jurisdictions to obtain higher revenues as a consequence of the joint or simultaneous audit. *In theory*, this is a worthwhile concept as audit teams from both countries work together to examine how the functions were performed, the assets used and risks assumed, to understand the value creation and allocate the corresponding profit amongst the entities involved. Through the provisions of Article 9 (Associated Enterprises) and Article 25 (Mutual Agreement Procedure) of the applicable double tax convention, tax officials will endeavour to accurately delineate the relevant transactions and eliminate any double taxation. Nevertheless, *in practice*, the effectiveness of the joint audit depends on the planning process and the administrations' possibility of potentially having to accept a loss on their portion of the tax base. The tax officials of both countries should consider this a cooperative process that might generate indirect benefits (e.g. increasing the taxpayer's risk perception).

The tax administrations may be hesitant to initiate this process, as there is little experience, not enough coordination and possible revenue loss. Ultimately, the goal is to find a balance between the two jurisdictions, however, if the outcome of the joint audit finds that a company is unfairly allocating its revenue to Country A, then Country A may be biased to recognize this behaviour as abusive since it does not want to lose this portion of the tax base. As of December 2018, the tax administrations that allowed joint audits were Argentina, Brazil (but not with the USA), Chile, Colombia, Dominican Republic, Ecuador (with Argentina and Honduras), El Salvador and Paraguay (currently in the process of approval).

For countries with smaller transfer pricing teams, another recommendation to increase taxpayer’s efficiency is to focus their efforts on specific industries (e.g. those that are economically significant, highly risky, but also low complexity like commodities, pharmaceuticals, or sectors where there have been many precedent cases to learn from). As opposed to valuing products that are hard to understand and less common (e.g. financial derivatives or hard-to-value-intangibles). Therefore, it may be convenient that countries with more experienced transfer pricing teams be the pioneers in dedicating their resources to these matters.

Similarly, a tax administration’s capability to perform a sophisticated audit (such as those dealing with financial derivative transactions and insurance services), could signal a higher level of expertise on behalf of the tax officials.

Table 12.4: Performance of sophisticated audits.

Countries that performed audits on:	
Financial Derivatives	Insurance Services
Argentina	Argentina
Chile	Colombia
Colombia	Ecuador
Ecuador	Uruguay
Mexico	Venezuela
Uruguay	

*It must be noted that there is no correlation between a country’s ability to perform these sophisticated audits and the results of the audit.

Source: Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019.

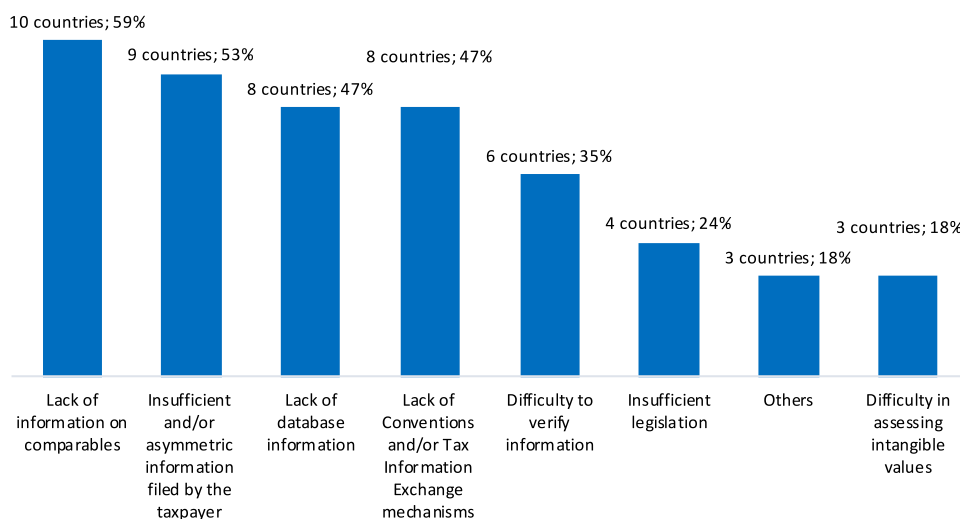
The abovementioned measures for sustaining transfer pricing rules could be proven less effective in situations where the tax administration has insufficient collection processes, few tax officials or no access to the necessary information for identifying noncompliant taxpayers or for discerning if transactions have been executed between related entities. This hardship is augmented by the use of chain transactions, imported hybrids, or, situations where beneficial ownership is unclear.

Where, for some reason, the taxpayer is out of reach of the normal risk assessment procedures, the tax administrations innovative other methods. For example, fifteen of the countries examined⁷² reported that they regularly crosscheck information from customs declarations or their import/export databases with tax returns. Other tools used by tax administrations to expand their scope were analyzing the remittance of withholding taxes (Peru), analyzing submissions of the ‘currency outflow tax’ and information relating to retentions or foreign payments found in the ‘transactions annex’ (Ecuador), using external public databases to see whether a financial relationship exists between foreign and domestic companies (Venezuela), or using information from third party denunciations (Colombia).

72 Argentina, Brazil, Bolivia, Chile, Colombia, Ecuador, El Salvador, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru, Uruguay and Venezuela.

The countries under analysis in this study also reported what they consider the main obstacles that tax administration must face during the auditing process. Interestingly, the top five reasons are related to a lack of information. It is not surprising that insufficient information on comparables is the most commonly reported difficulty as this is a global problem that plagues most transfer pricing regimes. The second most common reason is that the documentation provided by the taxpayer were incomplete, was submitted in a foreign language or containing vague accounting processes. Thirdly, there was no access to the relevant database, fourth, not enough Exchange of Information⁷³ instruments, and fifth, the tax officials were unable to verify the information.

Chart 12.3: Main barriers reported by the tax administration when performing audits (considering a sample of 17).



In the 'others' category are Ecuador (assessments are arduous and generally end up in court, also not enough expert officials), Guatemala (a judicial suspension of the 'Regulation for Valuation of Related Parties') and Peru (significant delays in receiving requested information leaves the auditing process inconclusive).

Source: Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019.

⁷³ This particular reason highlights the inefficiency of existing Exchange of Information agreements in the region. For more discussion on this topic see chapter 18.

The problems that arise from intangible transactions were enough to inspire the OECD's work on BEPS Action 8. However, as of 2018 only three of the countries in our study mentioned issues related to intangibles. These countries are Colombia, Dominican Republic and Jamaica. Similarly, Ecuador was the only country to report a lack of expertise and the strenuousness of the comparability analysis as being a barrier in the audit process. Most likely, the underrepresentation of these aspects is because countries considered only those barriers they have previously had conflicts with. However, past barriers are not necessarily indicative of present challenges. Tax administrations recognize intangible risks as problematic but there is a general lack of experience with these cases in the region. One exception being Ecuador who reported having a better-than-average results for a few cases involving intangibles.

Moreover, the tax administration is faced with information challenges on a smaller scale when taxpayers omit information or make formal mistakes on their tax returns, such as writing the wrong names or dates. These mistakes may be noticed and corrected if the country has mechanisms in place for the verification of formal obligations. Out of the countries in our study, Argentina, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Panama, Peru, Uruguay and Venezuela specifically mention having these procedures in place.

Furthermore, from an international perspective, there are massive control procedures available for verifying the declarations of international operations; using tax returns and other data to crosscheck the details reported in related party transactions. El Salvador, Peru and Venezuela have specific procedures that focus on the relationship features. As of December 2018, Brazil only has procedures to check transactions of products, not services. Argentina, Chile and Honduras focus specifically on export transactions. Lastly, Argentina, Colombia and Honduras use the interquartile range and the disparities between the different profit margins across the sector to identify the areas that require increased control.

13. Judicial Aspects

The tax administration is given its competence and mandate through the vigilant tax legislations of each country, such as Directives, the Income Tax Act, the Tax Code, tax conventions in-force, etc. As in any legislation, it is required to have in place administrative and judiciary processes to maintain and enforce the rules.⁷⁴ Any conflicts that arise may be resolved through administrative or judicial proceedings either within the competence of the tax administration or at the level of other executive branches like the ministry of finance. Administrative procedures may include alternative dispute resolution, the use of administrative tax courts, nonpartisan mediation and arbitration, amongst others. The judicial processes may take place within the regular judiciary system or via specialized taxation courts if these are available. On the other hand, alternative dispute resolution mechanisms are a convenient option for avoiding the high costs of judicial proceedings and for countries where there is a lack of consensus throughout the different levels of government as to the rights of the taxpayers.

In the Latin America and the Caribbean region, it is hard to find jurisprudence on taxation matters, such as transfer pricing. This could indicate distinct circumstances (e.g. there is no jurisprudence because the law is quite clear, leading to fewer conflicts, or, juridical processes are not a widely available option for the resolution of taxation conflicts in the country). Perhaps having a specialized court which focuses on taxation will allow the justice officials to attain the level of expertise required to analyze taxation issues (e.g. attending workshops and training sessions provided by experts in the tax administration). As of 2016, Argentina, Costa Rica, Honduras, Mexico, Panama, and Peru have specialized tax courts with enhanced transfer pricing knowledge and experience. Furthermore, the specialized courts of Bolivia, Chile, Ecuador, Guatemala, Jamaica, Mexico, Nicaragua, and Venezuela confirmed that there is an exchange of experiences and training sessions on transfer pricing issues between the tax administration and the tax court officials.

The following chart visually outlines the countries with courts that specialized in taxation cases.

Chart 13.1: Presence of a judicial court specialized in taxation cases (considering a sample of 18).



Source: Transfer Pricing Database, Section 1, Judicial Aspects. Accessed through CIAT Data, 2019.

⁷⁴ Extensive information and guidance from the tax authorities regarding the interpretation of administrative and judicial procedures is available at: <https://www.ciat.org/tributary-courts/?lang=en>

Over 70% of the analyzed countries have a judicial court for taxation matters, potentially increasing consistency in the interpretation of the tax laws (especially important for federal countries where competence over taxation can be divided amongst different levels of government: the municipality, the state or provincial level and the federal level).⁷⁵

Moreover, the two tables below present the countries with tax related jurisprudence at any level of the domestic judiciary system (table 13.2), and the number of transfer pricing cases that were in dispute as of 2016 (table 13.3).

Table 13.1: Countries with jurisprudence of taxation cases as of 2016.

Existence of Tax Jurisprudence
Argentina
Brazil
Chile
Colombia
Costa Rica
Ecuador
El Salvador
Honduras
Jamaica
Mexico
Panama
Venezuela

Source: Selected tax administrations of LAC CIAT member countries.

Table 13.2: Number of transfer pricing cases in dispute as of 2016 (descending order).

Country	No. of Transfer Pricing Cases
Colombia	60
Mexico	14
Costa Rica	3
Chile	1
Panama	1

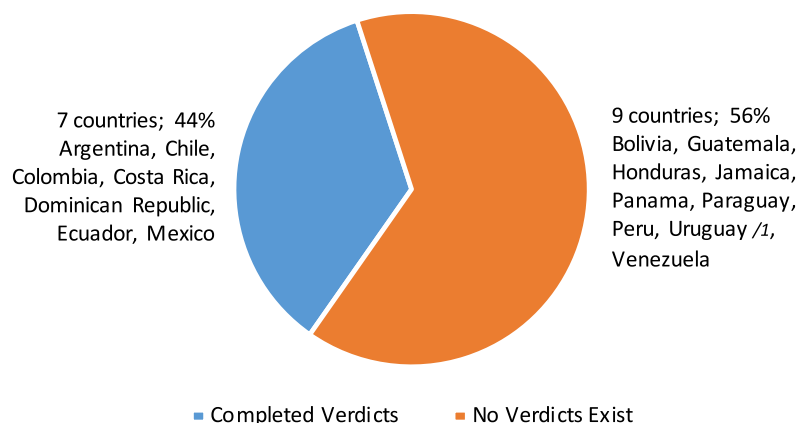
Source: Selected tax administrations of LAC CIAT member countries.

It can be seen that Colombia had by far the greatest number of transfer pricing cases in dispute, with Mexico far behind (although this comparison is highly subjective as mentioned at the beginning of this chapter).

For a more contextual view, the following chart provides information on the tax jurisprudence available as of 2018, specifically relating to transfer pricing verdicts.

75 Examples of federal countries where elements of taxation are governed by different levels of government are Argentina, Brazil and Mexico.

Chart 13.2: The existence of transfer pricing verdicts in the participating countries, as of 2018 (considering a sample of 16).



1/ Uruguay has three new transfer pricing cases in progress as of 2018.

Source: Selected tax administrations of LAC CIAT member countries.

In 2018, 56% of the countries were without verdicts. Regardless of the various reasons, the countries may wish to overcome the problems that arise from this lack of jurisprudence by allowing for international rulings to be used. Even though domestic legislations differ in their application, they are often based on the same principles (e.g. the ‘arm’s length principle’).

Furthermore, the table below exemplifies the resulting verdicts from 2009 to 2016, as issued by the competent authority tasked with resolving tax disputes in six countries across the region. Overall, the verdict was in favor of the taxpayer in 23% of the cases as opposed to 77% in favor of the tax administration.

Table 13.3: Tax related cases from 2009-2016 resulting in favor or against the tax administration.

Country	In favor	Against
Argentina	5	5
Chile	0	1
Colombia	4	1
Costa Rica	3	0
Dominican Republic	23	0
México	21	10
Total	56	17

No information was available for the cases from Ecuador.

Source: Transfer Pricing Database, Section 1, Judicial Aspects. Accessed through CIAT Data, 2019.

It may prove beneficial to give more resources to large cases that will create a shockwave of risk perception amongst taxpayers and therefore boost attitudes of compliance. Furthermore, easing up on otherwise strict confidentiality rules can provide the tax administration with the ability to access information (e.g. secret comparables⁷⁶), using the data to analyze cases and potentially cross reference with previously discovered aggressive tax plans for a more complete resolution.⁷⁷

76 More information on secret comparables can be found in chapter 5.

77 For more information regarding administrative and judicial processes in CIAT member countries see the database ‘Tributary Courts’ available at CIAT Data: <https://www.ciat.org/tributary-courts/?lang=en>.

14. Organizational Structure

Human resources and organizational aspects of the tax administration are not the newest topics when discussing transfer pricing. However, they are critical for the effective implementation of the transfer pricing regime. When transfer pricing is being newly introduced into a country, the tax administration has two options: to start developing its own processes from the bottom up, or, to start with the support of experts who have prior experience in the training and development of these regimes. Generally, the latter option is preferred, but consideration must be given to the fact that monetary resources must be available to the tax administration.

Given the high demand of experts in transfer pricing (and international tax), the tax administration officials are often lured into the private sector with the promise of a higher income. This obstructs the tax administration's ability to maintain their experts and skilled personnel in-house. Therefore, having superior human resource policies and flexible regulations is more critical than ever. In this regard, it could prove useful to disperse knowledge by having a second or third line of workers who learn from the top personnel and can replace those who emigrate from the administration if need be.

The following functional aspects of the tax administration are presented as examples of the various regional structures. It is impractical to compare or endorse a certain method as being more successful when each of the various country's resources, organization, culture and contexts are quite different.

We begin with a description of the various units within the tax administration that specialize and are responsible for dealing with transfer pricing and other international tax matters.

Table 14.1: Specialized unit within the tax administration for international tax and transfer pricing issues.

Country	Specialized Section(s) Within the Tax Administration	Reporting Entity
Argentina	International Technical Management and Evaluation Department	International Tax Directorate
Bolivia	Examination and International Taxation Department – International Taxation Unit	Examination Management Office
Brazil /1	1.International Taxation Division 2.International Institutional Relations Division	1. Taxation (Preparation of rules) – Taxation Coordination Office 2. Taxpayer examination and selection – Secretariat of Examination.
Chile	International Area	Tax Compliance Selective Analysis Department
Colombia	International Audit Unit	Audit Unit
Costa Rica	Deputy Directorate of Transfer Pricing Agreements /Deputy Directorate of Treaty Negotiation and Application	International Taxation Directorate
Dominican Republic	Transfer Pricing Department	Large Taxpayers Management Office
Ecuador	Large Taxpayers and International Taxation Department	Large Taxpayers and International Taxation Department
El Salvador	Transfer Pricing Department	Integral Deputy Directorate of Large Taxpayers / Deputy Directorate of Examination
Guatemala	Department of International Taxation	Examination Intendancy
Honduras	Transfer Pricing and International Taxation Department	Large Taxpayers Directorate

Country	Specialized Section(s) Within the Tax Administration	Reporting Entity
Jamaica	Commissioner General Executive Office	Commissioner General Executive Office
Mexico	Transfer Pricing Unit	General Large Taxpayers Administration
Panama	Transfer Pricing Department	General Director of Revenues of the Ministry of Economy and Finance
Paraguay /2	Special Unit of the General Directorate for Large Taxpayers	General Directorate for Large Taxpayers
Peru	International Examination and Transfer Pricing Management Office	National Main Taxpayers Intendancy (NMTI)
Uruguay	International Examination Department	Large Taxpayers Division and Examination Division Director
Venezuela	Public Policies and Internal Management Office and Transfer Pricing and Advanced Agreements Division	1. Public Policies and Internal Management Office - Superintendence. 2. Transfer Pricing – Examination Management Office and National Internal Tax Intendancy

1/ In Brazil, there are teams in charge of transfer pricing control, for the development of rules, as well as for taxpayer control and selection. Nevertheless, there is no exclusive transfer pricing department. Transfer pricing control with respect to taxpayer selection and supervision is not, as a general rule, centralized, but rather decentralized among the different regions of the country.

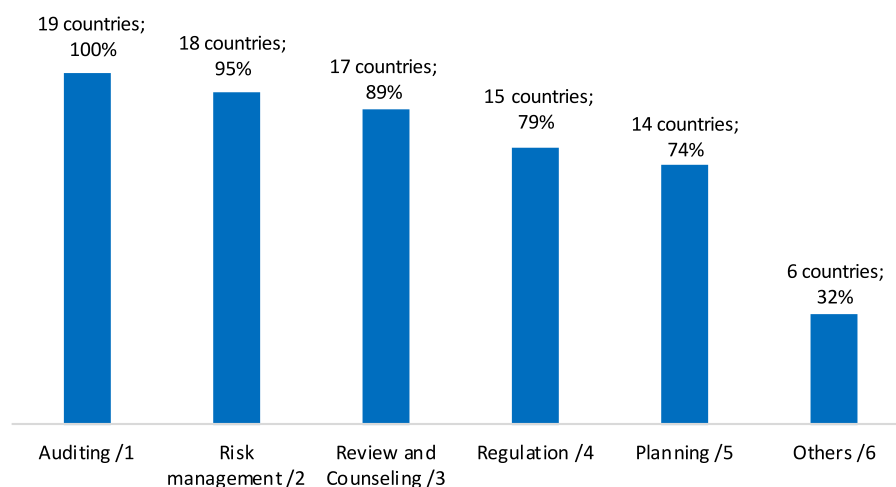
2/ In Paraguay, this unit is responsible to control the self-adjustment method for agricultural exports.

Source: Transfer Pricing Database, Section 1, Human Resources. Accessed through CIAT Data, 2019.

It is not easy to delineate what is the best structure for each tax administration, as the functionality of the tax administration depends on its individual features. However, some trends may be observed: in Costa Rica, the Dominican Republic, El Salvador, Guatemala, and Panama, there is a specific ‘Transfer Pricing’ department/directorate. In Bolivia, Brazil, Chile and Ecuador there is a more general ‘International Taxation’ department/division. Furthermore, in the Dominican Republic, Ecuador, Honduras and Mexico, there are specialized units that report to the department in charge of controlling ‘Large Taxpayers’ (Large Taxpayers Management Office, Directorate of Large Taxpayers, Large Taxpayers Division, etc.). There are also similarities between Argentina, Bolivia, Brazil, Colombia, Guatemala and Venezuela whose specialized units report to the department that deals with ‘Examinations’ (i.e. Directorate of Examination, Examination Management Office, Under secretariat of Examination, etc.). The units in El Salvador and Uruguay have the option of reporting to either the Large Taxpayers and/or the Examination departments.

Nineteen of the countries with specialized units, further described the daily functions that these teams partake in. These are quantified in the subsequent chart. Within the competences of the units, auditing is the most prominent one, followed by risk management and support functions such as the review, interpretation and employment of the transfer pricing regime.

Chart 14.1: Main functions of the abovementioned units within the tax administration (considering a sample of 19).



1/ Argentina, Bolivia, Barbados, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru, Uruguay, Venezuela.

2/ Argentina, Bolivia, Barbados, Brazil, Chile, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru, Uruguay, Venezuela.

3/ Argentina, Bolivia, Barbados, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Jamaica, Mexico, Panama, Paraguay, Peru, Uruguay, Venezuela.

4/ Argentina, Bolivia, Barbados, Brazil, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Panama, Uruguay, Venezuela.

5/ Bolivia, Barbados, Chile, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Panama, Paraguay, Peru, Venezuela.

6/ Colombia, Dominican Republic, Ecuador, El Salvador, Honduras, Mexico.

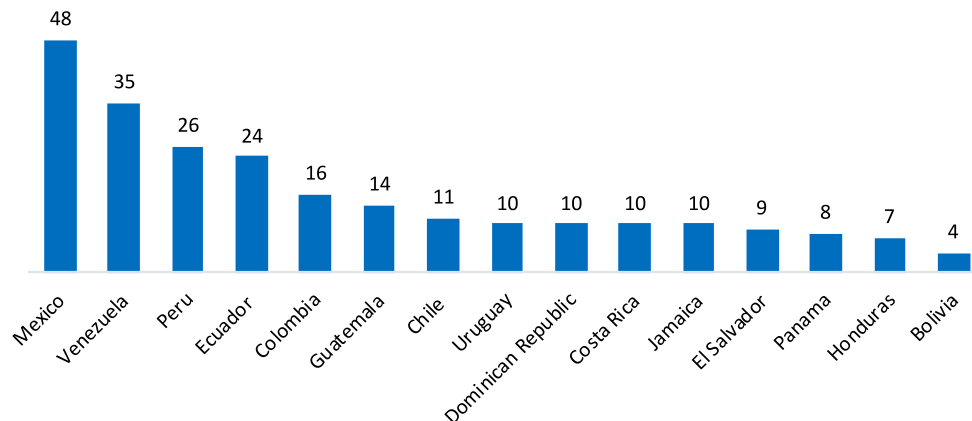
Countries not included in the chart are Guyana, Nicaragua, Suriname, and Trinidad and Tobago. For Paraguay the functions refer to the specialized unit that deals with controlling the self-adjustment method.

Source: Transfer Pricing Database, Section 2, Human Resources. Accessed through CIAT Data, 2019.

In the ‘auditing’ category, the functions are general and self-explanatory. The ‘risk management’ functions include mitigating base erosion risks due to transfer pricing, crosschecking database information and comparing reports to ascertain possible threats, etc. Included in the ‘review and counselling’ functions are; providing general assistance to other units in the tax administration, provision of information, review of taxpayer submissions, support for the resolution of mutual agreement procedures, support the proper application of double taxation agreements, and the analysis of internal and external databases. The ‘regulation’ related functions include reviewing and updating transfer pricing rules, the development of draft proposals on transfer pricing or international taxation issues, and other regulatory measures. The ‘planning’ category has to do with the obligations for the annual fiscal year, analyzing documentation requirements, procedures for tax control based on the national economy and the taxpayers’ behavior, preparation of programs related to international taxation, etc. In the ‘others’ category there were three main tasks mentioned by the countries; First, the processing, evaluating and monitoring of safe harbours and advanced pricing agreements (APAs). Second, the issuance of certificates of fiscal residency or similar international tax related documents. Third, providing support during the negotiation of double taxation conventions.

The following chart presents the count of how many specialized tax officials (focusing specifically on transfer pricing matters) were present in the administrations of fourteen countries during 2015.

Chart 14.2: Number of transfer pricing specialists in the tax administration in 2015.



Countries missing from the chart are Argentina, Barbados, Brazil, Guyana, Nicaragua, Paraguay, Suriname, and Trinidad & Tobago. Paraguay is not listed as they don't have a transfer pricing regime, however, they do have 8 personnel in a Specialized Unit which controls the self-adjustment method employed by taxpayers.

Source: Transfer Pricing Database, Section 1, Human Resources. Accessed through CIAT Data, 2019.

When the above data from 2015 is compared with similar information from 2012, it can be seen that most countries (75%) have increased the number of tax officials in their specialized units by at least one expert.⁷⁸ This comparison is over a relatively short time period (7 years), however, it can be expected that the positive trend will continue considering the rise of globalization and the facilitation of international business relations.

Table 14.2: Change in the quantity of transfer pricing experts in the specialized units.

Country	2015	2012	+/-	% Change
Panama	8	1	7	700%
Guatemala	14	3	11	367%
Costa Rica	10	4	6	150%
El Salvador	9	5	4	80%
Venezuela	35	20	15	75%
Uruguay	10	6	4	67%
Peru /1	23	15	8	53%
Dominican Republic	10	7	3	43%
Mexico	48	47	1	2%
Chile	11	11	0	0%
Ecuador /1	24	27	-3	-11%
Colombia	16	22	-6	-27%

1/ For Ecuador and Peru, these numbers relate to the entire international tax team (not just transfer pricing).

Source: Author elaboration.

78 The information for 2012 was taken from the 2013 CIAT Study: 'The Control of Transfer Pricing Manipulation in Latin America and the Caribbean'.

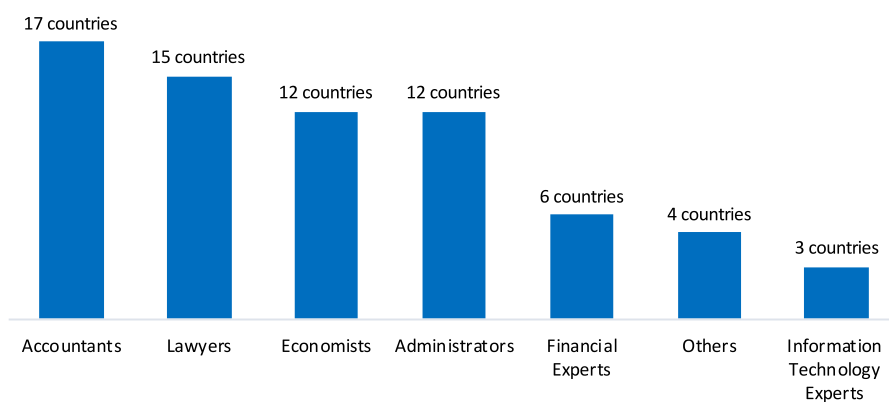
Further information was attained from Colombia, Peru and Guatemala which substantiates this growth pattern.

Country	2016	2017	2018	Increase
Colombia	-	-	30	+ 14 since 2015
Guatemala	-	-	16	+ 2 since 2015
Peru	27	31	42	Average yearly increase of + 8

Source: Author elaboration using information provided by the selected tax administrations.

Furthermore, some tax administrations rely on consultants, privately hired experts or similar external resources to assist them in their transfer pricing issues. It can be observed that Brazil is missing from the above chart because it does not have a department in the tax administration that is exclusively dedicated to transfer pricing. Transfer pricing control is decentralized amongst the different regions of the country; thereby, officials from a variety of work profiles may also handle transfer pricing issues. Nevertheless, the information could be helpful for countries trying to develop their domestic transfer pricing team or restructure it for better functionality. Similarly, the information presented in the subsequent chart (relating to the professional profiles of the team members) could prove useful for the same purpose.

Chart 14.3: Professional profiles that construct the transfer pricing team (considering a sample size of 18).



Countries missing from the chart are Barbados, Guyana, Nicaragua, Suriname, and Trinidad & Tobago. For Paraguay this refers to the specialized unit that deals with controlling the self-adjustment method (7 accountants and 1 lawyer).

Source: Transfer Pricing Database, Section 1, Human Resources. Accessed through CIAT Data, 2019.

A collection of seventeen countries further elaborated on the type of professional profiles they recruit to join the domestic transfer pricing team. The majority of the results were as anticipated, the type of professionals one might expect to work in tax: accountants, lawyers, economists, administrators, finance experts, and information technology experts. However, due to its nature, transfer pricing is an area that requires many vocations. Therefore, more profiles were mentioned by the countries in the ‘others’ category: fiscal scientists are hired in Brazil and Venezuela, engineers are hired in Brazil and Ecuador, and, international affairs experts are hired in Colombia.⁷⁹

The following table compares the average salaries paid to tax officials at different levels of the tax administration. However, a comparison of this sort must be taken with a grain of salt as salaries (and their corresponding purchasing capacity) vary substantially due to differences in domestic characteristics such as the cost of living, inflation, personal tax rates, the budget bestowed to the tax administration, minimum wage laws or a lack thereof. This comparison is further convoluted by the fact that countries may have the same job title for different positions. For example, an ‘auditor’ may be getting paid differently in the two countries, but in one country his responsibilities are limited, while in the other country they have control over many aspects. Regardless, the following charts are presented to give a vague idea of the salaries than can be expected per country for various positions in the tax administration in 2015. For consistency purposes, the domestic amounts have been converted into USD.⁸⁰

The first of these tables presents the estimated gross salary for managerial/supervisory positions;

Table 14.3: Estimated gross salary per country for managerial/supervisory positions in 2015 (USD).

Country	Job Title	Gross Monthly Compensation in 2015 (USD)*
Colombia	Deputy Director – Central Office	2,605
	Manager - Specialist	1,130 - 1,569
Costa Rica	Deputy Director	3,332
	Coordinator	2,832
Ecuador	Coordinator	2,900
	Expert - Chief	2,500
	Supervisor	2,300
El Salvador	Coordinator	1,400
	Expert / Chief	1,300
Guatemala	Supervisor	1,536
	Head of Section	1,707
	Operational Supervisor	1,445
	Head of Department	2,932
Jamaica	Managers	2,162 – 2,650
	“General Managers, Attorneys, Specialized Technicians”	2,790 – 3,418
	Senior Managers	3,348 – 4,185

79 The author does not discard the possibility that these could be causal connections; the specialized personnel working at the tax administrations may have been hired for other reasons, not necessarily due to their vocation.

80 Amounts were converted into USD using the exchange rate as of December 2015 sourced from <https://www.xe.com/currencytables/> (rates available in the annex to this chapter).

Country	Job Title	Gross Monthly Compensation in 2015 (USD)*
Mexico	Central Administrator	7,817 – 10,102
	Area Administrator	2,791 – 7,433
	Area Deputy Administrator	1,363 – 3,780
	Head of Department	981 – 1,657
Peru	Senior Managers	5,299
Dominican Republic	Official in charge	2,578

* Currency exchange rates from December, 2015 found at www.xe.com/currencytables (available in Annex).

Source: Selected tax administrations of LAC CIAT member countries.

The next table presents the estimated gross salary for analyst/specialist positions.

Table 14.4: Estimated gross salary per country for analyst/specialist positions in 2015.

Country	Job Title	Gross Monthly Compensation in 2015 (USD)*
Bolivia	Professional	742 - 1763
Brazil	Tax Analyst	3105 - 4398
Colombia	Analyst - Technical	1224
	Facilitator - Assistant	628
Costa Rica	Analyst	1,999
Ecuador	Analyst	1,400
	Specialist	1,700
Peru	Analyst	1,913 - 2,355
	Specialist	1,913 - 2,649
Dominican Republic	Analyst	1,111
Uruguay	Specialist	4,013

* Currency exchange rates from December 2015 found at www.xe.com/currencytables (available in Annex).

Source: Selected tax administrations of LAC CIAT member countries.

The last table presents the estimated gross salary for auditor positions;

Table 14.5: Estimated gross salary per country for auditor positions in 2015.

Country	Job Title	Gross Monthly Compensation in 2015 (USD)*
Brazil	Tax Auditor	5,951 - 7,503
Colombia	Specialist - Auditor/Inspector	2,134
Ecuador	Specialist - Auditor	1,700-2,000
El Salvador	Tax Auditor	1,200
Jamaica	Senior Auditor	1,674 – 2,023
Peru	Senior Auditor	2,502 - 2,944
Dominican Republic	Auditor	1,444

* Currency exchange rates from December 2015 found at www.xe.com/currencytables (available in Annex).

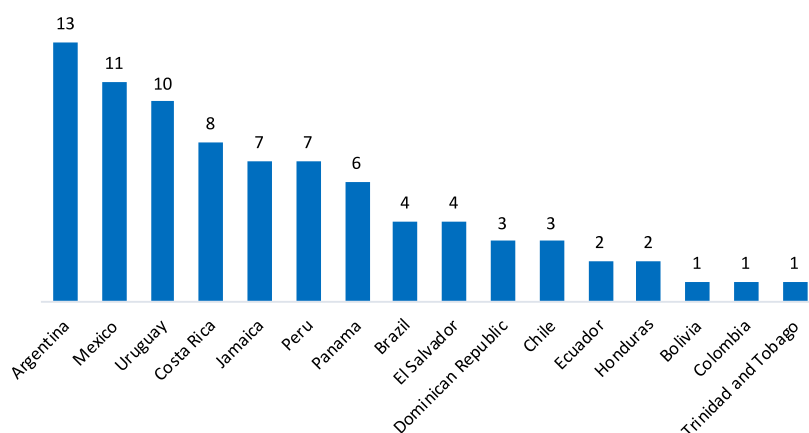
Source: Selected tax administrations of LAC CIAT member countries.

It is important to keep in mind that these numbers were provided by the various tax administrations for the 2015 calendar year. However, due to inflation rates it could be that the amounts are misrepresentative of current purchasing power. Salary data could be a point of reference when analyzing the differing levels of employee migration amongst tax administrations. However, the importance lies in the differences between the salaries paid by the tax administration and the salaries paid in the private sector of the same country (comparing salaries between the countries is impractical for all the reasons mentioned in the introduction to this section).

14.1. Resources for Strengthening the Tax Administration

It is anticipated that various tax administrations across the region will experience imminent growth in the field of information exchange as its importance is intensified due to the BEPS Report on Action 13, the MLI minimum standards and a surge in Tax Information Exchange Agreements (TIEAs). The following chart quantifies the number of officials in the exchange of information unit available in the administration.

Chart 14.4: Number of information exchange officials available in the specialized unit at the tax administration as of 2017.

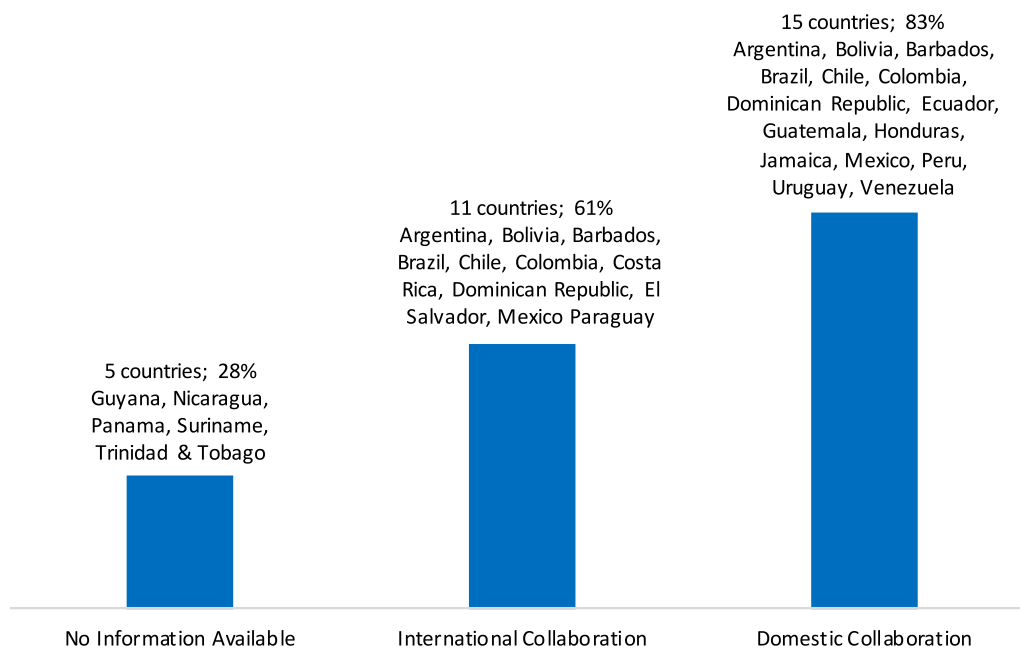


Source: Transfer Pricing Database, Section 1, Human Resources. Accessed through CIAT Data, 2019.

Two examples of countries that implemented systems which seemed to anticipate the growing evolution of exchange of information are Argentina and Chile. Argentina has a ‘Department for International Information Management’, which consists of 10 staff members and 3 chiefs. In Chile, the processing of ‘spontaneous’ and ‘upon-request’ exchange of information is done within the ‘Department of Tax Control and Massive Analysis’, while the ‘automatic’ exchange of information is processed by the ‘Area for Controlled Analysis’ that operates under the ‘Deputy Studies Directorate’.

Another tool that may prove to be useful for the tax administration to stay on top of the creative schemes that taxpayers sometimes come up with, is the ability to collaborate with other organizations at either a domestic or international level. Not simply for the exchange of information, but for mutual cooperation between entities to attain the goal of reducing taxpayer noncompliance.

Chart 14.5: Availability of collaboration between the tax administration and other domestic or international entities for dealing with transfer pricing issues (considering a sample of 18).



Source: Transfer Pricing Database, Section 2, Human Resources. Accessed through CIAT Data, 2019.

The following ten countries allowed for collaboration at a domestic level: Bolivia and Peru collaborate with their financial institutions; Bolivia and Jamaica collaborate with the national customs agency; Argentina and Honduras collaborate with the Secretariat of Agriculture, and similarly, some countries collaborate with entities that control certain sectors (e.g. Chile collaborates with the Chilean Copper Corporation and Honduras with the Institute of Geology and Mines).

At an international level, technical assistance is available through many tax oriented organizations and civil societies, such as the Inter-American Center of Tax Administrations (CIAT), German Development Agency (GIZ), the Inter-American Development Bank (IDB), the Organization for Economic Cooperation and Development (OECD), the United Nations (UN), Tax Inspectors Without Borders⁸¹, Swiss Secretariat for Economic Affairs (SECO), Norwegian Agency for Development Cooperation (NORAD), EUROsociAL, LATINDADD, and many more. Furthermore, a country may benefit from participating in the development of the work of these organizations (e.g. participating in the OECD's Working Parties, or the Committees of the UN and from the collaboration between jurisdictions (e.g. Argentina and Uruguay that collaborated with Paraguay to draft rules for transfer pricing adjustments and for the mutual exchange of experiences).

81 This is a relatively new project launched in 2015 as a joint initiative between the UN and the OECD. From the countries analyzed in this study, five of them have participated; Colombia, Costa Rica, the Dominican Republic, Jamaica and Peru. Upcoming programs have been proposed with Barbados and Honduras.

The mere enactment of legislation has an initial impact, but it is often not enough to motivate long term changes in the behaviour of either taxpayers or tax officials. The tax administration requires resources for the apt implementation of new laws; time and effort is required to uphold the intended objectives of any new regulations. These extra resources may be afforded either through an increase in the efficiency and productivity of other areas within the tax administration, or through an increase in revenue collection. The following strategies are presented to support an increase in the availability of resources. However, these are generic tools which may or may not be fitting depending on the history and characteristics of the domestic environment.

Specialized personnel in this matter is hard to find and possibly even harder to maintain after being trained. This is critical because they are essential for success. New personnel joining the transfer pricing team must be trained by knowledgeable experts in the field with the aim to replace those who decided to leave the tax administration. If there are no such specialists available in the country, an alternative is to contract foreign experts to avoid waiting 5 or 10 years to consolidate a domestic experience. Another approach is to trust in third parties (i.e.: international organizations, donors, NGOs, etc.) to build capacity through technical assistance, seminars, training courses, etc.

Another option for increasing efficiency within the administration, especially in the transfer pricing area, would be to analyze which are the most significant economic industries in the country and how they create value. For these purposes, it would be beneficial to create industry specific functional analysis standards and templates to help newcomers understand and analyze said industries. This could require horizontal cooperation between different entities such as sections of the government, the chamber of commerce, the central bank, and relevant business societies. Alternatively, the administration could choose to train a handful of tax officials to deal with specific types of business models, making them experts in such systems and able to accurately define their specific value creation and functions. For example, having a certain person who deals with business-to-business models, another for business to consumer models, consumer to consumer models, etc.

A further proposal could be to cooperate with the taxpayer to prepare a reasonable expectation of the tax revenue due based on the taxpayer's gross revenue statement, industry specific databases, taxpayer's history, financial reports and similar items. The tax administration could then offer a discount on the tax due, if the taxpayer accepts the amount determined by the tax administration and ensures its timely payment.

15. Advanced Pricing Agreements (APA)

Establishing an APA requires an agreement to be reached between the tax administration and the taxpayer, to determine a reasonable method for calculating the transfer price, for a specified set of transactions, during a certain period of time. Achieving this consensus can be resource intensive and time consuming at the beginning, however, the cost/benefit analysis may be positive as APAs provide certainty and alleviate forthcoming administrative burden for both, the taxpayer and the tax administration. The BEPS Report on Action 14 encourages the implementation of bilateral APA programs as part of the ‘best practices’ recommendations. Adopting an early version of this idea was Mexico, in 1989, with the initiation of the Maquiladora program to attract foreign direct investment. Since then, it has increasingly gained attention in Latin America and the Caribbean. As of 2015, the countries in our study can be classified into categories: the countries that do not offer APAs to their taxpayers (eleven countries), those that offer unilateral APAs (twelve countries), those that offer bilateral APAs (ten countries) and finally those that offer multilateral APAs (five countries).

Table 15.1: Availability and types of APAs in Latin America and the Caribbean (considering a sample of 23).

Countries without APAs:	Countries with APAs (unilateral, bilateral or multilateral):
Barbados	Chile: unilateral, bilateral, multilateral
Bolivia	Colombia: unilateral, bilateral, multilateral
Brazil /1	Jamaica: unilateral, bilateral, multilateral
Costa Rica /2	Mexico: unilateral, bilateral, multilateral
El Salvador	Dominican Republic: unilateral, bilateral, multilateral
Guyana	Ecuador: unilateral, bilateral
Panama	Peru: unilateral, bilateral
Paraguay	Honduras: unilateral, bilateral
Suriname	Uruguay: unilateral, bilateral
Trinidad and Tobago	Venezuela: unilateral, bilateral
	Guatemala: unilateral
	Nicaragua: unilateral
	Argentina: unilateral /3

/1 In the case of Brazil, the fixed margins may be subject to change based on Ordinance 222/2008.

/2 APAs present in Decree 37898-H. However, the administrative procedure resolution to issue the APAs is not yet in place.

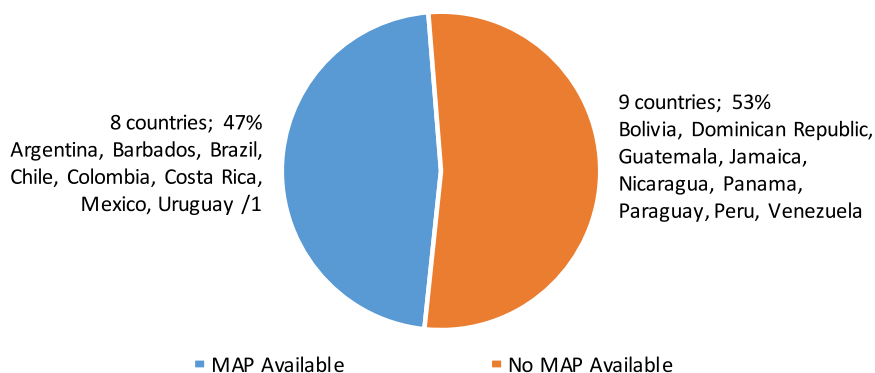
/3 The possibility to request a unilateral APA (or DCPAI for its Spanish initials in Argentina) exists in Law N° 27.430. However, the regulations regarding such processes are still pending.

Source: Transfer Pricing Database, Section 1, Advance Pricing Agreements. Accessed through CIAT Data, 2019.

To increase certainty and expand the benefits derived from an APA, countries such as Ecuador, Honduras, Peru, and Venezuela allow bilateral APAs. Furthermore, Chile, Colombia, Dominican Republic, Jamaica and Mexico allow both, bilateral and multilateral APAs. Meaning that the accorded pricing method must be agreed by the tax administrations of two [bilateral] or more [multilateral] countries. This increases the complexity, as all countries involved must reach an agreement on the arm’s-length character of related

party transactions. For the tax administration to process these requests, the Mutual Agreement Procedure (MAP) provided for in Article 25 of the relevant convention could prove useful. Unfortunately, less than half of the countries in the region incorporate MAP into their practices.

Chart 15.1: Availability of MAP in the region as of 2018 (considering a sample of 17).



1/ Uruguay is in the process of resolving their first mutual agreement procedure started in 2018.

Source: Transfer Pricing Database, Section 2, Advance Pricing Agreements. Accessed through CIAT Data, 2019.

Extensive preparation is required at the level of the tax administration, as tax officials must have enough knowledge of the business sector to negotiate a fair price. This requires capacity building, preparing negotiation strategies, information about the company's operations, industry characteristics, aspects of the production and value chains, relevant economic indicators, etc. Over time, tax administrations gain experience and knowledge from the extensive materials provided for in the APA applications. The following are some recommendations that could support tax officials to prepare for the negotiation:

- ▶ Evaluate the taxpayers' previous transfer pricing reports and tax returns.
- ▶ Analyze where potential risks or abuse could arise.
- ▶ Foster a cooperative relationship with taxpayers using transparency and open communication forums.
- ▶ Clear understanding of the context of the industry before going to negotiate.

Unfortunately, if the tax officials do not have sufficient experience or fail to prepare adequately then the APA could result inadvertently biased or lead to the taxpayer not paying a reasonable amount of taxes. Equally, if the taxpayer does not properly prepare, he could hastily reject a good proposal by the tax administration due to inexperience or a suspicion that the tax administration is taking advantage of the situation.

As of 2018, only Colombia and Mexico have a team of tax officials within the tax administration who are specifically dedicated to APA cases. Colombia's team being created more recently and consisting of three APA specialists, while Mexico's team of eleven specialists has more years of experience on this topic.

A 2017 toolkit created by the Platform for Collaboration on Tax⁸² highlights how the tax administration should weigh the potential advantages versus the effort that accepting and processing an APA application implies. If the taxpayer applying for an APA is a low- risk taxpayer, perhaps scarce resources would be better focused elsewhere (*conversely, it is also unfair to deny benefits to a taxpayer simply for being compliant*). For developing countries this may prove challenging as it requires prior risk assessment. International experience suggests that APAs work better for complex transactions undertaken by compliant taxpayers.

For countries that do allow APA applications, the following chart illustrates the time period afforded to the tax administration for issuing a reply, depending on the domestic regulations and administrative procedures. The period shown in the table below does not include the processing time necessary for the actual APA negotiation process.

Table 15.2: Tax administration’s expected response time for an APA request as of 2018 (in descending order).

Country	Average Response Time (months)	Time Limit Mandated in the APA Regulation
Guatemala	1	No
Chile /1	6	Yes
Mexico	14-24	No
Uruguay	8	No
Colombia /2	9	Yes
Venezuela	12	Yes
Ecuador	24	Yes
Peru	24	Yes
Dominican Republic	24	Yes
Jamaica /3	N/A	No

1/ The 6-month term only begins once the tax administration certifies that the taxpayer has provided all the background information needed for processing the request.

2/ In the case of requests for unilateral APAs, the rule provides for a nine (9) month term for the tax administration to accept or reject the request to begin an APA process. Furthermore, the negotiation process must be concluded in a maximum term of two (2) years, as of the date of acceptance of the request. If the agreement has not been signed after such term has elapsed, the proposal shall be rejected.

3/ Response time to be determined on a case-by-case basis.

Source: Transfer Pricing Database, Section 2, Advance Pricing Agreements. Accessed through CIAT Data, 2019.

As we can see from the table above, there is a very wide range between the countries (from one to twenty-four months). Moreover, this is only the average timing, it may change according to the various circumstances surrounding the application. For example, with bilateral and multilateral APAs, the administrative procedures may be modified as treaty law could have precedence over domestic law.

82 “A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses” page 78, published by the World Bank in 2017. The Platform for Collaboration on Tax (PCT) is a collaborative project between the UN, OECD, World Bank Group, and the International Monetary Fund.

At the taxpayer level, applying for an APA requires them to justify their reasoning and explain the methodology that will be used when setting the transfer price for controlled transactions. As of 2018, only Argentina, Barbados, Chile, Ecuador, Jamaica, Mexico and Uruguay include the provision for APA applications in their double tax conventions.⁸³ Moreover, many countries have specific regulations in place for requesting unilateral or bilateral APA's, for example;

Table 15.3: Regulations relating to the requirements of APA applications.

Country	Guidance for the APA Application
Argentina	General APA information found in Article 217 of the Tax Procedure Act. Law 27430. The regulation for this law is still pending.
Chile	For Bilateral APA's use MAP or No. 7, Article 41 E of the LIR, Resolution Ex. No. 68 2013 and Circular No. 29 of 2013.
Colombia	Art. 1.2.2.4.2. Decree 1625 of 2016.
Dominican Republic	Regulation 78-14.
Ecuador	NAC-DGERCGC14-00001048. For Bilateral APA's use the provisions of Article 9 of the relevant tax treaty (Associated Enterprises).
Guatemala	Art. 63 of Decree No. 10-2012.
Mexico	Art. 34-A of the Federal Fiscal Code in force. Rule 2.12.8. And, Procedure Form 102/CFF of the Miscellaneous Tax Resolution for 2018.
Nicaragua	Art. 102, numeral 1 Tax Agreement Act.
Peru	Resolution of the Superintendence No. 377-2013/SUNAT.
Uruguay	Internal Procedure of DGI (consisting of an interview and written request).
Venezuela	ITL, Chapter III, Section Five, Articles 143 to 167.

Source: Selected tax administrations from LAC CIAT member countries.

In the application and negotiation process of an APA, the taxpayer must be transparent and disclose confidential information about its corporate strategies and business dealings. The tax authorities will then choose to accept, reject or modify the proposed methodology. In order to apply for an APA, certain particularities must be included within the documentation, as exemplified below.

83 Argentina, Barbados, Chile and Uruguay do not have separate APA clauses in their tax conventions, but, consider APA's to be covered under the provisions of Article 25 (Mutual Agreement Procedure). Ecuador considers APA applications under the provisions of Article 9 (Associated Enterprises).

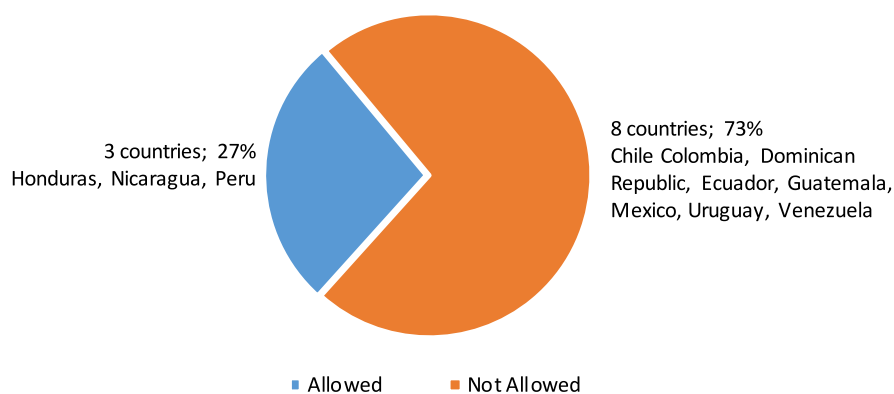
Table 15.4: Documentation and details to be included in the APA application (considering a sample of 13).

Required Documentation	Countries
Description and justification of the fundamental purpose of the intended agreement.	10 countries: Chile, Colombia, Ecuador, Guatemala, Jamaica, Mexico, Peru, Dominican Republic, Uruguay, Venezuela.
General information on the taxpayer and the related company.	9 countries: Chile, Colombia, Ecuador, Guatemala, Jamaica, Mexico, Dominican Republic, Uruguay, Venezuela.
Description of the material or content in the intended agreement.	9 countries: Chile, Colombia, Ecuador, Guatemala, Jamaica, Mexico, Peru, Dominican Republic, Venezuela.
Detailed explanation of the proposed transfer pricing methodology.	9 countries: Chile, Colombia, Ecuador, Guatemala, Jamaica, Mexico, Peru, Dominican Republic, Uruguay.
Basic predictions or critical assumptions with which the proposal has been formulated.	8 countries: Colombia, Ecuador, Guatemala, Jamaica, Mexico, Peru, Dominican Republic, Uruguay.
Generic information with respect to the types of transactions.	3 countries: Colombia, Jamaica, Dominican Republic.
Generic identification of other types of operations.	2 countries: Colombia, Jamaica.

Source: Transfer Pricing Database, Section 1, Advance Pricing Agreements. Accessed through CIAT Data, 2019.

The disclosure of this information leads to a major concern for the taxpayer as the tax authority may use it for the purposes of determine additional tax obligations to the company, on its affiliates, or on its competitors. The information (also known as a ‘secret comparable’) is not available to the public or any other taxpayer, it is confidential, and its use is often restricted. In all countries except for Argentina, domestic regulations exist to determine the legitimacy of using these secret comparables, as seen below.

Chart 15.2: Use of the ‘secret’ information attained through APA applications for transfer pricing control purposes (considering a sample of 11).



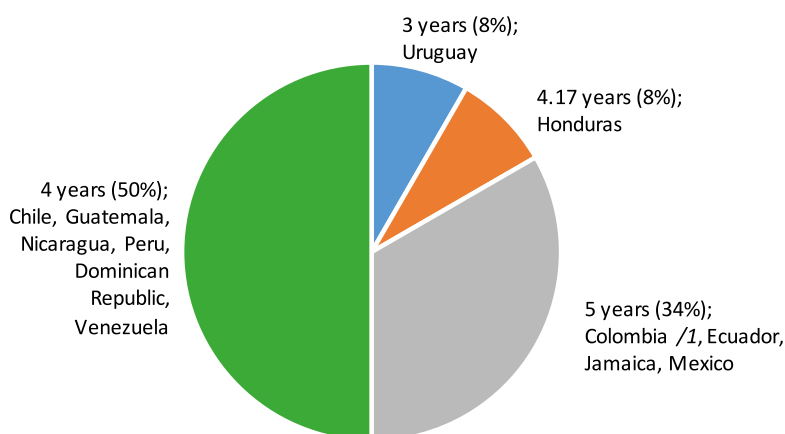
1/ The use of APA related information is not yet regulated in Argentina.

Source: Transfer Pricing Database, Section 2, Advance Pricing Agreements. Accessed through CIAT Data, 2019.

Although most countries disallow these ‘secret comparables’, taxpayers are still hesitant to remit sensitive information to the tax administration in the framework of the APA negotiations when there is no guarantee that the information will not be used for tax control purposes. This presents a choice for the tax administration, either to use the valuable, but restricted information for control purposes (most likely leading to a lack of confidence and consequently reducing the number of taxpayers wishing to apply for APAs). Or, choosing to indemnify taxpayers from potential persecution arising from the information obtained through the APA process, forsaking its future use, but encouraging confidence and cooperation amongst taxpayers. This is a strategic choice that each country makes according to its context: the goals of the APA regulation, the behaviour of the taxpayers, and the efficiency of their control processes, amongst others.

Thanks to the negotiation processes, the tax authorities may agree that the chosen method will result in a reasonable price and accordingly accept the APA. This will provide certainty and consistency for the duration of the agreement, usually between 3-5 years in the Latin American and Caribbean region, as can be seen in the chart below.

Chart 15.3: Expected legal duration of an APA (considering a sample of 12).



1/ Colombia; APA may become effective for the year it is signed, the year before and three subsequent taxable years.

Source: Transfer Pricing Database, Section 1, Advance Pricing Agreements. Accessed through CIAT Data, 2019.

Furthermore, Chile, Ecuador and Mexico allow for the possibility to extend the term of the APAs currently in force.⁸⁴ Surprisingly, when countries with APA regulations were asked how many APAs they had issued from 2012 until 2014, we found that 8 countries had not issued more than one APA.⁸⁵ In other words, the provisions have been put into place, but they are not being used. This could be due to many reasons: taxpayers are not experienced or do not feel confidence in applying for an APA, taxpayers do not feel there is a need to obtain an APA, or, tax officials may be resistant to relinquish sovereignty by committing to an extended agreement if they are not convinced by the negotiations.

84 In Mexico the extension may be up to 120 months. In Ecuador the extension may be up to 60 months, although this will require the taxpayer to resubmit the information in a new request (the extension is not automatic or simplified).

85 These eight countries are; Chile, Colombia, Guatemala, Jamaica, Nicaragua, Peru, Uruguay, Venezuela.

In this context, control mechanisms, such as compliance checks and sanctions must be implemented to build confidence and encourage respect between the administration and the taxpayer. Argentina, Chile and Ecuador explicitly allow for taxpayers with APA agreements to also be potentially subjected to audits (this is not allowed in Colombia, the Dominican Republic, Jamaica and Uruguay). For bilateral and multilateral APAs, certain provisions may be included in the relevant tax treaties; for the negotiation part there is Article 9 - Associated Enterprises and Article 25 - Mutual Agreement Procedure, for the maintenance and further implementation of APAs the Exchange of Information in Article 26 and the Assistance in the Collection of Taxes in Article 27 might be useful.

One of the most used control mechanisms for detecting APA non-compliance and fraud is the requirement of an annual report provided to the tax authority containing information that verifies the conformity of taxpayer transactions to the arm's length principle, and, to the conditions previously accorded in the APA. As is the case in Colombia, the Dominican Republic, Ecuador, Mexico and Uruguay. In Chile, there is a system of constant revision by tax officials, and in the case of fraud or substantial changes to the circumstances previously presented they may choose to revoke the APA. As of 2018, there are no alert mechanisms for detecting APA non-compliance in Guatemala, Honduras, Nicaragua, Peru and Venezuela.

To further mitigate risks, countries which lack experience with APAs may want to focus first on a low-risk economic sector. Officials can develop an extensive understanding of the business operations in that sector, and, potentially use this knowledge to negotiate with other taxpayers in that industry. Once the administration has gained more confidence, they can slowly branch out to other sectors. However, care should be taken that APAs are negotiated when an attitude of respect and compliance exists amongst the taxpayers. To reduce the potential workload for the tax administration, they can specify a minimum transaction threshold necessary when applying for APA.

Especially when the economic sector comprises of high-risk taxpayers, it is important to have good auditing and control processes that instil a sense of compliance. If such is not available, another option would be to give taxpayers the certainty that secret comparables will not be used, thereby encouraging trust in the tax administration.

A few of the countries in our study elaborated regarding the economic sector that their APA experience had proliferated in;

Table 15.5: Selected economic sectors for the elaboration of APA's.

Countries	Economic Sectors & Number of APA's	Total Number of APA's (2012-2014)
Ecuador	Construction (8) Non-renewable resources (2)	10
Mexico	Others (1) Automotive (1) Electronic (2) Dairy Products (1) Maquila (328) Retailer (2) Plastic (2) Call Center (1) Metal (1) Agricultural (1) Tobacco grower (1)	341
Dominican Republic	Hotelier (70) Telecommunications (2)	72 /1
Uruguay	Agrochemicals (1) Potential use in: logistics, services, distribution, or other sectors	1

1/ Corresponds to the period of 2013-2017.

Source: Transfer Pricing Database, Section 1, Advance Pricing Agreements. Accessed through CIAT Data, 2019.

The Dominican Republic and Mexico are two outliers that have allowed the negotiation of APA's for specific sectors ('safe harbour' rule). Both countries accepted the use of APA's within economically significant industries but did so in quite different manners. In the Dominican Republic it was negotiated in a group setting with the active participation and agreement of the taxpayers comprising the all-inclusive hotel industry.⁸⁶ Meanwhile in Mexico, the APA was offered to 'maquiladora' production plants owned by foreign companies. This is an example of how APA's may be used for attracting foreign direct investments, depending on the characteristics of the industry.

15.1. Controversies

Certain organizations, such as the European Union, have recently raised concerns over the neutrality of APA's. This region, which had previously endorsed APA's, is now questioning whether they cause a disproportionate competitive advantage. It is in this perspective that the EU questions whether APA's may comprise a form of 'state aid'.⁸⁷ Well-established companies may find themselves in a preferential position over those that are unable to meet the expenses of the arduous APA process. Therefore, controversy exists as to whether an APA application should carry a price tag with it. In Chile and Ecuador applying for an APA does not have an associated fee, however, in Mexico it is estimated to be around USD 520 and in Jamaica from USD 80 to 120.⁸⁸

⁸⁶ In the Dominican Republic this APA is no longer vigilant as of 2018.

⁸⁷ Article 107(1) of the Treaty on the Functioning of the European Union provides a legal definition of 'state aid', elements include: 1. Use of state resources, 2. Create an economic advantage, 3. For selected players, 4. Affecting competition and trade.

⁸⁸ In Mexican Pesos the amount is 10,000 MXN, and in Jamaican dollars between 10,000 to 15,000 JMD. These amounts are vigilant as of 2018. The amounts were calculated based on the exchange rates from www.xe.com/currencyconverter accessed on March, 2019.

Another issue is whether APAs simply serve as a Band-Aid solution to the overarching problem that is the inability of finding comparables. To better control the benefits granted by APAs, and, to implement the work of the BEPS Reports on Actions 5 and 13, the EU is now enforcing the automatic exchange of information so that any APA issued by a Member State, must be reported and registered in a central directory database.⁸⁹

Co-operative compliance approaches, such as APAs, Advance Tax Rulings (ATR) or pre-filing reviews, could be useful tools, providing alternatives for transactions where certainty is necessary. However, as the name suggests, mutual cooperation and trust between the taxpayer and the tax administration is essential.

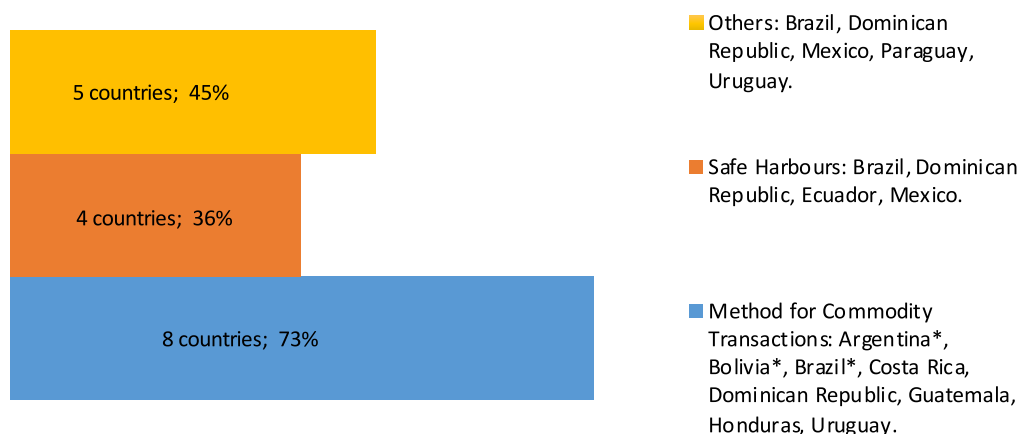
⁸⁹ Article 8a (1), Council Directive (EU) 2015/2376 of 8 December 2015.

16. Simplified Measures

Simplified measures consist of rules for reducing the burden of the often-complicated transfer pricing regimes and thereby increase taxpayer compliance. They can be a constructive way to overcome the difficulties that arise when no information on comparables is available, as taxpayers who meet specific requirements are able to file without necessarily concluding a full comparability analysis or an extensive transfer pricing report. These measures are meant to fix certain inefficiencies present within the current tax environment. However, to ensure appropriateness of the measure, its designers must first understand the characteristics of the domestic industries that will be affected, such as the business strategies employed in the marketplace, the variety of products that are being sold, aspects of the supply chain including the key functions, assets and risks, etc. Without this full analysis, it could be that the measure produces unintentional detrimental outcomes because it does not reflect the economic reality, or, it may inadvertently favour certain players in the industry. Additionally, some simplified measures could generate double taxation in situations where MAP experience is lacking, or, they could induce inequity for other taxpayers that can't apply to them. In any case, well designed simplified measures can have beneficial results for tax administrations and taxpayers such as: a reduction in transactional costs, more juridical certainty, and a positive impact on voluntary compliance levels. In the CIAT-GIZ Cocktail there are ideas on how to make simpler the transfer pricing regime.

As of 2016, the region's most used simplified measures are safe harbour regimes and those for commodity transactions (i.e. the so-called 'sixth method'), as shown in the following chart.

Chart 16.1: Simplified measures present in the region (considering a sample of 12).



*Bolivia considers the sixth method as another transfer pricing method, not a simplified measure. Meanwhile, Argentina and Brazil consider the sixth method as a way to apply the CUP method.

Source: Transfer Pricing Database, Section 2, Simplified Measures. Accessed through CIAT Data, 2019.

The ‘others’ category provides an interesting point of comparison as there are unique policies found in each of the five countries (Brazil, Dominican Republic, Mexico, Paraguay and Uruguay) further explained below:

Brazil simplifies the application of the transfer pricing methods by providing a set of fixed margins that are deemed by the government to be a fair arm’s-length compensation. Companies must use the predetermined margins to calculate the transfer price (often without the burden of performing a comparability analysis). Adhering to these margins increases financial certainty as the transfer price won’t be questioned or adjusted by the Brazilian tax authorities, however, a problem appears when the tax authorities of the country at the other end of the transaction, do not agree with the predetermined calculation and therefore refuse to provide relief for double taxation.

Another country with distinct measures in place is **Mexico**. First, with the ‘Maquiladora Program’ which acts as an indirect profit-split, defining a minimum profit attributable to the Mexican activities of maquiladoras. They must determine their taxable income considering the greater of either: i) 6.9% of the assets used in the maquila activity, or ii) 6.5% of the costs and expenses incurred by the maquila company as their taxable profits. Secondly, Mexico uses a threshold to exclude small taxpayers from the transfer pricing regime. Lastly, there are ‘De Minimis’ rules to exclude certain individuals and companies from the transfer pricing documentation requirements.

As for **Paraguay**, there is a simplified measure that provides for a predetermined formula to be used to make adjustments to the price of agricultural exports, particularly soy products and its derivatives. If the final price on the invoice is less than the ‘referential price’⁹⁰ of the product being exported, the difference must be accounted for via an adjustment that will be subject to further taxation. This measure has proven easy to administer as taxpayers can calculate the required adjustment themselves. From 2014 to 2018, there have been over 1,875 adjustments made by taxpayers adhering to the measure, with positive results reported by the tax administration.

In the **Dominican Republic** and **Uruguay**, there exist certain procedures that are regarded as simplified measures because they deviate from the regular transfer pricing regime. For example, in the Dominican Republic, there is a precedent of sector-wide Advance Pricing Agreements (APAs) that simplifies the transfer price calculation for companies operating in that sector. While Uruguay has an escape clause that allows the tax administration to make certain adjustments when assessing the domestic source income from related party transactions, as well as the sixth method.

16.1. Designing the Measures

Countries should try to design their domestic measures strategically, in such a way as to reflect the arm’s length price, effectively placing them in the scope of the bilateral treaty provisions. Doing so will minimize double taxation and, if necessary, ensure relief. For consistency and enhanced international cooperation it may be preferable to develop safe harbours or similar rules alongside trade partner countries. Although, this may prove difficult given the varying perspectives of the countries, case-in-point; the global controversy as to whether the sixth method is a simplified measure, an anti-abuse rule, a way to apply the CUP method, etc.⁹¹

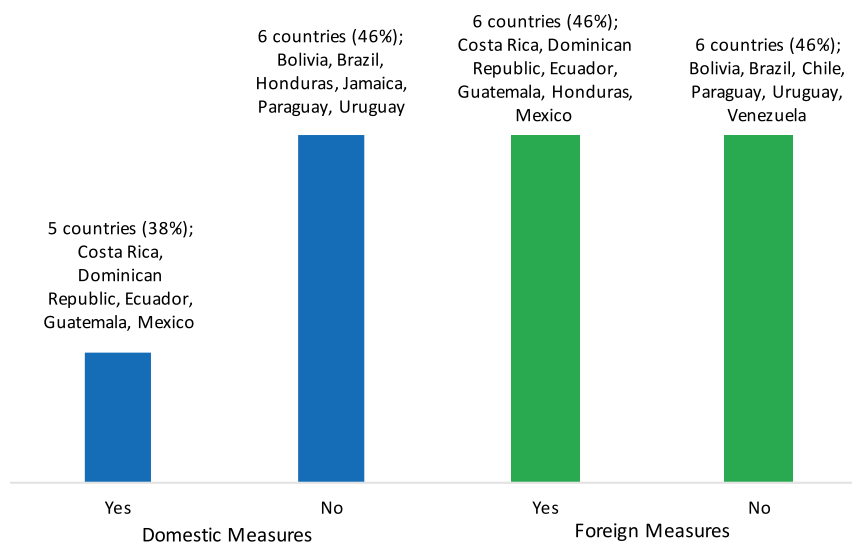
90 ‘Referential price’ calculated using the price of international transparent markets, plus or minus specific considerations such as transportation costs, quality checks, insurance fees, port fees, financing costs, etc.

91 The controversy as to whether the sixth method is a simplified measure or not, is further discussed in section 7.6 of chapter 7.

If the taxpayer meets the conditions for applicability, these measures could be either obligatory or optional. For Argentina and Uruguay, applying the sixth method is mandatory. In Paraguay, conducting the required calculations for the export price formula is mandatory. For the rest of the measures, taxpayers are allowed to opt-out which may create more work for the tax administration, but also increases flexibility of the domestic regime.

The following chart exemplifies the perceptions held by countries of their domestic simplified measures versus those applied in a foreign context.

Chart 16.2: Belief that double taxation is likely to be generated by domestic or foreign simplified measures (considering a sample of 13).

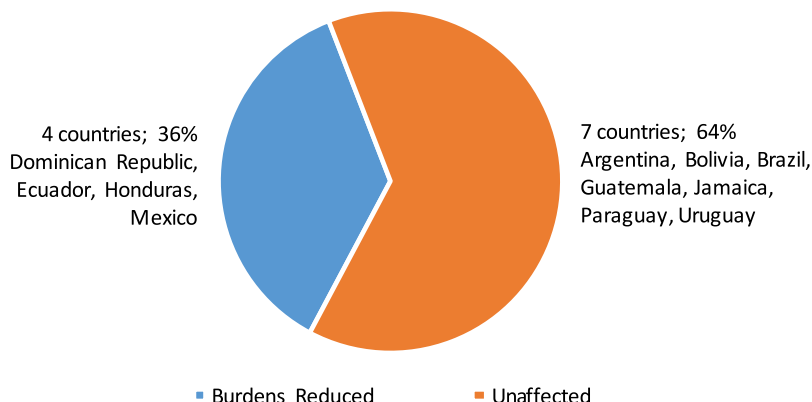


Source: Transfer Pricing Database, Section 2, Simplified Measures for Transfer Pricing Control. Accessed through CIAT Data, 2019.

Costa Rica, the Dominican Republic, Ecuador, Guatemala and Mexico consider that simplified measures could cause double taxation in both, a domestic and foreign context. Similarly, Bolivia, Brazil, Paraguay and Uruguay were consistent in their denial, simplified measures are not considered likely to cause double taxation in either a domestic or a foreign setting. In contradiction, Honduras stated that their domestic measures would not cause double taxation while foreign measures would. Chile and Venezuela responded only that foreign measures would not be likely to cause double taxation. Finally, Jamaica considered only that its domestic measures would not likely cause double taxation.

One of the objectives of simplified measures is to reduce obstacles in the tax regime for improved taxpayer compliance. However, when examining if the compliance burden or applicable sanctions thereto were reduced or eliminated thanks to the implementation of these measures, only four of the eleven examined countries concurred;

Chart 16.3: The reduction or elimination of taxpayer compliance burdens according to the tax administration (considering a sample of 11).



Source: Transfer Pricing Database, Section 2, Simplified Measures for Transfer Pricing Control. Accessed through CIAT Data, 2019.

There are domestic measures with the aim to incentivize compliance: Ecuador does not require a transfer pricing report to be filed when the safe harbour regime has been applied. Honduras has a measure that those classified as ‘small taxpayers’ (cumulative transactions of less than USD one million) are not be obliged to file the annual transfer pricing information return. Mexico applies ‘De Minimis’ rules whereby taxpayers may be exempted from the transfer pricing documentation requirements if their income from business activities and interests obtained do not exceed USD 677,789 (Mexican Pesos 13,000,000),⁹² or whose income related to the provision of professional services does not exceed USD 156,413 (Mexican Pesos 3,000,000).⁹³ In Argentina, taxpayers are exempt from filing the transfer pricing return when transactions are less than: 300,000 Argentinian Pesos per individual transaction, or, less than a cumulative 3,000,000 Argentinian Pesos for all transactions within that fiscal period. Lastly, in the Dominican Republic, taxpayers may be exempt from performing the transfer pricing analysis if their cumulative transactions are less than [approximately] USD 200,000.⁹⁴

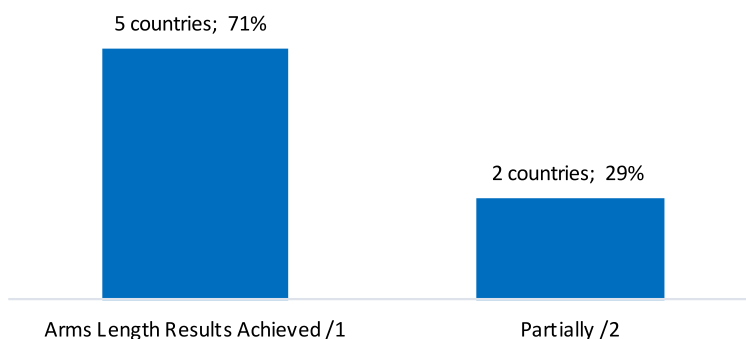
The abovementioned measures may help to reduce their administrative costs for companies and tax administrations. For taxpayers, safe harbour calculations may be less costly than undertaking a transfer pricing analysis and for tax administrations the processing workload and storage capacity may be alleviated.

92 Exchange rate Mexican Peso – USD of 19.18 Mexican Pesos per 1.00 USD. From www.xe.com/currencyconverter, accessed on May 2019.

93 This exemption does not apply to taxpayers that perform activities in the oil and gas industry as contract or assignation holders as defined in the Hydrocarbons Income Law.

94 The amount of USD 200,000 was reported by the Dominican Republic in 2018, however, the values are indexed annually.

Chart 16.4: Achievement of an arm’s length result through the implementation of the simplified measures, according to the tax administration (considering a sample size of 7).



1/ Argentina, Bolivia, Brazil, Costa Rica and Honduras.

2/ Dominican Republic and Guatemala.

Source: Selected tax administrations of LAC CIAT countries.

For further explanation, the countries described the most favourable circumstances or sectors in which to implement the simplified measures for optimal results:

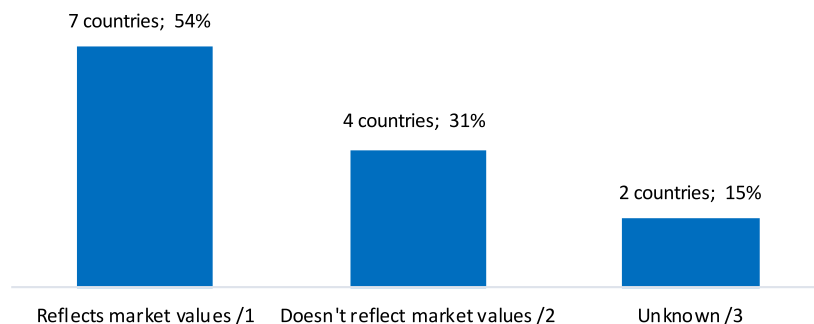
- ▶ Argentina no longer considers this a ‘method’, as much as an anti-abuse measure, whose consequence is to set a new price for transactions where intermediaries without economic substance are present. This being the quoted price from an internationally recognized market at the date of shipment. It is most commonly applied to the export of commodities, specifically in the cereal-producing sector.
- ▶ Bolivia finds the most success when applying the method to the import or export of commodity transactions (those listed in transparent markets).
- ▶ Brazil states that the simplified measure is best used to when help is needed to focus scarce resources on the most important or relevant cases.
- ▶ Costa Rica states their measure generates greatest success with commodity transactions.
- ▶ Guatemala also mentions success when examining commodities prices.
- ▶ Honduras believes the measure is best utilized for cases that involve commodities. And secondly, when there is no information as to the foreign buying or reselling prices of the products.
- ▶ Dominican Republic believes their measures are most useful in the context of commodity transactions, when there is a lack of certainty as to the pricing date of the transaction (for example; derivative instruments which may be traded when most convenient to the holder).

Source: Selected tax administrations of LAC CIAT member countries.

Moreover, when focusing purely on the results achieved by the employment of the so-called ‘sixth method’, we asked the participating countries whether they thought this method upheld the arm’s length principle by producing results that reflected the market value of the commodities in question.

The following chart exemplifies the sixth method’s average results (in the majority of the times in which it is applied). Seven countries agreed that the method accurately reflects market values, four countries disagreed, and two countries said they were unable to know (depends on the situation).

Chart 16.5: The sixth method's general achievement of results reflective of the market price (considering a sample of 13).



1/ Bolivia, Brazil, Costa Rica, Guatemala, Honduras, Uruguay and Venezuela.

2/ Chile, Ecuador, Jamaica and Paraguay.

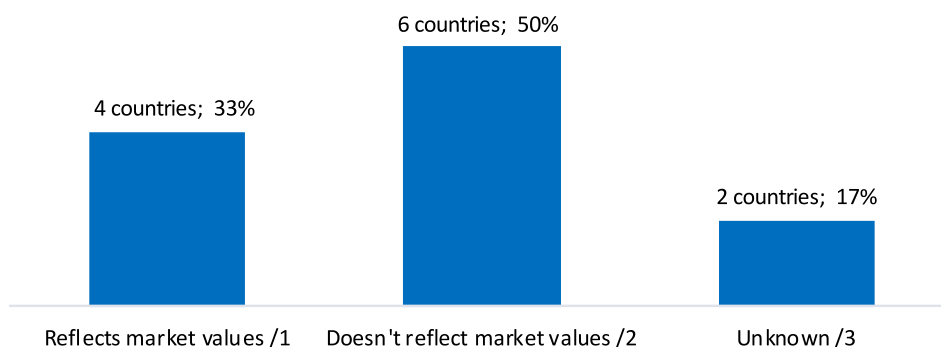
3/ Dominican Republic and Mexico.

*No information was available from Argentina, Barbados, Colombia, El Salvador, Guyana, Nicaragua, Panama, Peru, Suriname or Trinidad and Tobago.

Source: Transfer Pricing Database, Section 2, Simplified Measures for Transfer Pricing Control. Accessed through CIAT Data, 2019.

The second chart is slightly more stringent, as countries judge the consistency of the results of the sixth method in all cases. This time the results were reverse, only four countries believe that the method always accurately reflects market values. Six countries disagreed, while the same two countries (Dominican Republic and Mexico) were unable to issue judgement.

Chart 16.6: The sixth method's consistent achievement of results reflective of the market price (considering a sample of 12).



1/ Brazil, Costa Rica, Guatemala and Uruguay.

2/ Bolivia, Ecuador, Honduras, Jamaica, Paraguay and Venezuela.

3/ Dominican Republic and Mexico.

*No information was provided by Argentina, Barbados, Chile, Colombia, El Salvador, Guyana, Nicaragua, Panama, Peru, Suriname or Trinidad and Tobago

Source: Transfer Pricing Database, Section 2, Simplified Measures for Transfer Pricing Control. Accessed through CIAT Data, 2019.

Across the region, experience remains low as many of the countries have yet to implement, or only recently implemented, these types of measures. As of 2016, there has been limited information as to the number of taxpayers affected, however, as the practice grows, the lessons and opportunities for continuous improvement should not be undervalued.

Table 16.1: Number of taxpayers who benefitted from the simplified measures.

Country	Year(s)	No. of Taxpayers
Argentina	2009-2013	Average 68 per year
Dominican Republic	2016	40 taxpayers
Paraguay	2014-2016	Average 47 per year

Source: Transfer Pricing Database, Section 2, Simplified Measures for Transfer Pricing Control. Accessed through CIAT Data, 2019.

Lastly, the countries utilizing these measures should keep their objectives in mind when designing their requirements. Mainly simplicity, effectiveness and improved compliance, as simplified measures could bring about another set of formalities or obligations that taxpayers must conform to. The following examples are presented:

Table 16.2: Formalities and other obligations brought about by the application of the simplified measures.

Bolivia	Supreme Decree 2227 requires the taxpayer to present the Authenticated Information Statement for Related Party Transactions (Electronic Form F-601) and the transfer pricing study when applying the simplified measure.
Ecuador	Detail of operations with related parties must be presented to sustain the application of the simplified measure.
Honduras	Obligations/ documents and/or information regarding related parties are required to sustain the application of the simplified measure.
Mexico	Taxpayers must submit a document to the tax authorities stating the tax earnings of the period within the three months following the date of conclusion of said period (Article 182, second paragraph of the Income Tax Law in force).
Paraguay	Registry of Export Contracts within 10 days of setting contract. Monthly report regarding exports of soy and its by-products, indicating the dispatch of the export, dates of the invoice and a breakdown of prices and costs incurred.
Dominican Republic	For hotel industry APAs, the taxpayers must submit an annual report with a description of the operations performed, the policies of the hotels, contracts signed with related companies and a calculation of the adjustments in the income tax return.

Source: Transfer Pricing Database, Section 2, Simplified Measures for Transfer Pricing Control. Accessed through CIAT Data, 2019.

17. Transfer Pricing in Relation to Double Taxation Agreements

“There are now more than 3,500 bilateral double taxation agreements, as well as regional agreements (European Union, CARICOM, West African Economic and Monetary Union, etc.) that alter the conditions of taxation” - *Taxation, Big Data and Network Analytics*, Santiago Diaz de Sarralde Miguez, CIAT, 2018.⁹⁴

Double Taxation Agreements (DTAs), also known as Double Taxation Conventions (DTCs), or ‘tax treaties’ are signed by countries with the aim to provide taxpayers relief from double taxation and avoid double non-taxation. DTAs encompass the cornerstone through which transfer pricing principles are interpreted, more specifically, the provisions found in Article 9, introducing the concepts of a related party, the arm’s length principle, and adjustments. Through this article, governments can collaborate to reduce profit shifting by imposing tax on business dealings performed in their jurisdiction. The value of the tax imposed is based on a fair and reasonable price, calculated through the use of transfer pricing methodology. This tax is then recognized and accounted for by the country at the other end of the transaction through the provisions of Article 25 (Mutual Agreement Procedure). Without the interrelation between Articles 9 and 25 many of the currently accepted transfer pricing regulations would fail to meet their desired objectives.

Furthermore, the global network of DTAs bolsters trade by giving investors and entrepreneurs more confidence as to the tax treatment of their international transactions. However, there is no need for countries to rush into signing more treaties, they should first ascertain the potential consequences, the existence of economic benefits and their capacity to administer them. Having more treaties will not necessarily attract foreign direct investment as this requires infrastructure, natural resources, qualified human capital, and other similar factors. Treaties will act to restrict taxing rights, meaning that the imposition of tax must already be present in the domestic legislation, it will not be created by a treaty.

94 *Taxation, Big Data and Network Analytics: An introductory analysis to the global network of double taxation treaties*, Santiago Diaz de Sarralde Miguez, CIAT Director of Tax Studies and Research, 2018, Inter-American Center of Tax Administrations (CIAT), Page 7.

Table 17.1: Number of double tax treaties signed as of 2016 per country.

No. of Double Tax Agreements	Country
58	Mexico
33	Brazil
31	Trinidad & Tobago, Venezuela
30	Chile
28	Jamaica
25	Barbados
19	Argentina
18	Ecuador*
17	Panama
15	Uruguay
12	Colombia*
10	Peru*
9	Bolivia*
2	Costa Rica /1, Dominican Republic, Paraguay /2, Suriname
1	El Salvador

This number includes the agreements between Bolivia, Colombia, Ecuador and Peru separately, although they are all effected through the multilateral Andean Pact.

1/ Costa Rica has since increased their number of tax treaties to a total of 3 (signed with Germany, Mexico and Spain).

2/ Paraguay has since increased their number of tax treaties to a total of 4 (signed with the Chile, China, United Arab Emirates and Uruguay).

Source: Transfer Pricing Database, Section 1, Double Taxation Agreements. Accessed through CIAT Data, 2019.

For comparison purposes, as of 2018, the total number of treaties signed by countries in the EU numbered 1947. France, Italy and the UK have the most treaties with an average of 116, while Croatia, Malta and Slovenia have the least with an average of 67 treaties signed.⁹⁵

Signing a tax treaty is an ambitious process, maximizing long-term benefits can require months, or even years, of preparation depending on the level of expertise. For achieving short-term economic goals, there are less permanent unilateral measures that can be implemented. One option might be the provision of tax incentives (e.g. the Department of Tourism or the Ministry of Mining concede to tax breaks for companies in those sectors). The intended results being to encourage domestic economic growth and employment in that field. However, the government agencies must be careful what they concede to and should consult with the tax administration first to avoid excessive tax base erosion (especially if these sectors make up a large part of the country's economy). Another option would be to recognize the imposition of foreign taxes and allow the amount paid to be credited against domestic tax due.

95 'The European Union's Tax Treaties with Developing Countries' by Martin Hearson. Report for the GUE/NGL, published by the European Parliament in Brussels, September 2018.

The abovementioned options provide beneficial results for taxpayers, similar to those derived by a treaty. However, there is a major difference between the level of permanence and certainty in a unilateral measure versus a treaty. Investors and foreign taxpayers may find themselves in unfavourable circumstances if the government agency providing the beneficial regime suddenly decides to change its policy. In opposition, a change to the treaty provisions will require negotiation between the two countries and the ratification of a new protocol or amendment.⁹⁶

17.1. The Varying Model Tax Conventions

The origins that led to the creation of tax treaties can be traced back to a 1928 model drafted in London by experts from the League of Nations. A few years later, two conferences were held in Mexico City in 1940 and 1943 to further improve that work. Then, due to an increase in intra-European trade and investments after the Second World War, member countries of the Organization for European Economic Cooperation (OEEC) were urged to sign similar model bilateral treaties for the avoidance of double taxation. Subsequently, the [now rechristened] OECD (Organization for Economic Cooperation and Development), released its first ‘Draft Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital’ in 1963. Since then, various versions of tax treaty models have been published.⁹⁷

Treaty talks usually begin with the choice of which model to use as the starting point for negotiations between the countries. The previously mentioned OECD Model Tax Convention is commonly used by both OECD member countries and non-member countries interested in having an emphasis on residence country taxing rights. However, the OECD model is ‘ambulatory’, meaning that it is continuously revised and improved to better fit the changing needs of modern society.

Another frequently used model is the UN Model Tax Convention which is also ambulatory and is said to have a stronger focus on taxing rights for the source country. This model is published by the Department of Economic and Social Affairs of the United Nations.

The use of these models does not mean that the country in question is in agreement with every aspect as the models can be tweaked and customized. Furthermore, the option exists to create a personalized domestic model specifically tailored for that country’s characteristics. These models vary greatly in their allocation of taxing rights; the variation can often be traced to differences in the level of development as well as capital exporting or importing neutralities.⁹⁸

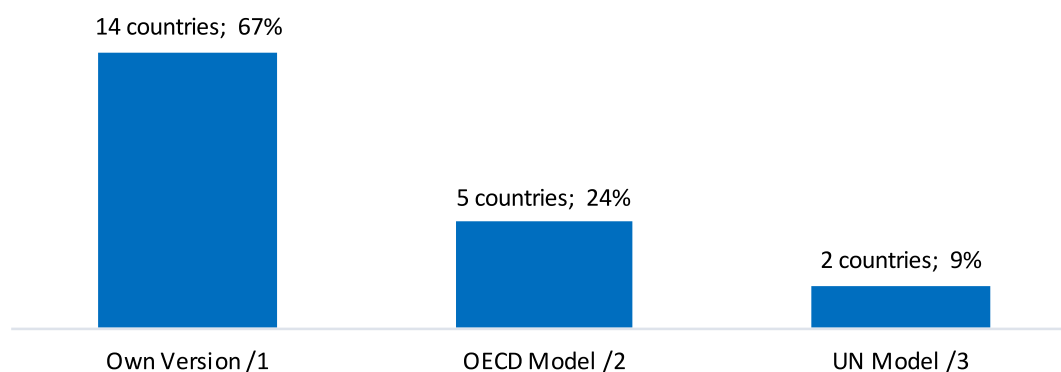
According to the countries examined, many of them consider combined provisions from both the OECD and UN models when negotiating, as can be seen in the chart below.

96 A change in the treaty may also be effected through the Multilateral Instrument, so long as both of the countries list that treaty and their provision changes match.

97 The 1963 title ‘Draft Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital’ was changed in later models to the name ‘Model Tax Convention on Income and on Capital’.

98 Some scholars believe the OECD model tends to favour capital exporting countries, while the UN model may favour capital importing countries.

Chart 17.1: Models used for the negotiation of tax treaties (considering a sample of 21).



1/ Countries that customize and combine provisions from different models: Argentina, Bolivia, Brazil, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Jamaica, Panama, Paraguay, Peru, Uruguay and Venezuela.

2/ Countries that prefer the OECD model: Barbados, Chile, Colombia, El Salvador, Mexico.

3/ Countries that prefer to use the UN model: Suriname and Trinidad and Tobago.

Source: Transfer Pricing Database, Section 1, Double Taxation Agreements. Accessed through CIAT Data, 2019.

The OECD model is exclusively adopted by five of the countries covered in this study: Barbados, Colombia, Chile, El Salvador, and Mexico. The UN model is preferred by two countries; Suriname and Trinidad and Tobago. Most of the countries prefer to customize, picking and choosing the provisions with which they prepare their own treaty model.

As previously mentioned, some countries like Barbados and El Salvador, choose to use the OECD model although they are not OECD members. This is encouraged by the OECD that allows non-member countries to make reservations on the articles and commentaries that they disagree with.

The difference between the OECD and UN models is minor but transcendent, however, the UN model is generally acknowledged to be more inclusive of the needs that are specific to developing countries. A controversial point that arises in the articles that have to do with interest, dividends and royalties is that of withholding tax. This gross tax may reduce the attractiveness of international business, as foreigners may be reluctant to invest in a state that imposes the added burden of withholding taxes. For developing countries, one such consequence may be a hindrance in the transfer of new technologies.

Moreover, when discussing the issue of royalties, Article 12 of the UN model allows for a tax on royalties to be withheld in the state where the payer is resident (the 'source' state), whereas, Article 12 of the OECD model provides for exclusive taxation in the residence state. The OECD argues that taxation should only be imposed in the country where the receiver is because it is where the value was created and where the expenses associated with the research and development of the property were made. However, the UN argues that the income would not exist if it were not for the market made available by the country where the user of such royalties is. Also, when the rights to the royalties are held in a different place than where they were created, this argument is removed.

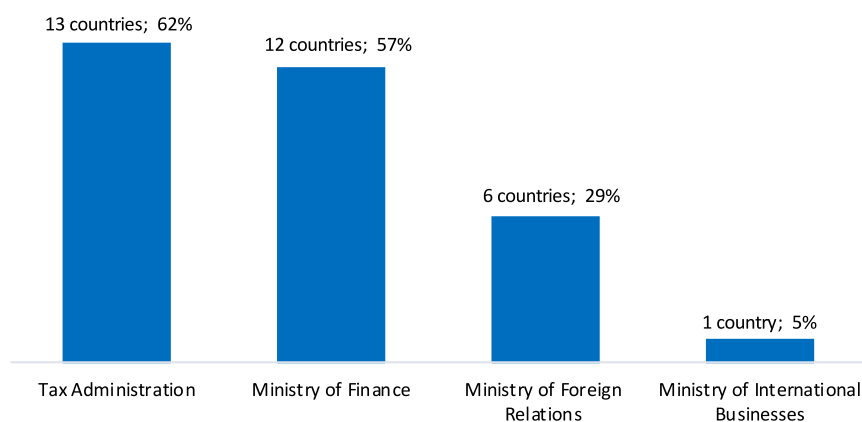
Over time, the two models have been diverging. This is supported by the following three examples: First, the force of attraction principle within Article 7 (1) of the UN model, which is not present in the OECD model. Secondly, the deletion of Article 14 from the OECD model, which is held to be an insignificant change as equal results of the provision are effected through Article 7. Lastly, in 2017, the UN adopted

Article 12A into its model. This new article allows for the imposition of a source withholding tax on fees paid for technical, managerial and consultancy services. However, as opposed to Articles 7 and 14, it does not require a physical presence to tax. Services rendered in another contracting state through digital means will be treated as a sufficient nexus for taxation in that state.⁹⁹ Concentrating in Latin America, there are countries that have already implemented similar measures in their treaties. For example; in five of Uruguay’s tax treaties there is a similar provision to that of 12A, for the taxation of fees for technical services, which are subject to a withholding tax of 12%. Also, in Brazil some treaties contain a provision to regard payments for technical services of any kind as royalties subject to a withholding tax (10% to 15% depending on the treaty), regardless of which contracting state they were rendered in.¹⁰⁰

17.2. Make Up of the Delegation

The delegation team, which is negotiating on behalf of the country’s interests, can be integrated by representatives from the tax administration, the ministry of foreign affairs, the ministry of finance, the ministry of economy, amongst others. According to the examined countries, most commonly present are experts from the tax administration and the ministry of finance.

Chart 17.2: Profile of the representatives that make up the delegation (considering a sample size of 21, it may be that representatives from multiple areas are chosen by the country).



Tax Administration: Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Honduras, Jamaica, Panama, Paraguay, Suriname and Venezuela.

Ministry of Finance: Argentina, Bolivia, Colombia, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Paraguay, Peru, Trinidad & Tobago and Uruguay.

Ministry of Foreign Relations: Argentina, Bolivia, El Salvador, Honduras, Panama, Paraguay.

Ministry of International Business: Barbados.

Source: Transfer Pricing Database, Section 2, Simplified Measures for Transfer Pricing Control. Accessed through CIAT Data, 2019.

99 Rendering services through ‘digital means’ involves the application of specialized knowledge, skill or expertise by the non-resident service provider. - The Taxation of Fees for Technical, Managerial and Consultancy Services in the Digital Economy with Respect to ART 12A of the 2017 UN Model, Committee of Experts on International Cooperation in Tax Matters, 2017.

100 Some of the treaties in Brazil contain the same wording as the UN Model Article 12A.

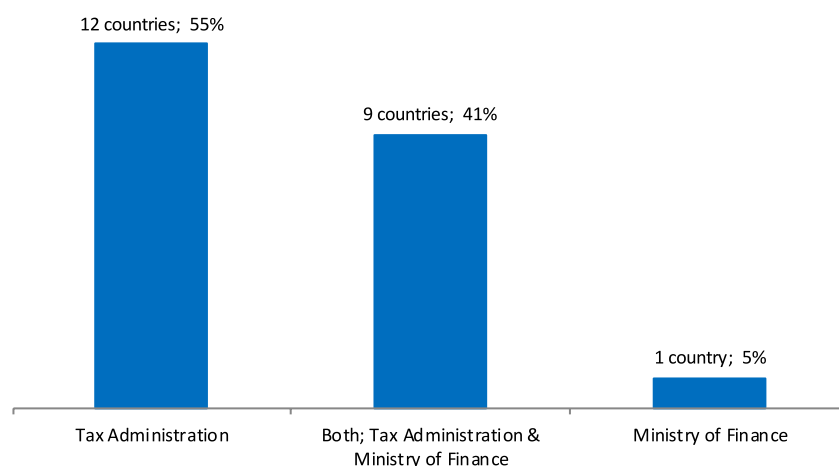
Before any negotiation takes place, the team should first perform an extensive economic analysis to ascertain the effects that the treaty will likely have, what can be expected to result from the proposed provisions and whether the potential benefits outweigh the risks.

Within the delegation, foreign relations representatives are necessary to maintain diplomatic ties between countries, however, it is important that tax and economy experts are present in the negotiations as they will be more likely to understand the economic and legal effects of the treaty. To increase flexibility in the negotiation process, the delegation could agree to the terms of a provision but with a time restriction. For example, accepting a 10% withholding tax for the next five years and then renegotiating. When renegotiating any provisions, there are two general options: an amendment to the current tax treaty via the adoption of a protocol, or, the negotiation of a new tax treaty, which would replace the old one.

If negotiations are at a standstill because a country is uncompromising on a stringent provision, perhaps a ‘Most Favored Nation’ clause (MFN) can help. The countries will agree to the restrictive provision, however, if they ever concede a more lenient position in the future, they will be forced to give that concession to any treaty with the MFN clause as well. This clause has the effect of freezing a country’s economic policy and should only be signed as a last resort. For example, Chile has recently experienced the activation of the MFN clauses in four of its treaties. The entry into force of the Chilean - Japan Income Tax Treaty concluded in 2016, brought with it lower withholding tax rate for interests and royalties. This activated the MFN clause in the treaties with Austria, China, Ecuador and Spain, forcing Chile to apply the lower rates to these treaties also as of January 1, 2017.¹⁰¹

The case of Chile exemplifies the importance of meticulously checking the potential effects of each treaty provision before signing. If possible, the review must be done by experts who fully understand and can interpret the tax treaty provisions. These ‘interpreters’ can also be useful for implementing certain articles into domestic legislation, or, to help resolve disputes that may arise from a particular provision.

Chart 17.3: Agency responsible for the interpretation of the treaties (considering a sample of 22).



Tax Administration: Barbados, Brazil, Chile, Costa Rica, Dominican Republic, Ecuador, Guyana, Jamaica, Paraguay, Suriname, Trinidad and Tobago and Venezuela.

Both: Bolivia, Colombia, El Salvador, Guatemala, Honduras, Mexico, Panama, Peru and Uruguay.

Ministry of Finance: Argentina.

Source: Transfer Pricing Database, Section 1, Double Taxation Agreements. Accessed through CIAT Data, 2019.

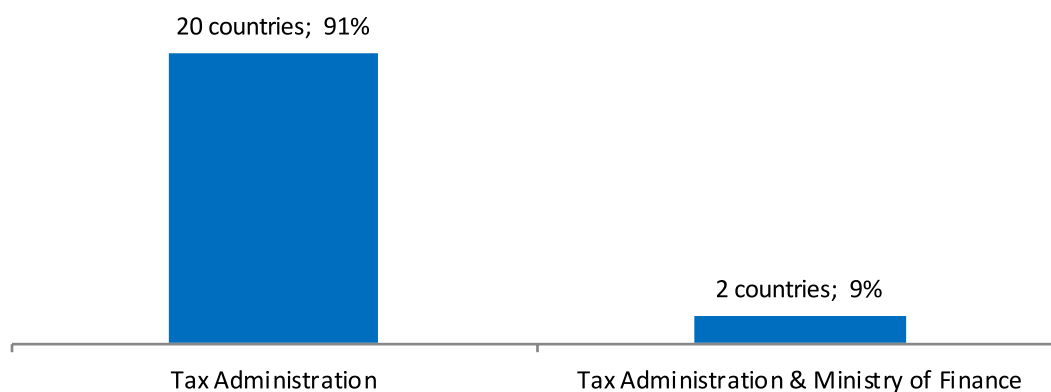
101 From Circular No. 50/2018, published on October 11, 2018 by the Chilean tax administration.

According to twelve of the countries in our study, the interpretation of the tax treaty is solely the responsibility of the tax administration. However, the other nine countries allow for representatives from both the tax administration and the ministry of finance to assist in the interpretation of the tax treaty. In Argentina, the Ministry of Finance has the primary rights, although the Tax Administration may submit an opinion for consideration. Furthermore, in Panama treaty interpretation can also be carried out by the Supreme Court of Justice. Moreover, Ecuador has specialized judges tasked with interpreting various treaty provisions.

17.3. Application

According to 22 countries, after the tax treaty has been ratified and comes into force, the application of the provisions is effected by the tax administration.¹⁰² The three outliers are Argentina, Barbados and the Dominican Republic that also include participation from the Ministry of Finance when applying the tax treaty. Perhaps, the additional participation by the ministry of finance could help to relieve pressure for tax administrations that find themselves with scarce resources.

Chart 17.4: Agency responsible for the application of tax treaty provisions (considering a sample of 22).



Tax Administration: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Guyana, Honduras, Jamaica, Mexico, Panama, Paraguay, Peru, Suriname, Trinidad and Tobago, Uruguay and Venezuela.

Tax Administration & Ministry of Finance: Barbados and Dominican Republic.

Source: Transfer Pricing Database, Section 1, Double Taxation Agreements. Accessed through CIAT Data, 2019

Disputes may arise when the terms contained in the tax treaty have not been well defined. In such cases, Article 3(2) requires the use of the domestic tax law definition of the country invoking the tax treaty provisions. When drafting these provisions, it is important to remember that any future amendments made to a country's domestic legislation may affect how the treaty is interpreted, potentially causing unintended changes to the results of the treaty (also known as 'treaty override').

¹⁰² The term; 'application of the treaty' refers to the process through which benefits are acquired. In particular, the interpretation, administration, and execution of treaty features.

18. Exchange of Information for Tax Purposes

The international exchange of information is an essential tool for tax administrations to trace the movement of money across their borders, to communicate and coordinate with each other, to understand global operations between parent companies and subsidiaries, to attain transparency over foreign tax positions, amongst others. Banking secrecy, strict privacy laws and the lack of international cooperation have allowed taxpayers to hold foreign accounts without the tax administration in their country of residence knowing about it. Furthermore, globalization and advancements in technology could potentially augment the problem as funds are easily transferred around the globe through digital means.

The exchange of information can increase the reliability of transfer pricing audits by reporting what the company is doing in foreign jurisdictions; where assets are being used, who the risk is attributed to, and where the value is being created. Thanks to the support given by the G20, the OECD Global Forum and the OECD's work on BEPS, the capacity and number of exchange of information agreements has increased exponentially in the past decade. Moreover, the work on BEPS, especially related to Actions 5, 12, 13 and 14, brought with it enhanced transparency and documentation standards. Most notably, the delivery of the Master and Local file to each of the jurisdictions that the taxpayers operate in, as well as the Country-by-Country (CbC) report submitted to the residence country of the parent company.

The predetermined format of the files and the minimum expected information is delineated in the report of BEPS Action 13. Although this level of detail may generate a higher compliance burden for multinational companies, the international consensus allows information to be shared more easily between the administrations. The CbC report and the Master file gives tax administrations all the relevant financial information to analyze the global transactions of an entity. If there is a specific set of transactions for which more information is desired, the Local file may be requested from the state where that corresponding entity is located.

To facilitate the implementation of BEPS Action 13, there are model 'Competent Authority Agreements' which can be adopted by domestic law, and which are meant to bridge the legislative divide so that government agencies can have a legal means through which they share information. Mechanisms for sharing information include: 1. Multilateral Convention on Administrative Assistance in Tax Matters (MAC); 2. Provision for the Exchange of Information in bilateral or multilateral tax treaties (Article 26 of OECD and UN model tax convention); and 3. Tax Information Exchange Agreements (TIEA).

18.1. Multilateral Convention on Administrative Assistance in Tax Matters (MAC)

This convention, which has been signed by over 75% of the world's countries is meant to increase tax transparency, using exchange of information mechanisms to reduce evasion and avoidance. Under this context, there are two 'Multilateral Competent Authority Agreements' (MCAA) that provide the legislative means to exchange information relating to the Country-by-Country report (the CbC MCAA) and the Common Reporting Standard report (the CRS MCAA).

The CbC MCAA is a way to automatically exchange the CbC report attained in the jurisdiction of the parent company with the rest of the jurisdictions in which the group operates in. The format in which

the CbC report is to be prepared and tendered has been standardized to facilitate the exchange, this is called the CbC XML Schema.

The Common Reporting Standard (CRS) is a tool for reporting taxpayers' financial information. CRS requirements must be implemented into domestic legislation as they call for confidential account information to be reported by financial institutions under the specified XML Schema format. The CRS MCAA provides the legal framework to automatically exchange this information. Similar to the Multilateral Instrument of BEPS Action 15, it requires a notification to be filed and both jurisdictions to list each other, in order for the agreement to take effect. The CRS MCAA specifies the information that will be exchanged, when it will be exchanged (reciprocity), as well as the data protection and confidentiality safeguards that must be in place at the time of the exchange.

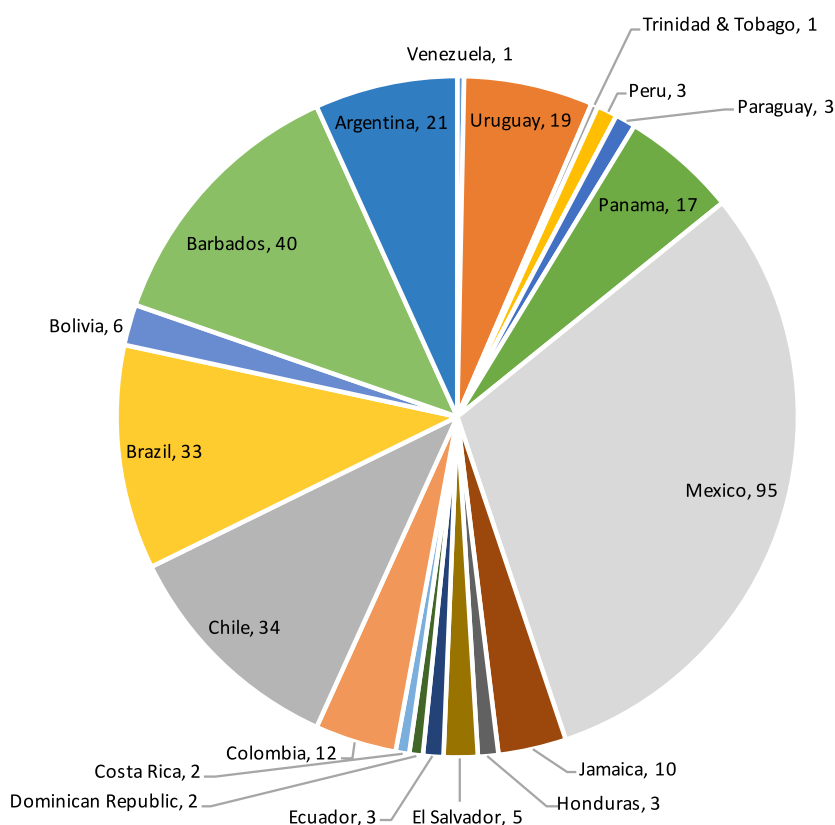
18.2. The Exchange of Information Provision in Tax Treaties (Article 26 of the OECD and UN Model Tax Conventions)

The exchange of information can also be affected through the inclusion of a specific clause in tax treaties, such as, Article 26 of both the OECD and the UN Model Tax Conventions.¹⁰³ This article involves three types of exchange of information: automatic, spontaneous, and on request. The exchange of information is not restricted by the provisions contained in Articles 1 or 2 of the tax treaty, therefore, it is possible to divulge information of non-residents. However, the information requested must be 'foreseeably relevant', meaning there should be a specific purpose for which the request is being made. The information must be kept secret and protected according to domestic confidentiality standards. The methods used to collect such information must meet the legal requirements of both jurisdictions involved, including the statute of limitation period for the alleged infractions. Likewise, if the information requested is to be used for non-tax purposes, this must be legally acceptable under the laws of both states, with explicit authorisation from the supplying state. If attaining the information will cause excessive administrative burdens, or, will contravene public policy in the supplying state, there is no obligation to act. However, the supplying state must not use banking or financial secrecy rules as a reason to decline the request. Finally, it could be possible when signing the bilateral agreement to request that this provision enter into force retroactively. This can be useful, for example, if there are ongoing investigations for which past information would be pertinent.

In the region, there are 302 tax treaties that have included this type of provision. The following chart shows the number of tax treaties per country.

103 Article 26 of the 2017 UN model is almost identical to the 2017 OECD model, with one exception; the addition of Paragraph 6 in the UN model: Art. 26 (6) 'The competent authorities shall, through consultation, develop appropriate methods and techniques concerning the matters in respect of which exchanges of information under paragraph 1 shall be made.'

Chart 18.1: Number of tax treaties containing a clause for the exchange of information, per country as of December 2018 (estimated).



The Barbados treaty with Slovakia is ratified but has not yet entered into force, the treaties with Ghana and Rwanda are in the process of ratification. Paraguay has since added another treaty with Uruguay that was signed in 2019. Argentina has four treaties in process (with China, Qatar, Turkey, and the United Arab Emirates) that are awaiting ratification.

Source: Selected tax administrations of LAC CIAT member countries, IBFD and OECD (<http://www.oecd.org/ctp/exchange-of-tax-information/taxinformationexchangeagreementstieas.htm>).

18.3. Tax Information Exchange Agreements (TIEA)

The OECD Global Forum Working Group on Effective Exchange of Information developed a model agreement for the exchange of information. These agreements are entered into by countries wishing to facilitate the sharing of confidential information regarding taxpayer activities in foreign jurisdictions. In Latin America and the Caribbean, many countries have signed these agreements, although at varying levels of development. This increases the challenge for tax authorities to protect the confidentiality rights of their taxpayers (e.g. if information is being exchanged with countries that have inferior data protection measures). For this reason, the safekeeping of data must be prioritized; tools like electronic encryption, restricted access, a clean desk policy and many others must be employed.

A controversial point in the exchange of information is banking secrecy legislations. Of the countries in our study; Argentina, Barbados, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Honduras, Jamaica, Mexico, Panama, Peru and Uruguay have all adopted legislation that facilitate access for the tax administration to attain confidential financial information from the banking sector, or similar entities. Meanwhile, three countries; Bolivia, Brazil, and El Salvador allow for banking secrecy to be lifted when

there is a specific request for the exchange of information or when there is an ongoing investigation for which the information is pertinent. In some cases, the requested information can be provided via authorization from the judiciary.

18.4. Beneficial Ownership¹⁰⁴

“The international community is increasingly aware that adopting laws, regulations, and mechanisms to gather and exchange information about “beneficial owners” (BOs) is crucial for combating tax evasion, money laundering, corruption, and the financing of terrorism” – Andres Knobel, *Regulation of beneficial ownership in Latin America and the Caribbean*, Abstract (2017).

To ensure transparency and accuracy of the financial information being reported, to prevent misuse of corporate vehicles, and, for the purposes of allocating interest, dividends and royalty payments under Articles 10, 11 and 12 of tax treaties, it is essential that domestic laws contain a definition for determining the beneficial owner (BO). The Financial Action Task Force (FATF) is an inter-governmental body that established recommendations which are commonly used for identifying beneficial ownership (e.g. recommendation number ten: any persons owning more than a certain percentage of a company are considered the beneficial owners of such entity). Out of the countries in our study, fifteen of them have such thresholds.

Furthermore, five of the countries in our study (Argentina, Brazil, Costa Rica, Jamaica and Uruguay) require the beneficial owners to be reported and registered with the tax authorities, the central bank, or, a specific beneficial ownership registry. Having this data easily available allows tax administrations to cross check taxpayer information for verification and continually update it.

Across the region, similar domestic legislations and reporting standards for the purpose of beneficial ownership arise. These are documented in the following chart.

Table 18.1: Country ‘Beneficial Ownership’ (BO) definitions.

Argentina
Threshold of 20% ownership, if no one meets the threshold then the senior manager must be identified in the public commercial registry.
Barbados
Those who ultimately own and control public companies (persons giving instructions or acting in the company’s name). Or, those possessing at least 10% of the shares in a private company.
Bolivia
No BO definition. Has ‘economic beneficiary’ which is determined by ownership, control, or the person whose name the operations are carried out in.
Brazil
The BO is defined as the natural person who ultimately owns, controls or ‘significantly influences’ the entity. ‘Significant influence’ is defined as when the natural person: (a) owns directly or indirectly more than 25% of the entity’s capital; or (b) directly or indirectly holds or exercises preponderance in corporate resolutions and the power to elect a majority of the directors of the entity.
Chile

104 For further reading: the Inter-American Development Bank (IDB) and the Organization for Economic Cooperation and Development (OECD) published an extensively detailed look at the beneficial ownership concept and its features in March 2019. This document is available through the OECD website at: <https://www.oecd.org/tax/transparency/beneficial-ownership-toolkit.pdf>

Threshold of 10% ownership or 'other forms of control'. No individual need be identified if not over 10% threshold.
Colombia
Threshold of 25% of shares or having the majority of the vote, the power to appoint the board of directors or having significant influence.
Costa Rica
Must register the BO with the central bank. Threshold between 15-25% of ownership or control through other means. If no BO owner identified, must register the administrator.
Dominican Republic
Threshold of 20% ownership or person with the ability to exercise control. If neither condition is met, no requirement to identify anyone else.
Ecuador
No BO definition for the purposes of information exchange. However, there is an 'effective owner' definition for the purposes of the income tax law. This focuses on the level of effective control without having a numerical threshold.
El Salvador
Unclear definition; those who possess effective control, no threshold.
Guatemala
Unclear definition; those who possess effective control, no threshold.
Guyana
Threshold of 25% of the votes of the entity.
Haiti
Threshold of 25% share ownership of the entity.
Honduras
Threshold of 25% of the capital, or a significant responsibility in control, management or direction.
Jamaica
Threshold of 51% through which ultimate ownership or effective control is exercised. Must register BO with the 'Companies Office'
Mexico
<p>Person or group of people who:</p> <p>a) Obtain the benefit derived from their own or another's actions, and who, in ultimate instance, exercise the right of use, or disposition of a good or service, or</p> <p>b) Exercise the control of a legal entity that, as a client or user acts or operates with whoever carries out 'vulnerable activities'¹⁰⁵, as well as the people on behalf of who, these activities are carried out.</p> <p>It is understood that a person or group of people controls a legal entity when, through ownership or holdings, by contract or any other act, may:</p> <p>i) Impose, directly or indirectly, decisions in the general meetings of shareholders, partners or equivalent bodies, or appoint or dismiss the majority of directors, administrators or their equivalent;</p> <p>ii) Maintain ownership of the rights that allow, directly or indirectly, to vote regarding more than fifty percent of the share capital, or</p> <p>iii) Directly or indirectly direct the administration, strategy or main policies of the entity.</p>
Nicaragua
Unclear definition; those with highest authority over management of the entity. No threshold.
Panama

105 Vulnerable Activities are defined as (i) activities carried out by financial entities in accordance with corresponding legislation, (ii) gambling activities (iii) activities of a financing nature but which are not performed by financial entities, (iv) real-estate and construction related activities, (v) precious metals and jewels activities, (vi) art auctions, (vii) certain activities carried out by public notaries and (viii) certain activities carried out by customs brokers.

Threshold between 10-25% of share ownership, a representative from the entity must be identified as the BO if threshold not met.
Paraguay
Threshold of 10% of share ownership, or having effective control, or having the right to use or benefit from the assets of another company, or being able to act in the name of another company.
Peru
Effective control through majority shareholding (no percentage given). If no BO then senior manager must be identified.
Suriname
Unclear definition; those who possess effective control, no threshold.
Trinidad and Tobago
Unclear definition; those who possess effective control, no threshold.
Uruguay
BO must be registered at the central bank. Threshold of 15%, no one need be identified if the threshold is not met.
Venezuela
No definition. No requirement to identify the BO.

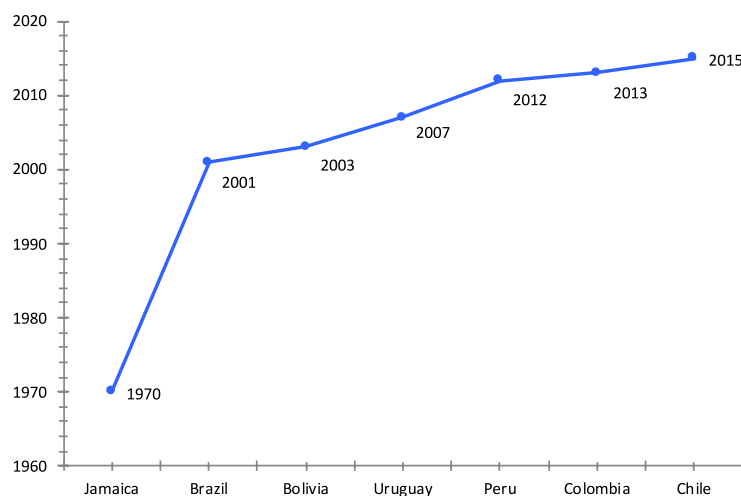
Source: Annex 3, Country-by-Country Details, 'Regulation of beneficial ownership in Latin America and the Caribbean' by Andres Knobel, IBFD (2017). Modified according to information from selected tax administrations of CIAT member countries.

19. Anti-Abuse Rules

The all-encompassing scope of tax collection combined with its self-reporting nature lends itself to potentially abusive situations. Anti-abuse rules are necessary to reduce the occurrence of aggressive tax schemes and encourage taxpayer compliance. There are two categories of anti-abuse rules: the general anti-abuse rules (GAAR's) and the specific anti-abuse rules (SAAR's). Usually, GAAR's are meant to uphold 'the spirit of the law' and applied as a last resort in the absence of more specific regulations. Their multipurpose nature provides flexibility for the tax administration to determine when an infringement has taken place. Therefore, there is a possibility that GAAR's could reduce legal certainty for taxpayers, but this result will depend on how objectively the tax administration applies the rule. A few of the GAAR's present throughout the region are: the 'Principal Purpose Test' (PPT) (an OECD recommendation found in the BEPS Action 6 Final Report which became one of the BEPS minimum standards). The 'substance-over-form' rule that focuses on the actual conduct of the parties instead of focusing on the contractual allocated functions. And, similarly, the concept of 'economic reality' that allows administrations to 'follow-the-money' and potentially re-categorize income if necessary.

As of 2016, Bolivia, Brazil, Chile, Colombia, Jamaica, Peru and Uruguay counted on at least one GAAR in their domestic legislation were. However, this result has been achieved during the span of over 40 years of legislations as can be seen in the following chart.

Chart 19.1: Timeline for the entry into force of GAAR's per country.



Source: Selected tax administrations of LAC CIAT member countries.

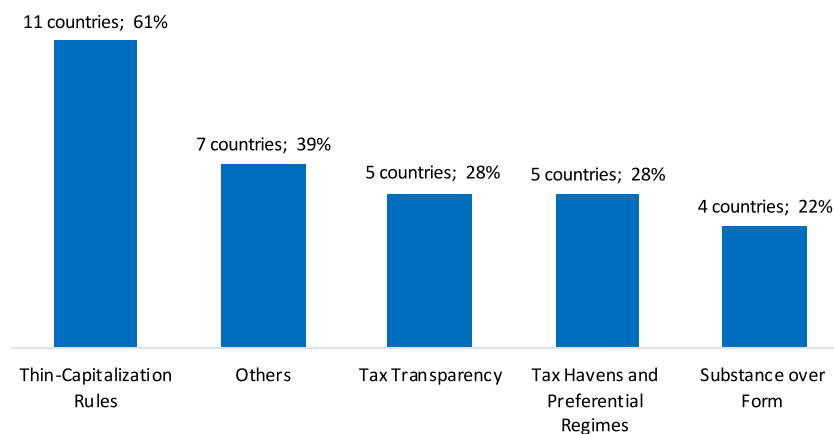
On the other hand, the SAAR's are limited to a specific action or infringement. These rules will only apply if the described situation arises. This black-and-white delineation of the SAAR makes it easier to apply, however, the taxpayers may implement strategic actions; modifying their behaviour just as much as is needed to circumvent the application of the SAAR. As a result of this behaviour, countries may feel the need to introduce more SAAR's to cover the next abusive situation that arises, eventually making the tax legislation too complex and excessively lengthy.

There are specific rules designed to address purely domestic situations (e.g. notional rental income deemed from the ownership of a second residence), however, these are outside the scope of our

study. Many SAARs address problems from an international tax context, for example, the Limitation on Benefits (LOB) rule, which limits the availability of treaty benefits to entities that meet certain conditions. The LOB is also part of the BEPS minimum standards; therefore, member jurisdictions of the Inclusive Framework on BEPS are committed to implementing into their tax treaties either the general PPT rule, the PPT with a simplified LOB, or, a detailed LOB. The so-called ‘sixth method’, which has been growing in popularity over the past two decades, may also be considered a SAAR when applied as a simplified measure since its application is often limited to transactions involving commodities. Furthermore, many of the countries in our study regard the introduction of any domestic transfer pricing legislation as a type of SAAR. These countries include; Chile, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Jamaica, Panama, Peru, Uruguay, and Venezuela. Such reasoning could be due to the fact that transfer pricing rules require a notional re-characterization of related party transactions as if they were unrelated, or, perhaps, because they are based on the fictional concept of the arm’s length principle.

Other anti-abuse rules commonly present in the region are thin-capitalization rules (to limit interest deductions), controlled foreign company (CFC) rules (to encourage transparency in taxpayer actions), rules to discourage the use of a foreign jurisdiction’s preferential regime, and, rules to restrict transactions with entities resident in tax havens (further explained below).

Chart 19.2: Anti-Abuse regulations present in the analyzed countries (considering a sample of 18).



Note: this chart shows examples of regulations that countries consider GAAR's or SAAR's, however, it could be that a country has anti-abuse rules that they don't consider as GAAR or SAAR, therefore, they will not be included in the above chart.

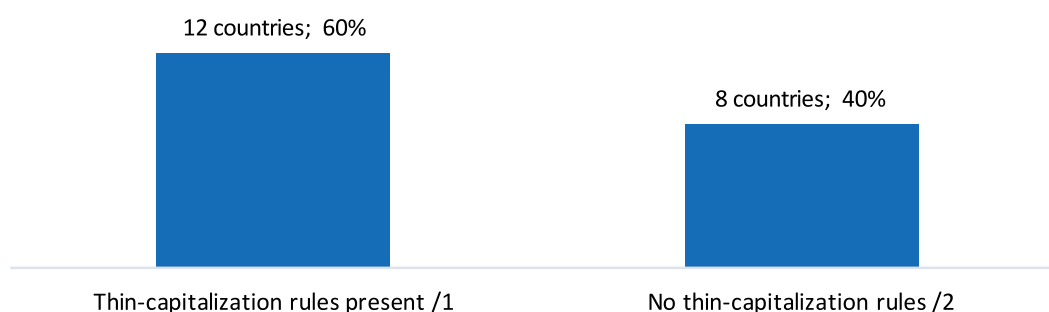
Source: Author elaboration using information found in the Transfer Pricing Database, Section 1, Anti-Abuse Rules. Accessed through CIAT Data, 2019.

Examples of anti-abuse rules in the ‘others’ category are: regulations for a deemed monetary increase of net worth and presumptive income, (Argentina and Paraguay respectively); a specific rule for the restriction of indirect expenses associated with technical services between related parties (Ecuador); a regime requiring authorization for the allocation of certain corporate expenses and for cost-sharing agreements (Dominican Republic); rules that restrict proportional deductions, force of attraction for domestic permanent establishments, and other locally imposed anti-abuse measures like those for the control of real estate purchases (Uruguay); beneficial ownership provisions (considered by Jamaica to be a type of GAAR, and by Panama to be a SAAR). Moreover, most of the countries in our study

have vigilant beneficial ownership regulations that may be considered anti-abuse measures as they require the identification of an ultimate beneficiary to ensure accountability, transparency and treaty entitlement.¹⁰⁶

The European Union's Council Directive 2016/1164, also known as ATAD 1, gives some examples of general and specific rules that might be taken into consideration by countries in Latin America and the Caribbean when creating their anti-abuse legislations (e.g. Article 9 of the Directive restricts hybrid financial payments to be deductible only in the country of source, Article 4 of the Directive introduces thin-capitalization rules restricting interest deductions to either three million euros, or, 30% of Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)). As of 2015, twelve of the countries in our study reported having thin-capitalization rules in their domestic regimes.

Chart 19.3: Countries with thin-capitalization rules (considering a sample 20).



1/ Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Mexico, Peru and Venezuela.

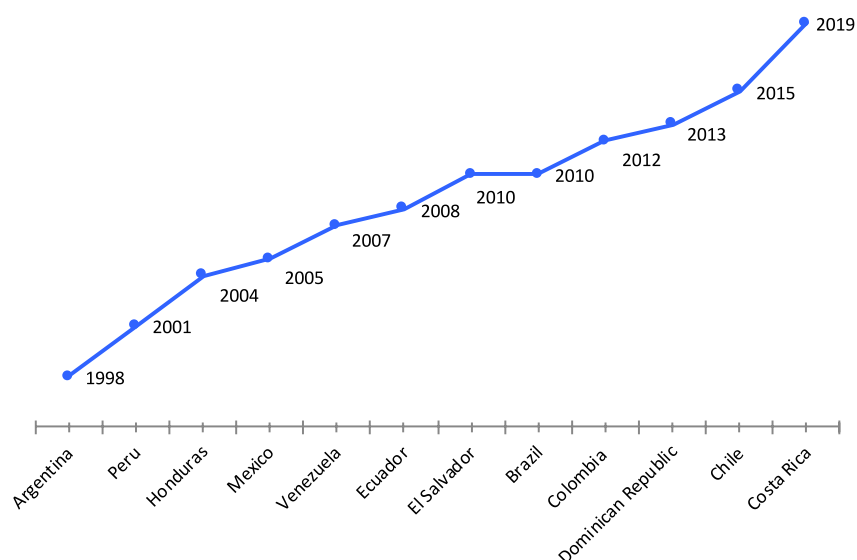
2/ Guatemala, Jamaica, Nicaragua, Panama, Paraguay, Suriname, Trinidad and Tobago and Uruguay.

Source: Transfer Pricing Database, Section 1, Anti-Abuse Rules. Accessed through CIAT Data, 2019.

Although Guatemala doesn't report having thin-capitalization rules, they do impose a regulation to restrict interest deductions (Article 24 of Decree No. 10-2012). These regional accomplishments are the result of a steady effort that has taken over 15 years, as can be seen in the following chart:

106 For further discussion on beneficial ownership see section 18.4 of chapter 18.

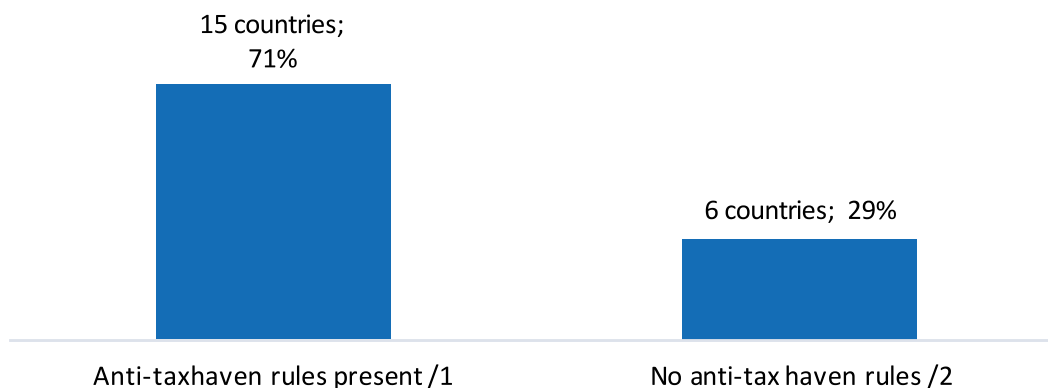
Chart 19.4: Year of entry into force of thin-capitalization rules.



Source: Transfer Pricing Database, Section 1, Anti-Abuse Rules. Accessed through CIAT Data, 2019.

Most of the BEPS Actions also have anti-abuse rules at their core (e.g. the anti-fragmentation rule to prevent the artificial avoidance of permanent establishments in BEPS Action 7, the substance-over-form approach in BEPS Action 9 to properly allocate risk and value within the transfer price, the mandatory disclosure of aggressive tax planning schemes in BEPS Action 12, or those contained in BEPS Action 5 to eliminate harmful tax practices and preferential regimes. Furthermore, as of 2015, fifteen of the countries in our study have vigilant legislation to reduce or eliminate the unintended advantages begot by taxpayers who conclude transactions with parties that are resident in a jurisdiction listed as being harmful.

Chart 19.5: Countries with rules meant to curb the use of tax havens (considering a sample of 21).



1/ Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, El Salvador, Jamaica, Mexico, Nicaragua, Paraguay, Peru, Dominican Republic, Uruguay and Venezuela.

2/ Costa Rica, Guatemala, Honduras, Panama, Suriname and Trinidad and Tobago.

Source: Transfer Pricing Database, Section 1, Anti-Abuse Rules. Accessed through CIAT Data, 2019.

These SAAR's may involve the attribution of tax haven income to the domestic taxpayer, disallowing the deduction of losses in tax havens, imposing withholding taxes on payments made to tax havens, or requiring transparency in transactions performed with tax havens. International organizations and countries prepare lists (i.e. blacklists or other classification methods) of jurisdictions that are labeled to be tax havens based on their encompassing of certain characteristics.¹⁰⁷

As we have seen from the complex organizational structures made famous by companies such as Google, Apple and Amazon, it could be that more intricate business structures are more likely to have tax avoidance as an objective. A potential solution may be to request taxpayers to demonstrate a clear and verifiable business purpose for each step added to their structure (e.g. genuine reasons for (re) structuring could include location savings, economies of scale, reaching new markets to increase sales).

107 Further details regarding tax haven classifications and rules, see the next chapter (20).

20. Aspects Related to Tax Havens

The OECD defines a ‘tax haven’ as a jurisdiction where non-residents can escape from tax in their country.¹⁰⁸ Common characteristics of tax havens include low-income taxation, lack of transparency, little exchange of information, and the use of harmful or preferential regimes. Despite these internationally agreed upon criteria, there is no consensus amongst countries as to the internal definition of “tax haven” given the imprecise nature of the term. Similar predicaments arise with ‘opaque’ or ‘uncooperative’ jurisdictions, ‘low’ income taxation or ‘aggressive’ tax regimes. Although there is no conclusive agreement on the terminology, defining a tax haven is necessary to delineate the scope of application for anti-abuse rules, special regimes and transfer pricing rules.

Internationally combatting profit shifting and other types of abuse requires coordination and harmonized regulations. Often, any transactions between domestic entities and entities resident in tax havens will automatically be subject to transfer pricing regimes (regardless of the relationship between them). For the effective application of rules aimed at diminishing tax haven abuse, countries must define under what circumstances they will consider jurisdictions to be harmful or abusive. This may be accomplished via three common methods: i. by individually evaluating different regimes on a case-by-case basis, ii. by publishing a list, or, iii. by providing a definition.

In relation to the first point (i); the individual evaluations take into account the effective tax treatment that is applied in a foreign country to certain transactions. This method grants flexibility to the tax administration in determining whether the foreign regime will be considered a tax haven or not, based on their stipulated criteria.

More common amongst countries and international organizations is the second point (ii): to identify preferential tax regimes by publishing either a ‘blacklist’ of the jurisdictions which are considered harmful from a tax perspective, or, in the opposite context, a ‘whitelist’ containing the jurisdictions that are considered as cooperative. The lists are updated often, giving clarity to taxpayers as to the regulations applicable to transactions with entities resident in the listed countries. The enumeration of harmful jurisdictions through a blacklist shines a spotlight aimed at increasing compliance with international standards of transparency and exchange of information. Different legislative forms, such as decrees, normative instructions, or regulations, allow countries to publish their official list. The following are a few examples:

108 International Tax Avoidance and Evasion, Four Related Studies, no.1, page. 22, OECD (1987).

Table 20.1: Domestic legislation giving legal effect to the ‘blacklist’

Bolivia	Normative Resolution of the Directorate 101800000006 dated 03/09/2018.
Brazil	Normative Instruction 1.037, of June 4, 2010.
Chile	Decree No. 628 of 2004.
Colombia	Regulatory Decree 1966 of 2014, amended through Decree 2095 of 2014. Also, included in Article 1.2.2.5.1. Decree 1625 of 2016.
Dominican Republic	Whitelist is given effect by Article 281 of Law No. 11–92, 2011.
Ecuador	Resolution No. NACDGERCGC1500000052.
El Salvador	Regulatory Decree - 002 /2018 and Article 62-A of the Tax Code.
Paraguay /1	Decree No. 1832 of 2014.
Peru	Annex to the Supreme Decree No. 122-94-EF, modified by Supreme Decree No. 007-2018-EF to exclude any OECD member countries from the list.
Venezuela	Administrative Providence No. SNAT/2004/0232.

1/ Paraguay chooses to coordinate its list in such a way so as it coincides with the OECD’s and Uruguay’s list. Any transaction between a domestic taxpayer and entities resident in the listed countries will be subject to a control analysis.

Source: Transfer Pricing Database, Section 1, Tax Haven. Accessed through CIAT Data, 2019.

Some countries may include a type of ‘saving-clause’ retaining the right to exclude jurisdictions from their list due to extenuating relations, such as diplomatic or commercial ties. Moreover, the act of identifying a specific country is politically sensitive and may be considered hostile or aggressive by the countries whose names are listed (or their allies).

To avoid these issues, countries may choose the less controversial third point (iii): to publish a definition describing the characteristics that constitute a tax haven (without identifying the specific countries). This method is widely adopted by the countries in our study. As of 2016, only five countries did not have a definition of tax haven in their domestic legislation (Costa Rica, Guatemala, Panama, Suriname and Trinidad and Tobago).

In the report ‘Harmful Tax Competition, An Emerging Global Issue’ published by the OECD in 1998¹⁰⁹, which was later adopted by the Global Forum, the OECD presented four main criteria to define a ‘tax haven.’ These four criteria are: i. low- or null-income taxation, ii. a lack of effective exchange of information, iii. a lack of transparency (e.g. vague details about the applicability of the tax regime, inadequate financial disclosure, and low regulatory supervision), and, iv. a lack of substantial activity requirement.

These criteria help to identify risks, but they are not absolute. The classification of a country as a tax haven might also depends on the context (e.g. a jurisdiction with low taxation may provide taxpayers with the potential opportunity to shift profits, but, if such jurisdiction is transparent and exchanges information then it may not be labeled a tax haven).

The abovementioned criteria are well reflected in the legislations of the countries in our study. The most common being that a foreign jurisdiction will be considered a tax haven if it has low- or no-income taxation. The subsequent question becomes what constitutes “low or no taxation”? Answers provided by some of the countries included in our study are as follows:

109 The OECD Council in 1998 published the “Harmful Tax Competition, An Emerging Global Issue” Report. Available at https://www.oecd-ilibrary.org/taxation/harmful-tax-competition_9789264162945-en

Table 20.2: Rates that may constitute a tax haven, according to the countries examined.

Venezuela	Any country which charges less than 20% of the tax that would have been charged in Venezuela.
Brazil	Any country which charges less than 20% of the tax that would have been charged in Brazil. /1
Chile	Any country which charges less than 50% of the tax that would have been charged in Chile. /2
Jamaica	Any country which charges less than 50% of the tax that would have been charged in Jamaica.
Peru	Any country which charges less than 50% of the tax that would have been charged in Peru. /2
Argentina	Any country which charges less than 60% of the tax that would have been charged in Argentina.
El Salvador	Any country which charges less than 80% of the tax that would have been charged in El Salvador.
Dominican Republic	Jurisdictions with income tax 'significantly lower' than that which would have been charged in the Dominican Republic.
Nicaragua	Jurisdictions with income tax 'significantly lower' than that which would have been charged in Nicaragua.

1/ The rate was reduced to 17% for countries compliant with the standards of the Global Forum on Transparency and Exchange of Information for Tax Purposes.

2/ Chile and Peru have other characteristics that must be met (further explained below).

Source: Selected tax administrations of LAC CIAT member countries.

Having a numerical standard to easily identify a tax haven to which the transfer pricing regime will apply, is efficient and simple to understand. However, setting an absolute percentage can leave out jurisdictions with a higher statutory tax rate, but which reduce their imposition through tax incentives and overly-beneficial rules that make the effective tax rate significantly less.¹¹⁰ Meanwhile, the Dominican Republic and Nicaragua use the term 'significantly lower' which leaves discretion in the hands of the tax administration.

The second criteria that assist the countries of our study in identifying a tax haven is the lack of exchange of information. The wording contained in their domestic legislation might be positive (Brazil, Chile, Peru) or negative (Argentina, Nicaragua, Uruguay).

Table 20.3: Exchange of information circumstances that may constitute a tax haven, according to the countries examined.

Argentina	According to the 2017 tax reform, Article 15 of the Income Tax Law, cooperative jurisdictions are those with which information can be exchanged on a regular basis.
Brazil	Countries with no access to information about corporate ownership or identification of the beneficial owner may be considered tax havens.
Chile	Countries where no exchange of information agreement is in effect may be considered tax havens. /1
Nicaragua	Jurisdictions with which exchange of information agreements are in place, or which have been individually evaluated by the ministry of finance may be exempt from the list.
Peru	Countries which are not willing to provide information about those benefiting from null or low taxation may be considered a tax haven. /1
Uruguay	Countries are excluded from the blacklist as soon as an exchange of information agreement becomes vigilant.

1/ Chile and Peru have other characteristics that must be met (further explained below).

Source: Selected tax administrations of LAC CIAT member countries.

110 African Tax Administration Forum: Suggested Approach to Drafting Transfer Pricing Legislation; Page 18, Explanatory Notes, Section Four.

Furthermore, a country may wish to maintain diplomatic relations and refrain from singling out neighbouring jurisdictions by shifting the decision making to another party (e.g. by specifically mentioning the influence of the other lists in their regulations).

Table 20.4: External source criteria to assist in defining a tax haven, according to the countries examined.

Bolivia	Countries identified as being uncooperative by the OECD, and, which are listed as such in the legislations of four or more South American countries.
Chile	A country considered by the OECD to maintain preferential regimes that do not comply with international standards. /1
Nicaragua	Any jurisdiction classified as uncooperative according to the OECD Global Forum.
Paraguay	Tax havens are not expressly defined, however, those considered in the OECD and Uruguay lists to be tax havens will be considered as such in Paraguay.
Peru	Countries which announce themselves, or perceive to announce themselves, as tax havens. /1
Dominican Republic	Any jurisdiction classified as uncooperative under the OECD Global Forum.

/1 Chile and Peru have other characteristics that must be met (further explained below).

Source: Selected tax administrations of LAC CIAT member countries.

Ten of the countries in our study choose to publish both, a black list, as well as a definition of harmful regimes.¹¹¹ The two countries that stand out are Argentina and the Dominican Republic who choose to publish a ‘whitelist’ of cooperative tax-friendly jurisdictions. Transactions performed with parties located in these jurisdictions are less likely to be subjected to the transfer pricing regime (unless they meet the requirements of being a related party).

As exemplified in the charts above, countries may choose to adopt a combination of these factors. For example, Ecuador requires two of the following three criteria to be met: i. lack of transparency and exchange of information, ii. low taxation, or, iii. no economic substance requirements for the attainment of tax benefits. Furthermore, Chile and Peru have a particularly extensive definition for classifying a tax haven. In Chile, Article 41 H of its Income Tax Law (implemented by Decree No. 824) states that a territory or jurisdiction is considered a preferential regime when it meets at least two of the following six requirements: i. less than 50% of the tax rate in Chile, ii. no exchange of information agreement currently in effect with Chile, iii. insufficient transfer pricing legislation which does not comply with the recommendations of the OECD or the UN, iv. considered by the OECD not to comply with international standards of transparency or exchange of information, v. considered by the OECD to maintain preferential regimes which do not comply with international standards, vi. countries which only tax income produced or generated in their territory.

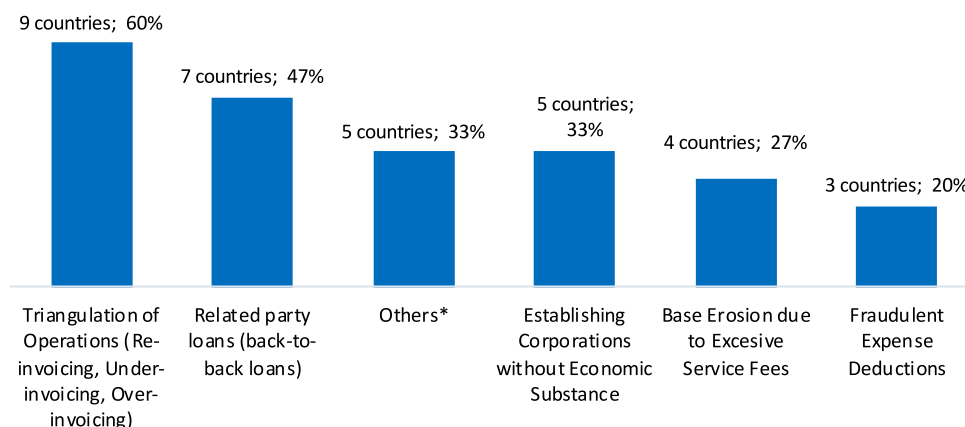
Peru denotes a similar definition, according to Article 86 of its Income Tax Law. A country will be considered a tax haven if the tax rate is less than 50% of that which would have been charged in Peru, and it meets at least one of the following requirements: i. it fails to provide information about those taxpayers benefitting from low or null taxation, ii. offers tax benefits and advantages aimed at non-residents, iii. restricts those benefitting from low or null taxation from operating in the local market, iv. pronounces itself, or is perceived to pronounce itself, as a tax haven. Both Chile and Peru have an exception that the tax haven classification does not apply in the case of OECD member countries, these are considered to be cooperative jurisdictions regardless of the preceding provisions.

111 Countries with both, a list and a definition: Bolivia, Brazil, Chile, Colombia, Ecuador, El Salvador, Paraguay, Peru and Venezuela.

20.1. Tax Haven Abuse and BEPS

The examined countries described the most common forms of evasion that arise from the use of tax havens.

Chart 20.1: Common forms of evasion through tax havens (considering a sample of 15).



*Others are Argentina; opacity in transfer pricing control, Colombia; difficulty in determining relationship, Ecuador; hiding assets to avoid dividend and capital gains taxes, Mexico; shifting ownership of intangibles, and Venezuela; omission of revenue attained in low tax jurisdictions.

Source: Selected tax administrations of LAC CIAT member countries, 2018.

Often, dealing with these types of evasion may be low on the list of priorities for a developing country's tax administration. However, it helps to have these issues in mind when drafting new legislations. Similarly, the advanced international tax issues dealt with in the OECD BEPS final reports provide tools that can support and guide countries that are starting to implement a transfer pricing regime, or, that are amending their current transfer pricing rules.

Furthermore, many of the BEPS Actions may help to combat the harmful behaviours shown in the previous chart (e.g. BEPS Action 2 provides a solution for imported hybrids, BEPS Action 3 might reduce the use of tax havens for the creation of shell companies, BEPS Action 4 can help outline interest deduction limits that will minimize the excessive use of related party debt and back-to-back loans, BEPS Action 6 curbs abuse in triangular situations and implements the LOB or PPT anti-abuse rules, and BEPS Actions 8 to 10 helps to reduce the shifting of intangible values abroad and the charging of excessive fees or non-existent expenses).

The BEPS Action most related to this topic is BEPS Action 5 on 'Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance'.¹¹² This action targets abusive structures by implementing a requirement that entities must maintain 'substantial activity' in the jurisdiction where they are claiming benefits. What constitutes 'substantial activity' is further outlined in the BEPS Action 5 Report. These criteria include the existence of 'core income generating activities', the effective management of the entity, and, maintaining an adequate number of full-time employees, expenditures and premises in that jurisdiction.¹¹³

112 The report for BEPS Action five can be found at: https://www.oecd-ilibrary.org/taxation/harmful-tax-practices-2017-peer-review-reports-on-the-exchange-of-information-on-tax-rulings_9789264309586-en

113 For 'high risk intellectual property (IP) entities' (such as those who acquire IP from a related party and further license it out), there is a fourth criteria which requires the entity to demonstrate a high degree of control over the development, enhancement, maintenance, protection and exploitation (DEMPE) functions of that IP.

21. Aspects Related to the OECD's BEPS Project

The BEPS project was a collaborative response by the G20 and the OECD to the aggressive strategies employed by multinational enterprises that exploit mismatches in tax rules and shift their profits to other jurisdictions, thereby successfully avoiding taxation. It comprises of 15 Action Points, covering topics of concern that tax administrations are currently faced with, from very specific recommendations like how to allocate deductions for hybrid financial payments to general ones like the mandatory disclosure of aggressive tax planning schemes. The harmonious nature of the actions allows them to complement each other and extend their potential impact (e.g. when the recommendations related to an action create an auxiliary 'ripple effect' indirectly advancing other issues). BEPS Actions fall within three main categories: 1. Coherence (BEPS Actions 2, 3, and 4): aims to improve the coordination of international tax rules, closing gaps between them to combat the obtainment of unintended tax benefits; 2. Substance (BEPS Actions 6, 7, 8, 9 and 10): aims to reinforce substance requirements and ensure that taxation takes place in the location where the economic activity and value creation took place; 3. Transparency (BEPS Actions 12, 13 and 14): aims at improving transparency and certainty for the tax administration and taxpayers. Finally, BEPS Actions 1, 5, 11 and 15 fall within the scope of multiple categories.

Many of the advanced issues dealt with in the BEPS project, such as the taxation of the digital economy and hybrid mismatching are especially crucial when trying to regulate large multinational companies. Adopting these recommendations is difficult considering the context and resources of many countries in the region. Nevertheless, these BEPS recommendations may be considered for the long-term vision of a country, being a useful consultation source for designing legislation, tax strategy, and implementation initiatives.

The examined countries reported on the most common sources of tax base erosion in their jurisdictions. Chile, Honduras and Uruguay made reference to BEPS Action 2 by specifically mentioning the base erosion that arises from financial hybrids and hybrid entities. The principal source of base erosion reported by the countries in the region was connected to the issues found in BEPS Action 4. All the countries, except for Chile,¹¹⁴ mentioned problems relating to financial payments, more specifically, interest, royalties, and back-to-back loan arrangements. Issues related to BEPS Action 5 (i.e. the use of tax havens and companies without substance) were mentioned by Argentina, Colombia, El Salvador, Guatemala, Honduras, Peru and Uruguay. As for BEPS Action 6, Argentina, Colombia, Costa Rica, Jamaica and Uruguay, mentioned base erosion due to the strategic use of intermediaries, abuse of double taxation agreements and treaty shopping. Regarding BEPS Actions 8-10, all the countries, except Brazil, El Salvador and Uruguay, mentioned transfer pricing in general as being problematic. Furthermore, Colombia, Dominican Republic, Jamaica, and Venezuela mentioned the transfer price of intangibles (e.g. copyrights or other intellectual property), while Argentina, Chile and Peru specified abuse in the transfer price of intra-group services. Argentina, Brazil, Chile and Colombia mentioned the base erosion that arises from abusive commodity transactions, an issue of a fluctuating nature which causes it to fall under the scope of many of the BEPS actions, especially BEPS Action 10.¹¹⁵ For a complete list of the base erosion problems reported by the countries examined, see the annex of chapter 21.

114 It is likely that Chile also experiences base erosion related to financial payments, although, perhaps they are less crucial than other types of transactions. Regardless, the fact that they did not mention this particular reason does not mean the problem is nonexistent in their jurisdiction.

115 This problem was touched upon by the OECD in the recent additions to the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2017, Chapter 2, Part 2.B, Pages 101-104. As well as by the United Nations in their Practical Manual on Transfer Pricing for Developing Countries, 2017, Part B.3.4, Pages 213-228.

The following table shows a general overview of the manner in which measures to counteract BEPS have been progressing across the region according to the BEPS Monitoring initiative conducted by CIAT. Further details and information regarding the BEPS recommendations that are being implemented across CIAT member countries, is available through the BEPS Monitoring database <https://www.ciat.org/beps-monitoring-database/?lang=en>

Table 21.1: Overview of the actions being implemented by some of the LAC CIAT member countries as of June 2019.

Partial (Ø) and Total (X) Implementation of the BEPS Actions															
Country	Actions														
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Argentina	Ø		X	X	Ø	X	X				Ø		X	Ø	Ø
Barbados						Ø								Ø	Ø
Belize						Ø									Ø
Bermuda					Ø								Ø		
Brazil					Ø	Ø	X					X	Ø	Ø	
Chile		Ø	X		X	Ø	Ø				Ø	Ø	Ø	Ø	Ø
Colombia	Ø		X	Ø	Ø	X	Ø			X			X	Ø	Ø
Costa Rica	Ø	Ø		X	X	Ø	Ø				Ø		X	Ø	Ø
Curacao															X
Dominican Republic										Ø					
Ecuador				Ø	Ø	Ø		X	X	X		Ø			
El Salvador						Ø	Ø								
Jamaica					Ø	Ø	Ø								Ø
Mexico	Ø	Ø	Ø		X	X	X	Ø	X	Ø	Ø	Ø	X	Ø	Ø
Panama					X	Ø							Ø	Ø	Ø
Paraguay						X								Ø	
Peru				Ø	Ø					Ø			X		Ø
Trinidad & Tobago					Ø										
Uruguay					X	Ø	Ø				Ø		Ø	Ø	Ø

Legend: 'Ø' means only some of the recommendations of the Action were implemented; 'X' means the Action was totally implemented. The LAC CIAT member countries that did not report any level of BEPS implementation are missing from this graph. Source: Author elaboration using information from the BEPS Monitoring Initiative of CIAT Data, 2019.¹¹⁶

The recommendations related to BEPS Action 3 (Controlled Foreign Company (CFC), rules) have been fully adopted by three countries: Argentina, Chile, Colombia, and partially adopted by Mexico. This is encouraging as the topics presented in BEPS Action 3 are relatively new in the region, also because this is not one of the minimum standard provisions. Furthermore, this number may rise quickly since these recommendations are “internationally recognized as a legitimate instrument to protect the domestic tax base.”¹¹⁷ The OECD further states that adequate CFC legislation is not in

116 Available at: <https://www.ciat.org/beps-monitoring-database/?lang=en>.

117 OECD Model Tax Convention, Commentary on Article 1, Paragraph 81 (2017).

contrary to any of the provisions in the OECD Model Tax Convention.¹¹⁸ Any changes or additions to a country's CFC rules may be excluded from the scope of the tax treaties in force, therefore, simplifying domestic implementation.

As for BEPS Action 13, the documentation requirements provided therein give tax administrations the opportunity to envisage aggressive tax schemes, identify risky structures and build a base for the exchange of information. This Action also brings some challenges: technical capacity to review and analyse the reports submitted, as well as, processes defining how to effectively use the information provided.¹¹⁹

Moreover, BEPS Action 15 comprises of a tool with which countries can modify existing tax treaties without individually renegotiating each one. This process is meant to save time, but may be hard to implement at an administrative level. Signatories must ensure the necessary judicial system is in place to effectively apply the MLI clauses.

118 Statement supported by the provisions of Article 1 (3) of the OECD Model Tax Convention. For tax treaties without this provision, the argument is also supported by the commentary of Article 7 at paragraph 14 and Article 10 at paragraph 37 of the OECD Model Tax Convention.

119 These types of information processing tools are available from companies such as Visor or Orbitax.

Annexes

Annex Chapter 1 – General Aspects

The table below provides the first provision of Article 9 (pertaining to the definition of ‘related parties’ and the ‘Arm’s Length Principle’) within the OECD and the UN Model Tax Conventions.

Article 9 of the UN and OECD Model Tax Conventions	
OCDE Model Tax Convention on Income and on Capital (2017)	UN Model Double Taxation Convention between Developed and Developing Countries (2017)
<p>Art. 9 Associated Enterprises</p> <p>1. Where</p> <p>a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or</p> <p>b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.</p>	<p>Art.9 Associated Enterprises</p> <p>1. Where:</p> <p>(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or</p> <p>(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.</p>

Annex Chapter 2 – Definition of Related Parties

Determination of related party status, according to the level of shareholder participation, per country.

Countries	Level of Shareholder Participation (Direct or Indirect)						
	≥25%	≥50%	≥40%	≥30%	≥10%	≥5%	≥1%
Bolivia							X
Colombia		X					
Costa Rica	X						
Ecuador	X					X	
El Salvador	X						
Guatemala	X						
Honduras		X					
Jamaica						X	
Nicaragua			X				
Peru				X			
Dominican Republic		X					
Uruguay					X		

Source: Transfer Pricing Database, Section 1, Related Parties. Accessed through CIAT Data, 2019.

Annex Chapter 3 – Formal Obligations

Informative obligations required by the transfer pricing regimes of each country.

Countries	Contracts/Legal Agreements	Miscellaneous Documents	Financial Statements	Accounting Reports	Invoices	Transfer Pricing Studies
Argentina		X				
Bolivia	X		X	X		X/1
Brazil	X		X		X	
Chile	X		X		X	
Colombia	X/2		X/3			
Ecuador	X	X/4	X	X	X	X
El Salvador		X/5				
Guatemala	X		X/6	X	X	X
Honduras	X	X/7	X	X	X	X
Jamaica	X	X	X	X	X	X

Countries	Contracts/Legal Agreements	Miscellaneous Documents	Financial Statements	Accounting Reports	Invoices	Transfer Pricing Studies
Mexico		X /8	X	X		
Nicaragua	X	X /9				X
Panama		X /10				X
Paraguay	X /11					
Peru	X	X	X	X	X	
Dominican Republic	X	X /12	X	X	X	X
Uruguay	X /13		X	X	X	X
Venezuela				X /14		
Totals	13	10	12	10	9	9

1/ Working papers that support the Transfer Pricing Study submitted, sources of information that support the search and selection of comparables.

2/ Copy of the contracts, agreements or conventions entered into by the taxpayer with its related parties abroad, in free zones and/or with individuals, corporations, entities or businesses located, residents or domiciled in tax havens in as much as they may have affected the types of transaction that are being examined, the profitability of the Company or the existing conditions. Contracts regarding the transfer of stock, increases or decreases of capital, reacquisition of assets, merger, demerger and other relevant corporate changes, occurring in the taxable year of the transfer pricing analysis to the extent they may have affected the types of transaction being examined, the profitability of the company or the conditions that would have occurred in comparable transactions with or between independent parties.

3/ Comparative financial statements through December 31 of the year being examined, prepared on the basis of generally accepted accounting principles in Colombia: a) Basic general purpose financial statements: balance sheet, profit and loss statement, net worth statement, financial situation statement, cash flow statement and consolidated financial statements when the parent or controlling Company is in Colombia; and, b) Special purpose financial statements, disaggregated or segmented by type of operation, as appropriate.

4/ Withholding certificates and other documents supporting the transaction or related with the tax obligations in general.

5/ All the information and documentation necessary for verifying and analyzing operations with related individuals.

6/ This is an obligation only for 'special taxpayers'.

7/ Declaration of Participation in Earnings and Partners.

8/ Form 76, monthly report on relevant transactions.

9/ Comparability analysis, identification of the taxpayer and its related parties and a list of advance pricing arrangements.

10/ All the information evidencing transactions with related parties.

11/ Export contracts for which the Export Contracts Registry has been created, wherein the individuals involved must register all the contracts and addenda thereof. As well as the declaration of the price adjustment report.

12/ All evidentiary information of transactions with related parties.

13/ The Administration has extensive examination powers, thus being able to require every type of information.

14/ List of fixed assets, inventory and any other information which the Tax Administration may consider, as provided in Article 169.

Source: Transfer Pricing Database, Section 1, Formal Obligations. Accessed through CIAT Data, 2019.

Annex Chapter 4 – Sanctioning Systems

Further explanation of the formal evaluation procedures carried out by countries when checking for tax noncompliance and transfer pricing manipulation, as of 2018.

Argentina: Methodological issues, market behavior, testing of some types of transactions, taxpayers incurring losses and types of economic activities are reviewed. An analysis is also made of sectorial behaviors and types of specific international transactions. The incorporation of new tools is being carried out, thereby generating more complex risk profiles for the analysis.

Bolivia: Formal evaluations are initially focused on transfer pricing risk analysis.

Brazil: has regular procedures for risk evaluation and transfer pricing examination. When through an examination it is verified that the taxpayer has not complied with the transfer pricing rules, the calculations filed are rejected and the administration may recalculate the parameter prices for determining the corresponding adjustment. In addition to the tax that must be paid, a fine is calculated on the unpaid tax as well as interest for delinquency in payment.

Chile: has a risk management model, which consists of 8 strategic taxpayer segments. Based on technical criteria, gaps and risks are measured with respect to each of them, including those related to Transfer Pricing. Examination and risk review programs are designed and structural, preventive and corrective control actions are implemented.

Colombia: Transfer pricing examination programs and control actions are designed. An independent office from the Deputy Directorate of Operational Analysis is in charge of carrying out risk analyses and selecting the taxpayers to be audited under each program, which thus guarantees transparency in the process of selecting taxpayers to be audited. The Deputy Directorate of International Examination Management and the working groups established in five Sectional Directorates carry out the transfer pricing examination function.

Costa Rica: The Deputy Directorate of Examination of the Large Taxpayers has carried out examinations by applying the arm's length principle, in five cases, some of which have been confirmed by the Administrative Fiscal Court and one case by the Administrative Litigation Court. Adjustments made totaled approximately USD 500,000.

Ecuador: Focused on controlling transfer prices through audit procedures.

El Salvador: The evaluation includes filing Form (F-982) entitled "Report on Operations with Related Parties", applicable to those who individually or jointly may have carried out operations with related parties equal to or exceeding USD 571,429.00 (Art. 124-A of the Tax Code). The sanction for noncompliance is regulated in Art. 244 paragraph 1 of the Tax Code, with a fine being imposed of 0.5% on the net worth or accounting capital appearing in the Balance Sheet less the surplus for reassessment of illiquid assets, which cannot be less than three minimum monthly salaries. Taxpayers must keep supporting documents for the price assessment for a 10-year period (Art. 147 paragraph e) of the Tax Code.

Guyana: Audits are carried out for enterprises, but not for specifically identifying transfer pricing problems. However, during the examination, these problems would be recognized and dealt with. There was no direct measurement of the effects of the transfer pricing problems.

Honduras: Until 2015, transfer pricing manipulation risks will be evaluated according to these indicators: companies with loss carry-forward; entrepreneurial reorganizations and restructuring; nominal rate vs effective rate; bad results; excessive payment of fees; cross border operations to tax havens or harmful preferential systems; excessive indebtedness.

Jamaica: The evaluation is part of our risk analysis process, which implies the review of the financial statements and analysis by third parties. One of those risk analyses has shown that there is a transfer pricing manipulation of approximately USD 17M.

Panama: At the moment, audits are being carried out on transfer pricing returns. These audits are based on the analysis of the income tax return, the annual transfer pricing form and the transfer pricing study.

Dominican Republic: When through a transfer pricing examination, it is determined that the taxpayer has used planning schemes to deviate or defer income, the tax rate of the corresponding period is applied to the undeclared income. Charges for delinquency (10% for the first month and 4% for the subsequent ones) plus interest (1.10% monthly) are also applied to the tax base. The legislation provides for sanctions for noncompliance with transfer pricing obligations, which may be up to triple the sanctions provided by the Tax Code.

Uruguay: Cross checking of information on a sample basis (using both internal and external information). Taxpayers who declare transactions with related companies over a certain amount (approximately USD 6,000,000) must submit a report on transfer prices. In addition, there are inspections that include in their scope the analysis of transfer prices that in the last year have generated corrections in fiscal income that cannot be quantified separately.

Peru: Simply answered that they have formal evaluations to ascertain tax noncompliance and transfer pricing manipulation but no further explanation given.

Source: Selected tax administrations of LAC CIAT member countries.

Annex Chapter 6 – Public Information Sources for Transfer Pricing

Detailed list of databases used for transfer pricing of commodities, interest and royalties.

Countries	Commercial Databases	Public or Internal Database Only	None
Argentina		Secretariat of Agriculture	
Bolivia		INFO SEC, EDGAR, Financial System Supervisory Authority - FSSA	
Brazil		X	
Chile	Osiris, Royalties module		
Colombia	KT Mine (Royalties) CUFT (Interests)		
Costa Rica			X
Ecuador	Roytystat, Petroecuador	Ecuador Central Bank (for interests), indexed prices for bananas is according to information from the IMF, World Bank and the USA Department of Agriculture	
El Salvador			X
Guatemala			X 1/
Honduras	Orbis, Osiris, Banking and Insurance Commission		
Jamaica			X
Mexico	Roytystat, Loan connector		
Nicaragua			X
Panama	Bureau van Dijk (Royalties module)		
Paraguay		Central Bank Database, National Directorate of Customs and Marangatu (SET)	
Peru	Bloomberg		
Dominican Republic	TP Catalyst (Orbis), Roytystat		
Uruguay	Orbis (Royalties module)		
Venezuela			X

1/ In the case of commodities, use has been made of the price information provided by the taxpayer.

Source: Selected tax administrations of LAC CIAT member countries, using information from Data Sources, Section 1 Transfer Pricing Database accessed through CIAT Data, 2019.

Annex Chapter 7 – Transfer Pricing Methods

Recommendations found in the CIAT-GIZ Transfer Pricing Cocktail:

Topic	Options	Commentary
Operations to which the measure applies.	<ol style="list-style-type: none"> 1. Only export operations. 2. Only import operations. 3. Import and export operations. 	Option 3 provides greater scope to the measure, it may be of interest to developed countries, importers of commodities or developing countries that export processed or unprocessed commodities.
Nature of the measure.	<ol style="list-style-type: none"> 4. The measure as a way to apply the direct method of comparing goods. 5. The measure as a way to reach a price attached to the principle of “arm’s length”. 6. The measure as a specific anti-abuse rule. 7. The measure as a tax calculated on the difference between the reference price and the price agreed by the parties. 	<p>Given the litigation that the measure could cause when it is linked to the direct method of comparing goods or to the “arm’s length principle” for developing countries, it may be appropriate to consider it as specific anti-abuse rule.</p> <p>Option 4 would also be convenient if we want to link the measure to the calculation of a tax other than the Income Tax.</p>
Products or goods subject to the measure.	<ul style="list-style-type: none"> • Renewable natural resources. • Non-renewable natural resources. • Goods with quotation on recognized and transparent markets (defined or not by the tax authorities). • Some rules allow the tax authorities to extend the measure to other products under certain conditions: • The international intermediary has no economic substance. • Tax Administration deems it appropriate. 	It is important to define the operations on which the measure applies. This depends on the profile of the country and its capabilities. In conducting this analysis, it is essential to link the measure to cases in which it is possible to know the markets where the goods subject to the measure are destined, the public price of goods sold and the negotiated amount, as well as the conditions under which they are marketed.
Linkage condition.	<ul style="list-style-type: none"> • The condition of ties between the exporter and the importer and/or the actual recipient is a prerequisite for the implementation of the measure. • The condition of ties between the exporter and the importer and / or the actual recipient is not a requirement for the application of the measure. 	For a fair and well-defined implementation of the measure, it may be desirable that the linkage condition exists. However, given the complexity that exists in some cases to determine the existence of linkage, it may require that the measure is applicable to all cases of import and /or export of goods that meet certain requirements.
Status of an international intermediary.	<ul style="list-style-type: none"> • A requirement to apply the measure is that there is an international broker who allegedly have no economic substance. • No such condition. 	This condition is important to define the application of the measure, especially when we choose to consider it as a special anti-abuse measure. For some countries it may be difficult to determine the existence of an international intermediary without economic substance. It could also be complex for the taxpayer to prove that an intermediary has substance when it is not linked. If there installed and administrative capacity, adopting this condition would be appropriate and justify the application of the measure as anti-abuse, as it is directly linked to a risk from the taxpayer behavior. To include this option, it is suggested to make clear the characteristics that the intermediary should have and/or the jurisdiction in which it is located.
Other conditions for application.	<ul style="list-style-type: none"> • Depending on the circumstances, it is recommended to evaluate in which situations risks arise that could trigger the application of this measure, with or without evidence to the contrary. For example, price distortions, manipulation of contract dates, destination / origin of goods, etc. 	If the Sixth Method is implemented as an anti-abuse measure, it is advisable to define all possible situations that would give rise to its application so as not to leave gaps that may lead to its avoidance. The method’s design depends on the objectives and context of each country.

Topic	Options	Commentary
Prices to consider.	<ul style="list-style-type: none"> • Highest price between: <ul style="list-style-type: none"> • The price of the good in a recognized and transparent market on the date of shipment. • The price agreed upon with international intermediary. • differential treatment between exports and imports: <ul style="list-style-type: none"> • Exports: research of international prices at the date of the last day of shipment, unless proven otherwise that it was agreed on another date. • Imports: the price based on international parameters of the purchase date at source is the best. • Multiple criteria in a single standard: <ul style="list-style-type: none"> • Price in a recognized and transparent market on the date of shipping/ landing. • Average price of 4 months or 120 days before landing or after shipping. • Price on the date of signing the contract. • Average price 30 days after signing the contract. • Market value of a recognized and transparent market at the date of shipment, the previous trading day or any day of shipment (the approach taken varies depending on the country). • International price in a recognized and transparent market (lowest quote in international markets), lower costs (port services, quality control, insurance and freight) and other items (losses, financial expenses from loans or loans), equivalent to the referential price. • Price of exporter in the source market or of the importer in the target market, according to customs documentation. <p>Some countries support the price agreed by the parties when the contract is filed with the tax authorities or other governmental body at a predefined time.</p>	<p>Each country should define the formula or pricing mechanism according to its reality (Example: relevant business context and its economy). It is always advisable to rely on a public market price and, according to the needs, restrict the use of comparability adjustments to avoid subjectivity and promote greater control and management of the measure.</p> <p>In defining the norm, the date that should be considered for the price in a recognized and transparent market, it is important to pay attention in markets or industries relevant to the country's economy and consider their business cycles and seasonality. For example, if you take the date of shipment of goods, it is important to identify the duration in shipping the goods and consider it in the price calculation. It should be noted that for each type of good, a specific mechanism of trading and markets that fit each of them could be considered. Depending if we deal with publicly traded goods with "spot" or future quote, it is important to analyze the date that should be used for the purpose of proceeding with the respective comparability. Example: date of contract, date of shipment, others.</p> <p>It has been identified as a good practice that taxpayers have the possibility of signing their contracts before the Tax Administration, which drastically reduces the subjectivity inherent in the analysis and control of such transactions.</p> <p>As an alternative to the consideration of the date of pricing under the contract, when taxpayers register them before government agencies; a tax administration -after evaluating their convenience- could negotiate the pricing dates with the taxpayer. This could avoid the risk of not knowing the context in which operations were performed by basing the date of pricing on criteria that are too formalistic. Some experts believe that, under certain circumstances, the date of the contract could generate problems in implementing this measure, suggesting that the focus of the standard is always the date of shipment.</p> <p>Also, while costly for the tax administration and requiring extensive networks for the exchange of information, some experts propose to consider the price of the good according to the values of the office of destination or origin. This could, under certain circumstances, create risks of undervaluation or overvaluation (depending on how efficient are the respective customs).</p>
Exceptions to the application of the measure.	<ul style="list-style-type: none"> • Situations where the taxpayer could not be subject to this standard (presenting evidence/ information and risk level) are established. • No situations that exempt the taxpayer from its application are established. 	<p>Options of exemption from the measure might be advisable under some circumstances (Example: through an anticipated price agreement [APA]). Criteria or conditions exist to implement the measure, involving presumptions of tax erosion, it is recommended that there is a possibility that the taxpayer can prove otherwise. It is therefore important that the regulation makes clear under what precise circumstances the measure may not apply.</p>

Source: CIAT-GIZ Transfer Pricing Cocktail, section 3.4, page 52 (2019).

Methods provided for in the transfer pricing legislation of LAC CIAT member countries as of 2016:

Countries	Traditional Methods (CUP, RPM, CPM)	PSM	TNMM	Methods for Commodity Transactions	Alternative Methods
Argentina	X	X	X	X (sixth method)	/1
Bolivia	X	X	X	X (sixth method)	
Brazil	X			X	X /2
Chile	X	X	X		X /3
Colombia	X	X	X		
Costa Rica	X	X	X	X (sixth method)	
Ecuador	X	X	X	/4	
El Salvador	X	X	X		
Guatemala	X	X	X	X (sixth method)	
Honduras	X	X	X	X (sixth method)	X
Jamaica	X	X	X		X /5
Mexico	X	X	X		
Nicaragua	X	X	X	/6	
Panama	X	X	X		
Paraguay					X /7
Peru	X	X	X	X (sixth method)	
Dominican Republic	X	X	X	X /8	
Uruguay	X	X	X	X /9	
Venezuela	X	X	X		
Total	18	17	17	9	5

1/ In 2018, Argentina introduced a norm that allowed taxpayers to use alternative methods when pricing transactions involving valuable and unique intangibles or certain financial assets as defined in Decree 1170/2018.

2/ These methods are not applied as provided by the OECD in its Guidelines, but rather they are applied through the use of fixed margins.

3/ Method determined by the taxpayer.

4/ In 2017, Ecuador introduced specific anti-abuse rules for transactions of crude oil, metals and bananas which was based on the CIAT-GIZ Transfer Pricing Cocktail suggestions.

5/ Any method determined by the taxpayer or the General Commissioner.

6/ As of February 2019, the tax reform of Law 987 was passed, introducing a method for commodity transactions.

7/ Paraguay does not yet have traditional or transactional transfer pricing methods in place, however, it currently uses the price adjustment method.

8/ Comparable price on transparent markets.

9/ International publicly known price through transparent markets, trade exchanges or the like.

Source: Elaborated using information from the Transfer Pricing Database, Section 1, Methods. Accessed through CIAT Data, 2019.

Annex Chapter 9 – Economic Sectors

The five main economic sectors reported by participating countries.

Country	Agricultural, livestock, forestry and fishing	Mining	Energy	Construction	Oil and gas	Manufacturing	Services	Insurance and reinsurance	Commercial	Financial	Automotive	Others
ARG	X/1	X			X						X	
BOL	X	X			X		X/2		X			
BAR	X			X	X	X	X			X		
BRA			X					X	X	X	X	
CHI	X/3	X							X	X		
COL	X	X	X	X	X		X		X	X		
CR	X					X	X		X	X		
ECU	X/4	X			X							
SAL		X				X	X/5		X			
GUA	X	X		X		X	X		X	X		
HON	X	X	X			X	X			X		
JAM		X				X	X/6			X		
MEX		X		X			X/7		X	X		
NIC				X		X	X		X	X		
PAN				X			X	X	X	X		
PAR	X			X		X	X		X	X		
PER		X					X		X	X		
DR	X		X	X		X/8	X/9		X			
SUR		X										
T&T			X			X	X					
URU	X		X	X			X			X		
VEN					X	X			X		X	X/10

1/ Grain-producing and Fishing.

2/ Transportation and Storage

3/ Forestry.

4/ Banana, Shrimp, Fish and Canned Goods.

5/ Restaurants and Hotels.

6/ Telecommunications and Tourism.

7/ Educational.

8/ Alcohol and Tobacco.

9/ Telecommunications, Hotels, Bars and Restaurants.

10/ Pharmaceutical.

Source: Transfer Pricing Database, Section 2, Economic Sectors. Accessed through CIAT Data, 2019.

Annex Chapter 11 – Adjustments

Comparability adjustments most used by taxpayers (according to the tax administration):

ADJUSTMENTS	ARG	BOL	CHI	COL	ECU	SAL	GUA	MEX	PAN	PER	DR	URU	VEN	Total	%
Accounts receivable adjustments	X	X	X	X	X	X	X	X	X	X	X	X	X	13	20%
Accounts payable adjustments	X	X	X	X	X	X	X	X	X	X	X	X	X	13	20%
Inventory turnover adjustments	X	X	X	X	X	X	X	X	X	X	X	X	X	13	20%
Others				X 1/ X 2/	X 3/					X 4/ X 5/	X 6/			6	9%
Differing accounting practices	X		X		X	X			X	X		X	X	8	12%
Installed and used capacity	X			X	X		X					X	X	6	9%
Monetary adjustments				X						X			X	3	5%
Total inventory value	X								X					2	3%
Capital financing costs									X					1	2%
Intangible assets			X											1	2%

Others:

1/ Property, plant and equipment.

2/ Price control adjustments.

3/ Country risk adjustment, payment term, amounts negotiated, advertising and publicity, intermediation cost, conditioning of freight and insurance, physical and contents nature, differences in date for carrying out transactions.

4/ Atypical situations determined by the country.

5/ Property, plant and equipment.

6/ Freight and insurance in certain cases.

Source: Transfer Pricing Database, Section 1, Adjustments. Accessed through CIAT Data, 2019

Annex Chapter 12 – Transfer Pricing Controls

Number of transfer pricing control cases per year from 2011-2015:

Country	2011	2012	2013	2014	2015	Average
Colombia 1/	251	103	82	135	47	123.6
Mexico	73	65	81	63	66	69.6
Argentina	Total 279 audits over the five years ('Large Taxpayers' only)					55.8
Brazil	63	47	67	61	21	51.8
Chile 2/	1	113	38	60	Not Available	53
Dominican Republic 3/	Not Available	6	10	43	14	18.25
Peru 4/	4	1	15	44	24	17.6
Venezuela	26	14	11	10	14	15
El Salvador 5/	Not Available	4	8	9	11	8
Uruguay	9	7	9	9	5	7.8
Panama 6/	Not Available	Not Available	Not Available	8	6	7

1/ In 2015, these are only fundamental cases, not formalities.

2/ No information from 2015.

3/ No information from 2011.

4/ Cases from 2011-2012 refer to the TNMM method, 2013 to other methods, 2014 and 2015 to scheduled cases. Furthermore, Peru reported information for the years 2016-2018 which is found in the chart below.

5/ No information from 2011.

6/ No information from 2011-2013.

Source: Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019.

Additional information from the Peruvian tax administration:

Country: Peru	2016	2017	2018	Average
Cases completed	37	41	40	39
Cases in process	56	32	51	46

Number of transfer pricing cases vs. number of specialized officials in the tax administration:

Cases vs. Transfer Pricing Officials in 2015		
Country	No. of Cases	No. of Specialized TP Officials
Mexico	66	48
Colombia	47	16
Peru	24	26
Venezuela	14	35
Dominican Republic	14	10
El Salvador	11	9
Bolivia	7	4
Panama	6	8
Uruguay	5	10
Correlation 72.5%		

Source: Selected tax administrations of LAC CIAT member countries. Using information from the Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019.

Revenue collection per country from 2010-2015 (in USD):¹²⁰

Amounts Collected in USD from Transfer Pricing Cases Between 2010-2015								
	2010	2011	2012	2013	2014	2015	Average	USD Exchange Rate
Argentina	4,648,987	5,466,887	506,433	3,169,181	12,892,981	1,044,865	4,621,556	13.07
Brazil	411,274,369	457,213,084	229,954,062	2,972,900,719	1,000,506,703	N/A -	1,014,369,788	3.87
Chile	394,954.49	N/A -	416,608.02	281,984.60	29,242.94	N/A -	280,697.51	707.20
Colombia	4,277,417	4,029,087	6,355,936	7,693,601	20,897,127	53,174,812	16,071,330	3,186.00
Costa Rica	1,202,846	N/A -	11,521,207	N/A -	1,257,299	N/A -	4,660,451	600.22
El Salvador	N/A -	N/A -	12,679	383,164	2,175,871	4,776,045	1,836,940	1.00
Mex.	42,996,420	63,568,348	97,191,054	195,232,155	167,117,925	308,749,828	145,809,288	17.26
Peru	N/A -	N/A -	N/A -	N/A -	1,766,264	2,649,397	2,207,830	3.40
Dom. Rep.	N/A -	N/A -	109,823,218	9,654,212	24,856,681	820,004	36,288,529	45.00
Uruguay	N/A -	3,595,964	1,228,354	14,994,265	14,427,916	17,405,937	10,330,487	29.75
Venezuela	4,988,396	2,781,120	5,260,645	4,606,160	4,141,016	10,136,906	5,319,040	6.28

Source: Transfer Pricing Database, Section 1, Experience in Transfer Pricing Control. Accessed through CIAT Data, 2019. Using exchange rates from December 2015.

¹²⁰ Using exchange rates from December 2015 (<https://www.xe.com/currencytables>)

The previous numbers were used in the calculations for chart 12.3. (Average Yearly Revenue Collection from 2010-2015), found in chapter 12.

In this table, looking specifically at El Salvador, the rise in its collection every year since 2012 could be linked to the fact that their transfer pricing regime came into effect in 2010.¹²¹ Also, the robust collection of the Dominican Republic in 2012 could be representative of the multilateral APA negotiated with the All-inclusive hotel industry.

Further information was provided by Peru for the years 2016-2018:

Amounts Collected from Transfer Pricing Cases Between 2016-2018				
Peru	2016	2017	2018	Average
Millions of Peruvian Sols	292	920	928	713.33

Annex Chapter 14 – Organizational Structure

The currency rates used for the conversion of the salary information are shown below. For the values in local currency go to the Transfer Pricing Database, Section 1, Human Resources. Published by CIAT Data, available at: <https://www.ciat.org/transfer-pricing/?lang=en>.

USD Exchange Rate on December, 2015 (Local currency per 1.00 USD)	
13.07	Argentina
6.85	Bolivia
3.87	Brazil
707.20	Chile
3,186.00	Colombia
600.22	Costa Rica
1.00	Ecuador
1.00	El Salvador
7.61	Guatemala
119.48	Jamaica
17.26	Mexico
3.40	Peru
45.00	Dominican Republic
29.75	Uruguay
6.28	Venezuela

Source: www.xe.com/currencytables

¹²¹ The revenue collection is not immediate as it can take years for new regulations to be fully implemented by officials in the tax administration.

Annex Chapter 16 – Simplified Measures

General overview and information of the simplified measures in the region as of December 2018:

Country	Type or name of the measure	Is the arm's length result achieved?	Advantages/ disadvantages of the measure	In which cases do you consider the measure generates greater success?
Argentina	Modified CUP (up until recently it was considered the sixth method).	Yes	Advantage: Certainty of the moment to which the assessment refers.	Cereal-producing and oil sector.
Bolivia	Publicly known price method of transactions in transparent markets.	Yes	Advantage: tax administration analysis of the import and/or export of goods priced on international markets. Disadvantage: Not obligatory for all import/export transactions.	Import and/or export operations of commodities in transparent markets.
Brazil	Simplified system – fixed margins.	Partially	Advantage: Increased collection and foreseeability.	Always for the taxpayer, and in some situations, also for the tax administration.
	Safe harbor – all the measures.	Partially	Advantage: Focus the tax administrations resources on the most relevant cases. Potential to obtain greater tax revenue.	When it is necessary to focus on the most relevant cases.
Costa Rica	Sixth method.	Yes	Advantage: Easier to obtain comparables. Alignment with the OECD recommendations for commodities.	This measure generates greater success in the cases dealing with commodities.
Guatemala	Method for imports and exports.	Partially	Advantage: It is used when there is no internal or external comparable. Disadvantage: Difficult to obtain an exact international price.	When examining commodities prices.
Honduras	Commodities Export and Import Method.	Yes	Advantage: Information is of public access. Not so strict comparability standards Disadvantage: Only applicable for certain products.	When there is no information on the price, at which the buyer abroad pays or at which the broker resells.
Dominican Republic	Comparable Uncontrolled Price Method- CUP, taking trading quotes on transparent markets on the date of declaration of import clearance/day of loading the goods (sixth method).	Partially	Advantage: Clear guidelines on the valuation date of the transaction. Disadvantage: May result inconsistent with arm's length principle.	When there is no certainty about the pricing date of the transaction (forwards).

Source: Selected tax administrations of LAC CIAT member countries.

Annex Chapter 21 – Aspects Related to BEPS

Non-extensive list of base erosion sources detected by the tax administrations of selected LAC CIAT member countries.

Country	Most common sources of base erosion:
Argentina	<ol style="list-style-type: none"> 1. Inappropriate criteria in the allocation of expenses from the parent company to the subsidiary. 2. Triangulation with the use of intermediaries in commodities exports. 3. Intra groups - value chain services. 4. Relocation of intermediaries. 5. Financial operations, use of rates not in keeping with the coordinates of the operation. 6. Abuse of double taxation agreements. 7. Transfer of one's own intangibles to related companies established in countries with low or null taxation.
Brazil	<ol style="list-style-type: none"> 1. Use of cost sharing agreement to avoid paying income tax on payments. 2. Use of traders in commodity sales. 3. Use of companies without economic substance.
Chile	<ol style="list-style-type: none"> 1. Financial hybrids. 2. Use of traders in commodity sales. 3. Intragroup services.
Colombia	<ol style="list-style-type: none"> 1. Payment of royalties for the use of brand to related party (located in jurisdiction with low or null taxation) which, although being the legal owner of the intangible, does not create any value therein. 2. Restructuring of the business when going from selling the totality of the mineral production to one customer abroad, to the sale to three companies located in jurisdictions with low or null taxation, in order to avoid the transfer pricing system on not complying with the relationship criterion which in due time considered the sale of over 50% of the production to the same customer. Additionally, there was no transparency in relation to these three companies abroad. 3. Free assignment or transfer of intangible property (trademarks) to a company located in a jurisdiction with low or null taxation. Formal and substantial transfer pricing obligations are not fulfilled. Additionally, once ownership of the brands has been transferred, the payment of royalties is generated by the Colombian Company to the company established in a low taxation jurisdiction. 4. Creation of a small subsidiary company in the country by a taxpayer with operational activity in Colombia. The small subsidiary receives bank credit from abroad (indication of a back-to-back) for a very high amount. Aggressive tax planning by the taxpayer for acquiring or absorbing the small subsidiary company, assuming the latter's rights and obligations. Accordingly, the taxpayer ends up assuming an enormous debt through which it erodes the base through interest payments and their corresponding deduction.
Costa Rica	<ol style="list-style-type: none"> 1. Transfer pricing measures. 2. Limitation of interests. 3. Abuse of agreements to avoid double taxation. [DTA]
Dominican Republic	<ol style="list-style-type: none"> 1. Service operations. 2. Intangible operations. 3. Financial operations.
Ecuador	<ol style="list-style-type: none"> 1. Financial expenses and undercapitalization charges. 2. Transfer pricing in general. 3. Indirect expenses associated with technical services between related parties.
El Salvador	<ol style="list-style-type: none"> 1. Transactions with tax havens. 2. Thin-capitalization.
Guatemala	<ol style="list-style-type: none"> 1. Use of cross border payments to mobilize its earnings to jurisdictions with zero or low taxes which may include: payment of royalties. 2. Transfer pricing.

Country	Most common sources of base erosion:
Honduras	<ol style="list-style-type: none"> 1. Deductibility of interest. 2. Excessive royalty payments. 3. Transfer pricing. 4. Transparent companies. 5. Trusts and pension funds. 6. Hybrids.
Jamaica	<ol style="list-style-type: none"> 1. Operational expenses. 2. Copyright. 3. Abuse of agreements (DTA).
Mexico	<ol style="list-style-type: none"> 1. Supply chain structures. 2. Migration of intangibles abroad. 3. Classification of taxpayer according to functions, assets and risks.
Peru	<ol style="list-style-type: none"> 1. Payment of royalties for use of brand to related party (located in a jurisdiction of low or null taxation). 2. Restructuring of operations by transferring income to related companies. 3. Treaty shopping. 4. Payment of interest on back-to-back financing operations. 5. Transactions generating cost and/or expense with related companies lacking in substance.
Uruguay	<ol style="list-style-type: none"> 1. Payment for services. 2. Use of corporations without economic substance. 3. Payment of royalties for use of brands. 4. Use of hybrid entities. 5. Treaty shopping. 6. Characterization of company. 7. Restructuring of company.
Venezuela	<ol style="list-style-type: none"> 1. Transfer of earnings through transfer pricing. 2. Interests with related parties. 3. Operations of intangibles with related parties.

Source: Transfer Pricing Database, Section 1, Aspects Related to the BEPS Project of the OECD. Accessed through CIAT Data, 2019.

Annex – Paraguay’s Transfer Pricing Regime (2019)

Paraguay will be implementing transfer pricing regulations that will come into force on January 1st, 2020. Due to the timing of these developments, the information pertaining to the 2019 reform of the Paraguayan tax regime was not taken into account throughout the charts and graphs presented in this book. However, in the interest of maintaining the book as up to date as possible, a general overview of these changes was added as an Annex shortly before publication.

Regarding the arm’s length principle found in Law No. 6380/19, taxpayers who are subject to the Corporate Income Tax regime and who execute transactions with related parties are now obliged to determine their profits and losses for those operations in accordance with the arm’s length principle (i.e. pricing these transactions as if they had been unrelated parties). Furthermore, the tax administration has the competence to adjust said profits and losses if this principle is not represented in the taxpayer’s declarations.

As for the relationship criteria, those considered ‘related parties’ for the purposes of the transfer pricing regime are:

- ▶ Entities who participate, directly or indirectly, in the management, control or capital of the other entity. A ‘participation in capital’ refers to a holding of over 50% (with voting rights where applicable). Meanwhile, participation in the management or control of the entity refers to having an influence over the decision making of the other entity (for example by having the same management team, the same administrators, or the same directors).
- ▶ A permanent establishment is deemed to be related to its parent company.
- ▶ Operations between residents of Paraguay and residents of countries listed as tax havens, residents of free trade zones, or maquiladoras will be deemed related and therefore, transfer pricing rules will be applicable.

To ascertain the comparability of transactions, the Paraguayan system follows the five criteria for analysis that are outlined in the OECD Transfer Pricing Guidelines; 1. Characteristics of the transaction, 2. Analyzing the functions, assets and risks, 3. Contractual terms, 4. Economic circumstances, and 5. Business strategies.

The transfer pricing methods which are available include those found in the OECD’s Transfer Pricing Guidelines, as well as an extra method for commodity transactions;

1. Comparable Uncontrolled Price Method,
2. Resale Price Method,
3. Cost Plus Method,
4. Contribution Profit Split Method,
5. Residual Profit Split Method,
6. Transactional Net Margin Method,
7. Method for Goods with a Quoted Price (goods found in transparent international or regional markets, stock exchanges or similar).

The ‘Referential Price Adjustment Method’ found in Law 5061/13 and discussed throughout the length of this document, will now be incorporated to fit within the new ‘Method for Goods with a Quoted Price’. The list of products which will fall subject to this category are to be defined by a regulatory decree.

The rules dictate a preference over the CUP method, however, if the other methods are more suited to the circumstances then the most appropriate one shall be utilized.

The documentation requirements include a transfer pricing technical study which must be conserved by the entity, and ready to be submitted upon request. Furthermore, taxpayers who have less than \$1,575 USD of gross profit (10 million Paraguayan Guarani¹²²) and who do not have operations with maquiladora's, residents in tax havens, or in free zones, will not be obliged to provide the transfer pricing study.

122 Currency exchange rate of 6,350.45 Paraguayan Guarani per 1.00 USD. From www.xe.com/currencyconverter, accessed on May 2019.



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