BANCO INTERAMERICANO DE DESARROLLO
DEPARTAMENTO DE INTEGRACIÓN Y PROGRAMAS REGIONALES
DIVISIÓN DE INTEGRACIÓN, COMERCIO Y ASUNTOS HEMISFÉRICOS
INSTITUTO PARA LA INTEGRACIÓN DE AMÉRICA LATINA Y EL CARIBE

REVIEW AND COMPARISON OF TRANSFER PRICING REGULATIONS IN LATIN AMERICA, THE UNITED STATES AND THE OECD GUIDELINES

DELOITTE TOUCHE TOHMATSU
(MEXICO)

JANUARY 2001

Table of Contents

EXECUTIVE SUMMARY **1**

I. Introduction 1
II. The Arm's Length Principle 1
III. Methods 2
IV. Administrative Approaches 2
V. Other Chapters 2
VI. Conclusion 3

CHAPTER 1: OECD TRANSFER PRICING GUIDELINES **7**

I. Introduction 7
II. The Arm's Length Principle 8
III. Methods 10
A. CUP Method *10*
B. Resale Price Method *11*
C. CP Method *11*
D. Other Methods *11*
IV. Administrative Approaches 12
A. Examination Practices *12*
B. Penalties *13*
C. Mutual Agreement Procedure *13*
D. Corresponding, Primary and Secondary Adjustments *13*
E. Safe Harbors *13*
F. Advance Pricing Agreement *13*
G. Arbitration *13*
V. Other Chapters 14
A. Documentation *14*
B. Special Considerations for Intangible Property *14*
C. Special Consideration for Intra-Group Services *14*
D. Cost Contribution Arrangements *14*
E. Advance Pricing Agreements *15*
VI. Conclusion 15

CHAPTER 2: ARGENTINA **17**

I. History of Transfer Pricing 17
II. Legislation and Regulations 17
Definition of Related Parties *18*
III. Low-Tax Jurisdictions 20
IV. Transfer Pricing Methodologies 20
A. Comparability *21*
B. Documentation Requirements *22*
C. Penalty Provisions *23*
V. Tax Treaties, MAP and Competent Authority 24
VI. Application (Best Practices and Methods) 24

A. Taxpayer Obligations *24*
B. Tax Administration *24*
C. Examination, Dispute Resolution, APAs *25*
D. Compliance With OECD Guidelines *25*
VII. Conclusions and Recommendations for Improvements 25

CHAPTER 3: BRAZIL 27

I. History of Transfer Pricing 27
II. Legislation and Regulations 27
Definition of Related Parties *28*
III. Transfer Pricing Methodologies 29
A. Methodologies for Import Transactions *29*
B. Methodologies for Export Transactions *30*
C. Documentation *30*
D. Penalty Provisions *31*
IV. Tax Treaties, MAP and Competent Authority 31
V. Application (Best Practices and Methods) 32
A. Taxpayer Obligations *32*
B. Tax Administration *32*
C. Examinations, Dispute Resolution, APAs *32*
D. Compliance with OECD Guidelines *33*
VI. Conclusions and Recommendations for Improvement 33

CHAPTER 4: MEXICO 34

I. History of Transfer Pricing 34
II. Legislation and Regulations 35
A. Definition of Related Parties *35*
B. Transfer Pricing Methodology *36*
C. Comparability Analysis *38*
D. Documentation Requirements *39*
E. Penalty Provisions *39*
III. Treaties, MAP and Competent Authority 40
IV. Application (Best Practices and Methods) 41
A. Taxpayer Obligations *41*
B. Tax Administration *41*
C. Examinations, Dispute Resolution and APAs *41*
D. APAs *42*
E. Compliance with OECD Guidelines *43*
F. Maquiladoras *43*
V. Conclusions and Recommendations for Improvement 44

CHAPTER 5: UNITED STATES 45

I. Background 45
II. Section 482 Regulations – General Rules 45
A. Purpose *45*
B. The Arm's Length Standard *45*
C. Best Method Rule *46*

D. Comparability *46*
E. Arm's Length Range *46*
F. Scope of Review *47*
III. Determination of Taxable Income for Loans, Services and Leases 47
A. Loans *47*
B. Services *47*
C. Leases *48*
IV. Methods for Transfers of Tangible Property 49
A. Comparable Uncontrolled Price Method *49*
B. Resale Price Method *49*
C. Cost Plus Method *49*
D. Unspecified Methods *49*
E. Coordination with Intangible Property Rules *49*
V. Methods for Transfers of Intangible Property 50
A. Overview *50*
B. Comparable Uncontrolled Transaction (CUT) Method *50*
C. Unspecified Methods *50*
D. Implementation of the Commensurate with Income Standard - Periodic Adjustments *51*
VI. Comparable Profits Method 51
VII. Profit Split Method 53
A. Comparable Profit Split *53*
B. Residual Profit Split *53*
VIII. Cost Sharing Arrangements 54
A. In General *54*
B. Definitions *54*
C. Intangible Development Costs *55*
D. Cost Allocations *56*
E. Buy-In/Buy-Out Payments *56*
F. Character of Payments Made and Administrative Requirements for Qualified Cost Sharing Arrangements *56*
IX. Penalties and Recordkeeping 57
Section 6662 and Contemporaneous Documentation *57*
X. Competent Authority 58
A. In General *58*
B. U.S. Competent Authority *58*
XI. Advance Pricing Agreements 59
A. In General *59*
B. Procedure for Requesting an APA *59*

CHAPTER 6: VENEZUELA 61

I. History of Transfer Pricing 61
II. Legislation and Regulations 61
A. Definition of Related Parties *61*
B. Transfer Pricing Methodologies *64*
C. Documentation Requirements *69*
D. Penalty Provisions *69*

III. Tax Treaties, MAP and Competent Authority 69
IV. Application (Best Practices and Methods) 70
A. Taxpayer Obligations *70*
B. Tax Administration *70*
C. Examinations, Dispute Resolution, APAs *70*
D. Compliance With OECD Guidelines *70*
V. Conclusions and Recommendations for Improvement 71

Appendix: Latin America, United States and OECD Transfer Pricing Matrix

This report was prepared by Deloitte Touche Tohmatsu transfer pricing specialists in the Americas with the funding at the Inter American Development Bank.

EXECUTIVE SUMMARY

CHAPTER 1: OECD TRANSFER PRICING GUIDELINES

I. Introduction

The Organisation for Economic Cooperation and Development ("OECD") has published the following reports dealing with transfer pricing issues:

1979.- *Transfer Pricing and Multinational Enterprises*.

1984.- *Transfer Pricing for Multinational Enterprises --Three Taxation Issues*.

1987.- *Thin Capitalization*.

1993.- *Tax Aspects of Transfer Pricing within Multinational Enterprises: The United States' Proposed Regulations*.

1995.- *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (updated in 1996, 1997, 1998 and 1999) (hereinafter OECD Guidelines).

Transfer prices are the prices at which an enterprise transfers tangible or intangible property, provides services or financing to related enterprises. The aim of transfer pricing regulations is to reflect the arm's length result a controlled taxpayer must obtain, placing that controlled taxpayer on a tax parity with an uncontrolled taxpayer, thus obtaining a fair allocation of the tax base.

The OECD Guidelines constitute the international standard that OECD member countries have agreed should be used in analyzing transfer pricing issues between multinational enterprises and tax administrations. However, the OECD also has a program that encourages non-member countries to follow the OECD Guidelines.

II. The Arm's Length Principle

The arm's length principle enables taxpayers or tax administrations to analyze whether the prices paid or the results obtained in a cross-border controlled transaction are comparable to the prices or results the associated company would have obtained had the transaction been carried out between independent enterprises. This chapter also discusses the comparability analysis used to compare conditions in controlled transactions with conditions in uncontrolled transactions.

The following factors should be examined to determine whether the transactions might be considered comparable: (i) Characteristics of property transferred or services provided; (ii) Functions performed, assets used and risks assumed by the party under examination; (iii) Contractual terms; (iv) Economic circumstances and (v) Business strategies.

III. Methods

The OECD Guidelines classify the transfer pricing methods as (i) traditional transactional methods that comprise the Comparable Uncontrolled Price Method (CUP), the Resale Price Method (RPM) and the Cost Plus Method (CP Method); and (ii) transactional profit-based methods that include the Profit Split Method (PSM), and the Transactional Net Margin Method (TNMM). The OECD Guidelines express a preference for the traditional methods and recommends the use of the transactional profit based methods when practical difficulties prevent application of traditional transactional methods.

- CUP*:* Used to evaluate transfers of tangible and intangible property as well as the provision of services. Compares the price charged in a controlled transaction to the price charged in a comparable uncontrolled transaction under similar circumstances. Requires high degree of comparability of products and functions.
- RPM: Used to analyze transfers of tangible and intangible property. Evaluates whether the amount charged in a controlled transaction is at arm's length by reference to the gross margin obtained in comparable uncontrolled transactions. Requires less product comparability than the CUP.
- CP Method: Compares the cost plus markup of a controlled transaction with the cost plus markup obtained in comparable uncontrolled transactions, specially applied in sales of tangible property and the provision of services. Requires detailed comparisons of products manufactured, functions performed, risks borne, manufacturing complexity, cost structures and intangibles.
- PSM: Allocates operating profits or losses from controlled transactions in proportion to the relative contributions made by each party creating the combined profit or loss, and should be applied when the transactions are so interrelated that they cannot be evaluated on a transaction-by-transaction basis.
- TNMM: Examines the net profit margin relative to an appropriate base. TNMM starts from the premise that ideally transactions are analyzed individually and that each level of aggregation must be justified.

IV. Administrative Approaches

The OECD Guidelines address various administrative issues related to avoiding and resolving transfer pricing disputes such as examination practices, penalties, mutual agreement procedures, adjustments, safe harbors, advance pricing agreements (APA's) and arbitration.

V. Other Chapters

The OECD Guidelines address special issues regarding (a) documentation, recommending that taxpayers should examine the related transactions at the time the transfer prices are established to determine whether they are at arm's length; (b) intangible property, stating that the prices established for transfers of intangible property should be based on reasonable expectations of future benefits; (c) intra-group services,

stating that when analyzing intra-group services it should be considered whether the services were actually rendered and what the arm's length charge should be; (d) cost contribution agreements and; (e) APA's.

VI. Conclusion

Transfer pricing policies are not exclusively about taxation. Transfer pricing regulations should enable tax administrations to obtain a fair tax base at the same time they minimize the risks of double taxation for multinational enterprises. The OECD Guidelines provide the guidance on transfer pricing issues for both taxpayers and tax authorities by establishing a comparison with what would have happened between independent enterprises. However, there is no universal solution to transfer pricing issues in the OECD Guidelines.

Is important to mention that the OECD Guidelines can be considered work in process, due to the fact that are being updated continuously.

CHAPTER 2: ARGENTINA

The tax authority is the Federal Administration of Public Income (*Administración Federal de Ingresos Públicos* or AFIP). The Argentine legislation considers a broad definition of related parties, including an exclusive supplier, an exclusive customer or an exclusive vendor as well as a party that funds another through loans or guaranties, or taxpayers that assume another party's obligation, losses or expenses, among others. Law 25,239 indicates that the transfer pricing documentation rules apply to related party transactions with non-residents and to import and export transactions if the parties are unable to prove the wholesale price in the country of origin or destination.

The Best Method Rule is applied and all OECD methods were acceptable; however, Law 25,239 eliminated the RPSM for tax years ending on December 31, 2000 and onwards. Comparability between transactions implies considering: the financial structure of the transactions, the nature of the services, the physical characteristics of the goods and the type of intangibles. In addition, there is no guidance regarding what comparables should be used when applying the profit-based methods and the tax authorities may use "secret comparables."

There is no provision for reduction in transfer pricing penalties as there are no specific penalties on a transfer pricing related tax assessment, nevertheless any additional tax is subject to a 3% monthly interest rate. A transfer pricing return (Form 662) must be electronically filed and reflect all related-party transactions. This form is due within the first 10 days of the fifth month following the fiscal year end.

Regarding the administrative approaches, APA's are not available and there are no formal procedures for self-initiated adjustments. The legislation also lacks a formal provision for taxpayers' set-offs for other related party transactions. Finally, the submission of a tax adjustment to competent authority follows mutual agreement procedures for respective treaty provisions.

In addition the Argentinean transfer pricing regulations consider that transactions carried out with a party located or resident in a low-tax jurisdiction are controlled transactions which were not carried out at arm's length; nevertheless, this assumption constitutes a rebuttable presumption.

CHAPTER 3: BRAZIL

The tax authority is the Federal Revenue Secretariat (*Secretaria da Receita Federal* or SRF). Brazil's transfer pricing rules generally are based on the OECD Guidelines although they contain some substantial deviations. The rules target transactions between a Brazilian entity and its foreign related parties involving the import and export of goods, services and rights without distinguishing between tangible property and services. The rules provide two safe harbors that, however, do not apply to export transactions with companies located in tax havens.

The Brazilian transfer pricing regime provides for a broad definition of related parties. In addition, there is no arm's length principle on which this regime is based which means there is no strict priority regarding the method that should be used in a given situation although taxpayer may use the method that provides the least amount of taxable income. All of the approved Brazilian transfer pricing methods involve price comparisons or reconstruction rather than a determination of profits margins. CUP, RPM and CP Method are the only acceptable methods. Royalties, technical assistance and technological services are excluded from transfer pricing regulations.

Ordinary penalties on transfer pricing assessments are based on additional tax; 75-150% if all documentation is available; 112.5-225% if documentation and information is not provided to authorities upon request. Upon examination and assessment, the taxpayer may be granted a reduction in penalties for uncontested payment.

Regarding documentation requirements, there is no contemporaneous obligation, but if no study is prepared, the government is entitled to use the method that yields the highest taxable income. APA's are available based on Regulatory Instruction 38 and Ministerial Order 95. There is no procedure for self-initiated adjustments. The application for mutual agreement procedure can be filed after notification of the tax assessment.

CHAPTER 4: MEXICO

The tax authority is the Tax Administration Service (*Servicio de Administración Tributaria* or SAT). The Mexican legislation considers a broad definition of related parties based on the OECD Guidelines as well as Article 9 of the OECD Model Tax Convention on Income and on Capital. The definition of related parties is based on the participation in the management, control or capital; however, there is neither a minimum percentage requirement for control or participation nor a definition of direct or indirect participation, management, control or capital. In addition the Mexican transfer pricing regulations consider that transactions carried out with a party located or resident in a low-tax jurisdiction are controlled transactions which were not carried out at arm's length; nevertheless, this assumption constitutes a rebuttable presumption.

There is no priority of methods, CUP, RPM, CP Method, PSM, RPSM and the Transactional Operating Profit Margin Method (equivalent to TNMM) are acceptable.

Ordinary penalties on tax assessments apply –50% of tax deficiency if paid before notice of deficiency issued, 70 to 100% in other cases adjusted for inflation and interest, however there is a 50% reduction if documentation is provided at the time the examination begins.

The annual tax return requires a profit/loss statement of related and unrelated transactions. The tax report (*dictamen fiscal*) is signed by an independent CPA attesting to the existence of appropriate documentation and the amount of related party transactions. Beginning in 2001 a transfer pricing information return must be filed containing detailed information on non-resident related party transactions. Contemporaneous documentation must show prices or results of transactions carried out with non-resident related parties are arm's length.

Multiyear, bilateral and multilateral APAs are available. Taxpayers are encouraged to request an APA when the application of traditional method is not straightforward or these methods are difficult to apply.

Is important to mention about the reform of section XIV of article 58 of the Mexican Income Tax Law in force effective January 1, 2001. Such reform establishes that Transfer Pricing studies must be performed on a transactional basis, this means that the information relative to functions or activities, assets used and risks assumed by the taxpayers will have to be for each type of operation, as well as for each related party.

CHAPTER 5: UNITED STATES

The tax authority is the Internal Revenue Service (IRS). The Best Method Rule is used. CUP, RPM, CP Method, Comparable Profits Method and PSM are acceptable methods for tangible property. Comparable Uncontrolled Transaction Method is accepted; however other unspecified methods may be used in the case none of the specified methods can reasonably be applied; special considerations are made for loans, services and leases.

There are transfer pricing penalties of 20 or 40% of additional tax for adjustments exceeding objective thresholds, and there is no penalty if the transfer pricing method is reasonably applied and documented.

Forms 5471 and 5472 require disclosure of detailed information on controlled transactions with foreign entities. Contemporaneous documentation is required, as well as supporting background documents.

APA's are available based on Revenue Procedure 96-53, with a filing fee computed, based on the size of the particular U.S. taxpayer or transaction. Self-initiated adjustments are permitted in filing original return after close of year-end book, and adjustments on amended return are permitted as long as it does not provide for a decrease in income.

Transactions with the same taxpayer in the same year are taken into account if taxpayer; (1) determines appropriate arm's length charge; (2) documents all correlative adjustments and; (3) notifies district director within 30 days of notice of proposed adjustment or deficiency.

Cost Sharing Arrangement are accepted under the Reg. 1.482-7 of the Internal Revenue Code.

CHAPTER 6: VENEZUELA

The tax authority is the National Integrated Tax Administration Service (*Servicio Nacional Integrado de Administración Aduanera Tributaria* or SENIAT). There is no priority of method, but for tangible property only CUP, RPM, CPM and TOPMM are acceptable methods for imports and exports. However, there are specific safe harbors for imports and exports which are established annually for each type of industry. For loans, interest should be six month LIBOR plus statutory margin. Royalties, technical assistance and technological services are excluded from transfer pricing regulations. There is no strict priority regarding the method that should be used in a given situation although taxpayer, may use the method that provides the least amount of favorable income.

There are no specific transfer pricing penalties but interest and penalties on tax deficiency range from 10 to 200%. There is no specific tax return disclosure. Recommended documentation should follow OECD Guidelines, but there is no contemporaneous obligation.

APA's are not available. Taxpayer set-offs for other related party transactions and tax adjustments follow mutual agreement procedures for respective treaties.

CHAPTER 1: OECD TRANSFER PRICING GUIDELINES

I. Introduction

The Organisation for Economic Cooperation and Development (OECD) is an international organization whose 30 members include most industrialized countries.[1] The OECD is organized in committees of member country representatives; the OECD's main tax policy body is the Committee on Fiscal Affairs (CFA) and is governed by a Council of member representatives. One of the objectives of the OECD has been to strive to build an international consensus on principles of international taxation.

As part of its efforts to minimize conflicts among taxing jurisdictions, the OECD has published several reports dealing with transfer pricing issues. The first report, *Transfer Pricing and Multinational Enterprises*, was issued in 1979. This was followed by three additional reports that tackled specific topics within the context of transfer pricing: *Transfer Pricing for Multinational Enterprises -- Three Taxation Issues* (1984), *Thin Capitalization* (1987) and *Tax Aspects of Transfer Pricing within Multinational Enterprises: The United States' Proposed Regulations* (1993). In 1995, the OECD revised the 1979 report, replacing it with *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (hereinafter OECD Guidelines). The 1995 document, which was updated in 1996, 1997, 1998 and 1999, expand and clarify many of the concepts enunciated in the 1979 report.

Transfer prices are the prices at which an enterprise transfers tangible or intangible property, provides services or financing to related enterprises. For tax purposes, the existence of significant economic relations between the parties involved in a transaction is not irrelevant. In the case of transactions between related enterprises, external market forces might not directly determine the commercial and financial relations of the related parties -as happens in uncontrolled transactions[2]- and, in addition, the controlled transaction[3] might be designed to reduce or avoid tax by shifting or distorting income, deductions, credits or allowances. The aim of transfer pricing regulations is to reflect the arm's length result a controlled taxpayer must obtain, placing that controlled taxpayer on a tax parity with an uncontrolled taxpayer, thus obtaining a fair allocation of the tax base.

The OECD Guidelines constitute the international standard that OECD member countries have agreed should be used in analyzing transfer pricing issues between multinational

---

[1] The OECD member countries are Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Korea, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, and United States.

[2] Uncontrolled transactions are transactions between enterprises that are independent with respect to each other.

[3] Controlled transactions are transactions between enterprises that are associated enterprises with respect to each other.

enterprises and tax administrations. It is important to note at the outset, however, that the OECD Guidelines are not binding on OECD member countries although member countries are encouraged to follow them when analyzing transfer prices between related parties.[4] The purpose of the transfer pricing recommendations is to ensure that taxpayers clearly reflect income attributable to transactions carried out with associated parties (controlled transactions) as if the transactions were carried out with independent companies under normal market conditions. In other words, to ensure that transactions between related parties adhere to the arm's length principle.

The OECD Guidelines are divided into eight chapters and a glossary. Chapter I, *The Arm's Length Principle,* discusses that principle and its status as the international standard and includes guidelines for its application. Chapter II, *Traditional Transaction Methods*, explains the application of the Comparable Uncontrolled Price method (CUP), the Resale Price method (RPM) and the Cost Plus method (CP). Chapter III, *Other Methods,* describes the two methods that may be used when the traditional transactional methods cannot be used, *i.e*., the Profit Split Method (PSM) and the Transactional Net Margin Method (TNMM). Chapter IV, *Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes,* details penalties, corresponding adjustments, procedures to avoid double taxation, simultaneous examinations, safe harbors, advance pricing agreements (APAs) and arbitration. Chapter V, *Documentation,* establishes the type of information that taxpayers should maintain when setting transfer prices. Chapter VI, *Special Considerations for Intangible Property,* sets out the most important facts and circumstances that should be taken into consideration for transfers of intangible property. Chapter VII, *Special Considerations for Intra-Group Services,* defines the characteristics of different types of intra-group services. Chapter VIII, *Cost Contribution Arrangements,* discusses those types of arrangements between two or more associated enterprises. The Annex, *Guidelines for Conducting Advance Pricing Arrangements under the Mutual Agreement Procedure (MAP APAs),* provides guidance to tax administrations about conducting MAPs that involve APAs. The Glossary defines important transfer pricing terms that are used throughout the OECD Guidelines.

As noted below, the OECD Guidelines are premised on Article 9 of the OECD Model Tax Convention. That article deals with the taxation of profits of associated enterprises and adjustments to those profits when transactions between associated enterprises (parent and subsidiary companies and companies under common control) are not made on arm's length terms. A number of countries with transfer pricing legislation (*e.g*., Argentina, Brazil, Mexico and Venezuela) have expansive definitions of related parties that include as taxpayers parties that may be deemed to be unrelated under Article 9. Inconsistencies arising from such definitions potentially may expose such parties to double taxation and/or inconsistent transfer pricing adjustments.

II. The Arm's Length Principle

OECD member countries endorse the arm's length principle as the appropriate standard to be used for tax purposes by multinational groups and tax administrations. The arm's

[4] The OECD also has a program that encourages non-member countries to follow the Guidelines.

length principle enables taxpayers or tax administrations to analyze whether the results obtained in a cross-border controlled transaction are comparable to the results the associated company would have obtained had the transaction been carried out between independent enterprises.

Chapter I of the OECD Guidelines discusses the arm's length principle as well as the comparability analysis used to compare conditions in controlled transactions (*i.e.*, transactions between associated enterprises) with conditions in uncontrolled transactions. The economically significant characteristics of the transactions should be sufficiently similar so that both the controlled and the uncontrolled transactions could be considered comparable. According to the OECD Guidelines, the following factors should be examined to determine whether the transactions might be considered comparable:

- Characteristics of property transferred or services provided;
- Functions performed, assets used and risks assumed by the party under examination (*i.e.*, a functional analysis);
- Contractual terms;
- Economic circumstances such as geographic location, size of the markets, extent of competition in the markets, relative competitive positions, availability of substitute goods or services, etc; and
- Business strategies.

The OECD Guidelines permit the use of inexact comparables that are similar to the controlled transaction although, to improve the reliability of the selected pricing method, reasonably accurate adjustments must be made to the uncontrolled comparables so that material differences between controlled and uncontrolled transactions can be taken into account. The OECD Guidelines reject the use of "unadjusted industry averages" to adjust the result of controlled transactions because they are considered to be arbitrary.

The OECD Guidelines acknowledge that a range of prices or profits may be appropriate to establish the arm's length nature of a transaction. Although the OECD Guidelines do not include specific rules for establishing the arm's length range, they recognize that substantial deviation in the results of the comparable uncontrolled transactions may imply that some of the comparables may not be as reliable.

The OECD Guidelines do not advocate that adjustments be made in the case of an overly broad range by applying statistical methods but propose additional analysis of the comparables and that the taxpayer have the opportunity to demonstrate that the conditions of the transaction fall within the range that is consistent with the arm's length principle. Further, the OECD Guidelines provide that if the price or margin of a controlled transaction falls outside the arm's length range and the taxpayer is unable to provide

evidence of an arm's length result, tax adjustments should be made to the point that best reflects the facts and circumstances of the particular controlled transaction.

The OECD Guidelines recognize that business strategies may be reflected in transfer prices. Several considerations must be made: (1) the conduct of the parties should be consistent with the professed business strategy; (2) the nature of the relationship between the parties to the controlled transaction should be consistent with the taxpayer bearing the cost of the business strategy; and (3) the business strategy must be credible to produce a return that justifies its cost within a reasonable period of time.

Although the OECD Guidelines provide that, "ideally," the arm's length principle should be applied on a transaction-by-transaction basis, they acknowledge that in certain circumstances aggregation of transactions would be more appropriate (*e.g.*, long-term contracts for the supply of commodities or services, rights to use intangible property, etc.).

The OECD Guidelines do not explicitly mention the Best Method Rule (as used in the U.S. transfer pricing regulations or in Argentine legislation) although they establish the same principle when indicating the considerations a taxpayer must take into account to select the method that better reflects the arm's length nature of the controlled transaction (*i.e.*, the facts and circumstances of the transaction, the evidence available and the reliability of the different methods).

III. Methods

The chapter of the OECD Guidelines dealing with transactional methods provides a detailed description of the three traditional methods: the CUP, the RP and the CP methods. The OECD Guidelines specify how to apply the methods and the special circumstances under which the methods would likely be the best method. Significantly, the OECD Guidelines express a preference for the traditional transactional methods and state that the cases when there may be practical problems in the application of the methods are exceptional.

A. CUP Method

The OECD Guidelines apply the CUP to transfers of tangible and intangible property and to the provision of services. The CUP compares the price charged in a controlled transaction to the price charged in a comparable uncontrolled transaction under similar circumstances. The CUP requires a high degree of comparability of products and functions and is generally the most reliable measure of arm's length results if transactions are identical or if only minor quantifiable differences exist. The CUP is therefore usually applicable if the same or very similar products sold to related parties are also sold to unrelated parties under similar circumstances.

It is often difficult to locate comparable uncontrolled transactions since minor differences in the transferred property in the controlled and uncontrolled transactions may have a material effect on price even though the business activities associated with the transactions are sufficiently similar to generate the same overall profit margin. Comparability may be achieved by a reasonable number of adjustments to account for

differences in product quality, contractual terms, geographic markets, embedded intangibles and foreign currency risks.

B. Resale Price Method

The OECD Guidelines apply the RP method to transfers of tangible and intangible property, the latter when the property is sublicensed to third parties. The RP evaluates whether the amount charged in a controlled transaction is at arm's length by reference to the gross margin obtained in comparable uncontrolled transactions. The RP compares the resale price margin[5] of a controlled transaction with the resale price margin obtained in comparable uncontrolled transactions. An appropriate RP is easiest determined in cases in which the reseller does not add substantial value to the products or alter them. Although this method requires less product comparability than the CUP, closer comparability of products will produce better results.

C. CP Method

The OECD Guidelines contemplate the use of the CP method to sales of tangible property and the provision of services, i.e., transfers of semi-finished goods, the conclusion of joint facility agreements or long-term buy-and-supply arrangements, or the provision of services between associated enterprises. The basis of comparison in the CP method is the gross profit because the CP compares the cost plus markup of a controlled transaction with the cost plus markup obtained in comparable uncontrolled transactions. When applying the CP method, it is particularly important to consider differences in the type and level of expenses associated with functions performed and risks assumed. The CP method requires detailed comparisons of products manufactured, functions performed, risks borne, manufacturing complexity, cost structures and intangibles between the controlled and uncontrolled transactions.

D. Other Methods

The OECD Guidelines accept the use of transactional profit methods, the PSM or the TNMM, that analyze the profits arising from certain aggregated controlled transactions. The transactional profit methods are methods of last resort because they are applied only when practical difficulties prevent application of traditional transaction methods (although the OECD Guidelines advocate considering traditional methods before applying the profit methods). The OECD Guidelines recognize that most countries prefer the PSM to the TNMM because the former considers both parties to the transaction while the latter only considers one of the parties. As a result, the PSM is less likely to generate an extreme result for either party while the TNMM may yield a very different result for members of a group that have extremely high or low profits.

1 PSM

The PSM should be applied when the transactions are so interrelated that they cannot be evaluated on a transaction-by-transaction basis. The OECD Guidelines distinguish

[5] The resale price margin represents the amount out of which the reseller would seek to cover its selling and other operating expenses and even make an appropriate profit.

between a contribution analysis and a residual analysis. Under the contribution analysis, the PSM allocates operating profits or losses from controlled transactions in proportion to the relative contributions made by each party in creating the combined profit or loss. Since the PSM does not rely directly on closely comparable transactions, it can be applied when no comparable uncontrolled transactions could be easily identified. The nature of the information required by this method makes it more subjective and difficult to apply than the other methods. The residual analysis is similar to the contribution analysis although it requires the existence of highly profitable intangibles. Mexico considers the residual analysis as a separate method called the Residual Profit Split method.

2 TNMM

The TNMM starts from the premise that ideally transactions are analyzed individually and that each level of aggregation must be justified. The TNMM examines the net profit margin relative to an appropriate base (*e.g.*, sales, costs, assets). Net profit margins are less affected by transactional differences than the price used in the CUP and are more tolerant to functional differences than gross profit margins. In most cases, the related party being evaluated should not own intangible property or unique assets that distinguish it from unrelated comparable companies. The degree of comparability affects the reliability of the TNMM analysis. Ideally, the operating profit that a taxpayer obtains from the controlled transaction should be established by reference to the operating profit that the taxpayer obtains incomparable uncontrolled transactions. If no such comparison is possible, the operating profit earned in third party comparable uncontrolled transactions may serve as a reliable reference.

The OECD Guidelines criticize the use of the global formulary apportionment method[6] (such as the approach currently followed in Brazil) but acknowledge that a proportional apportionment formula that takes into consideration the taxpayer's facts and circumstances that could be agreed between a taxpayer and tax administration when other recognized methods could not be applied.

IV. Administrative Approaches

The OECD Guidelines address various administrative issues related to avoiding and resolving transfer pricing disputes.

A. Examination Practices

The OECD Guidelines encourage tax administrations to be flexible in their transfer pricing approaches and not demand from taxpayers an unrealistic precision on their transfer pricing results. The OECD Guidelines also encourage tax administrations to

[6] The global formulary apportionment method allocates global profits among associated enterprises on the basis of a predetermined, mechanical formula. Formulary apportionment differs from the transactional profit methods in that under the formulary approach profits are allocated on a global basis, whereas the profit methods compare profits on a case-by-case basis, considering the profits that comparable independent enterprises would have obtained under similar circumstances.

initiate their transfer pricing analysis from the perspective of the method that the taxpayer has selected in setting its prices.

B. Penalties

The OECD Guidelines strongly recommend that the primary objective of civil tax penalties be to promote compliance.

C. Mutual Agreement Procedure

The MAP is a process by which tax administrations consult with each other to resolve disputes regarding the application of tax treaties. The MAP does not, however, compel competent authorities to reach an agreement and resolve their tax disputes.

D. Corresponding, Primary and Secondary Adjustments

A corresponding adjustment (which is often part of the MAP) can reduce or eliminate double taxation in cases where the tax administration increases a company's taxable profits (primary adjustment) as a result of applying the arm's length principle to the transaction involving an associated enterprise in a second tax jurisdiction. To make the actual allocation of profits consistent with the primary transfer pricing adjustment, some countries that proposed a transfer pricing adjustment will assert under their domestic legislation a constructive transaction (a secondary transaction), whereby the excess profits resulting from a primary adjustment are treated as having been transferred in some other form and taxed accordingly. Since tax administrations are not required to reach an agreement under the MAP, corresponding adjustments are not mandatory.

E. Safe Harbors

A safe harbor is a provision that allows taxpayers to follow a simple set of rules whereby transfer prices would be automatically accepted as being at arm's length by the tax administration. The OECD Guidelines find a number of disadvantages to safe harbors, and therefore recommends they not be used. The OECD Guidelines also state that where the safe harbor is incompatible with an arm's length result, the taxpayer may be exposed to a risk of double taxation. Venezuela has an alternative to safe harbors: taxpayers that do not want to carry out a detailed transfer pricing analysis may use the gross margins provided by the tax administration, or alternatively may prepare a detailed study supporting the arm's length nature of related party transactions.

F. Advance Pricing Agreement

An APA is an agreement that determines, in advance, an appropriate set of criteria for the determination of the transfer pricing for the transactions over a fixed period of time. The OECD Guidelines distinguish between unilateral and multilateral APAs, enumerate a number of advantages and disadvantages in connection with the use of APAs, and endorse the preference of most countries for multilateral APAs.

G. Arbitration

The OECD Guidelines contain a brief discussion of transfer pricing arbitration.

V. Other Chapters

A. Documentation

The documentation chapter provides substantial guidance on the type and level of documentation that taxpayers should prepare and provide to the tax authorities. The OECD Guidelines reject a general requirement that taxpayers take account of and produce documents that become available only after the controlled transaction has taken place. The OECD Guidelines recommend that taxpayers endeavor, at the time the transfer prices are established, to determine whether the prices are consistent with the arm's length principle.

Argentina, Mexico and the United States require contemporaneous documentation demonstrating that transactions with nonresident related parties are at arm's length. Venezuela does not have a statutory documentation requirement, although the Venezuelan tax authorities recommend that taxpayers follow the OECD Guidelines. There is no contemporaneous documentation obligation in Brazil, although if a study is not prepared, the Brazilian tax authorities will be entitled to use the transfer pricing method that produces the highest taxable income.

B. Special Considerations for Intangible Property

This chapter discusses special facts and circumstances that may arise when trying to determine whether the conditions established between associated enterprises regarding the transfer of intangible property are at arm's length. The prices established for transfers of intangible property should be based on reasonable expectations of future benefits so tax authorities should not adjust the prices based on actual benefits.

C. Special Consideration for Intra-Group Services

Two main issues must be considered when analyzing intra-group services: (1) whether the services were actually rendered; and (2) what the arm's length charge should be. The OECD Guidelines focus on compliance with the arm's length principle by recharging costs specifically incurred by one member in the group for services provided to another member of the group. In such a case, the costs incurred include a reasonable allocation of indirect costs. According to the OECD Guidelines, the inclusion of a profit margin is part of the cost of the service provided because an independent company would seek to obtain a profit in rendering the service to a third party.

D. Cost Contribution Arrangements

A cost contribution arrangement (CCA) is contractual arrangement whereby business enterprises agree to share the costs and risks of developing, producing or obtaining assets, services or rights, and to determine the nature and extent of the interests of each participant in those assets, services or rights. The peculiarity of the CCA is that some benefits of the CCA activity will be known in advance whereas other benefits will be uncertain. Another distinctive characteristic of the CCA is that every participant involved in the CCA must have a reasonable expectation of benefits derived from the agreement.

A CCA will be deemed consistent with the arm's length principle if each participant's proportionate share of the overall contribution to the arrangement is consistent with the

participant's proportionate share of the overall expected benefits derived from the arrangement.

None of the Latin American countries considered in this report allow cost contribution or cost sharing payments to be deducted.

E. Advance Pricing Agreements

In October 1999, the OECD released an annex to the OECD Guidelines that provides guidance on how to obtain a MAP APA, focusing on the role of tax administrations of both OECD member countries and non-member countries. The annex emphasizes the significance of an APA and provides a detailed description of the different types of APAs mentioned in Chapter IV and explains the main objectives of an APA (*e.g.*, to resolve transfer pricing issues expeditiously, to use the resources of the taxpayer and the tax administration more efficiently and to eliminate double taxation). The annex also describes the process of obtaining an APA: whether it is possible for a taxpayer to apply for an APA; the request and finalization of an APA; and monitoring taxpayer compliance with the terms and conditions in the APA.

Of the countries considered in this report, Brazil, Mexico and the United States make provisions for APAs, but neither Argentina nor Venezuela authorize the use of APAs.

VI. Conclusion

The existence of intercompany transactions within a multinational enterprise group should not be automatically considered as an attempt to manipulate profits; in fact, transfer pricing policies are not exclusively about taxation. In the cases where manager remuneration is based on the local company operating profit, transfer pricing policies will directly impact the company management behavior. It should also be noted that advance transfer pricing planning (i) allows multinational groups to considered implications beyond direct taxation, and (ii) might provide an important way of not only gathering information about the business but also identifying commercial or tax opportunities that otherwise would have gone unnoticed.

Transfer pricing regulations should enable tax administrations to obtain a fair tax base at the same time that they minimize the risks of double taxation for multinational enterprises. The OECD Guidelines provide the guidance on transfer pricing issues for both taxpayers and tax authorities by establishing a comparison with what would have happened between independent enterprises. In order for the guidelines to be successful, they should considered facts as important as globalization and e-commerce, the increase in global trade and investment as well as the fact that the multinational economic groups are organized by profit centers or product lines. In many cases, multinational organizations do not consider profit of individual companies but the profit of the whole economic group. These multinational groups might be indifferent regarding where the tax is paid in an attempt to reduce the overall group tax.

Although the OECD Guidelines are a standard of analyzing intercompany transactions that should be followed by OECD member countries, the Guidelines also encourage non-member countries to regulate transfer pricing issues taking into account the potential

needs of global rules and some specific issues of non-member countries (e.g. natural resources). However, there is no universal solution to transfer pricing issues in the OECD Guidelines.

CHAPTER 2: ARGENTINA

I. History of Transfer Pricing

Argentina introduced its transfer pricing regime in December 1998. The legislation generally is consistent with the OECD Guidelines, but also resembles the transfer pricing rules in Mexico and the United States.

The legislation, which became effective January 1, 1999, affects both foreign companies doing business in Argentina through related parties and Argentine businesses (either local or foreign-owned) carrying out business abroad. The rules require that related party transactions be at arm's length and may capture import and export transactions even if the parties are unrelated. The regime also applies to transactions between an Argentine entity and a party located in a tax haven jurisdiction, regardless of whether the parties are related. The transfer pricing rules do not address other transactions such as the shifting of income to related parties in Argentina or to subsidiaries of Argentine corporations located in moderately taxed jurisdictions.

In issuing the transfer pricing rules, the Argentine tax authorities sought to set up a structure that would thwart activities that reduce Argentina's tax base. In the case of foreign-owned Argentine businesses, the tax authorities were concerned that higher prices of imported goods or lower prices of exports would reduce the amount of income that would be taxed in Argentina. In the case of tax haven operations, the tax authorities wanted to ensure that it could prevent the siphoning of the income tax base from Argentina.

Concentrating on the need to bolster Argentina's tax base, the AFIP ignored -- at least temporarily -- the shifting of income among Argentine affiliates. Implicit in the transfer pricing rules is a presumption that purely domestic transfers merely shift the tax base from one pocket to another within the Argentine jurisdiction. The AFIP did not address the shifting of income from a higher tax party to a lower taxed party. The AFIP chose not to address the shifting of income to subsidiaries in moderately taxed jurisdictions for three reasons: the frequency of occurrence, the limited effect on Argentina's tax base and the difficulty of enforcing compliance.

II. Legislation and Regulations

Since the transfer pricing law was introduced in December 1998, the tax authorities have only issued two sets of guidance on how the law should be applied. A resolution issued in October 1999 requires taxpayers to file a new form, Form 662, outlining their intercompany transactions and to maintain documentation to support their transfer prices.[7] The second resolution issued in November 2000[8].

[7] General Resolution 702 dated October 15, 1999.

Foreign-owned Argentine businesses are subject to the transfer pricing provisions when they carry out business transactions with foreign corporations or partnerships, or with foreign individuals or foreign groups of individuals. The transfer pricing rules are triggered where there is direct or indirect foreign participation in the capital, control or management of the Argentine entity.

Parties are also considered related for transfer pricing purposes when a foreign-based entity exercises significant influence over a local company, as is the case when a company is the exclusive distributor or agent, or has exclusive use of technology or assistance, even though the foreign-based entity does not participate in the capital, control or management of the Argentine company. Factors that might be considered to give rise to related party status include voting control of one entity by another, common directors or officers, an agency relationship and the ability of one entity to exert significant influence over the price-setting process of another entity.

The provisions also apply if an Argentine business carries out transactions with foreign individuals or legal entities that are indirectly related to it. Transactions between an Argentine business and an offshore tax haven entity are subject to documentation since there is a presumption that the parties are related and that the transaction is not at arm's length.

The transfer pricing legislation also covers import and export transactions if the parties (even if unrelated under the Argentine rules) are unable to prove the wholesale price in the country of origin or destination, respectively.

According to recent amendments, taxpayers engaged in transactions with related parties must file an annual tax return (from the tax year ending December 31, 2000, bi-annual tax returns will be required).

Definition of Related Parties

The regulations impose an expansive definition of related parties. The transfer pricing rules are triggered if any of the following circumstances exist:

- One entity, directly or indirectly, controls another party with which it engages in transactions;
- The entities that engage in transactions are under the common control of a third entity (*i.e.*, brother-sister companies);
- A person (*i.e.*, an individual or legal entity) owns all or a controlling part of the capital of another person;
- A person fully owns or has the majority interest in another person;
- An individual or legal entity has a sufficient number of votes to control the corporate will or to prevail in shareholders meetings or over another taxpayer's

[8] Decree 1037/2000 issued by the Executive branch on November 9, 2000, and published in the Official Gazette on November 14, 2000.

partners. The presence of common directors, common executive officials, and common managers indicates related party status;

- A person has the authority to act for another person, such as through a trust or as the exclusive agent or distributor for the purchase or sale of goods, assets, services or rights;
- A person licenses proprietary or technological information even if the licensor and licensee are unrelated;
- An entity substantially participates in the formation of another party's business or in the supply of raw materials to, or the trading or marketing of another business.

Two or more individuals or legal entities can be viewed as related in a number of circumstances. For example, a common control relationship between parties may result in related party status. There are three aspects to a common control relationship: (1) where an individual or entity has the whole or a majority interest in the capital of two or more other entities; (2) where a person has control over two or more businesses; or (3) where the person has a significant simultaneous influence over two or more entities.

Parties that share a participation with another party are treated as related even if the relationship is through a condominium, joint venture, group or assembly with no legal existence if a party exerts a significant influence on the price-setting process. Contract terms can indicate related party status when the parties undertake preferential contractual clauses, such as for discounts, funding, delivery or other terms.

A person that is a single supplier, single customer or single vendor in relation to another party is not independent of that party under the Argentine rules. A party that funds another through loans or guarantees is not independent of that other party. A taxpayer that assumes another party's obligations, losses or expenses is not independent of that party nor is an entity independent of a second entity if the second entity gives instructions to directors, executives or managers of the first entity or if the first entity acts in the best interest of the second entity. Shifting management or stewardship to an individual or legal entity that has a minority interest may destroy independence.

III. Low-Tax Jurisdictions

As mentioned above, the Argentine transfer pricing rules capture transactions with entities located in tax havens by presuming that such transactions are related party transactions, regardless of whether the parties actually are related. As originally drafted, the tax haven rules relied on cumbersome and confusing criteria to determine whether a jurisdiction qualified as a low-tax jurisdiction.[9] Amendments issued in November 2000, however should provide some clarity since the tax authorities have issued a list of 84 countries and territories deemed to be tax haven jurisdictions. Any transactions with entities in these jurisdictions will be deemed not to be at arm's length and are subject to the scrutiny of the Argentine tax authorities.

IV. Transfer Pricing Methodologies

While the Argentine legislation is in many respects similar to the U.S. rules, it is clear that the actual Spanish language was taken from articles 64-A and 65 of the Mexican Income Tax Law as well as relevant Miscellaneous Tax Provisions. The Argentine rules provide for the same methodologies set forth in the Mexican legislation and the OECD guidelines: CUP, RP, CP, PSM, residual profit split and TNMM which, depending on the level of aggregation of transactions, is equivalent to the CPM frequently used in the Under Law 25,063 applicable during 1999 and 2000 with the exception of taxpayers with year end on December 31, 2000 the residual profit split was a valid method. For tax years ending on December 31, 2000 and onwards the new Law 25,239 eliminated the residual profit split.

As in the United States, the Argentine rules require a taxpayer to use the "best method" to determine its transfer prices. The best transfer pricing method for a transaction is the method that is most appropriate based on regular market practices and economic reality. The best method should be the method that is most compatible with the business and corporate structure; utilizes the greatest amount and highest quality of information available to warrant application of the method in question; provides the greatest degree of comparability among related and non-related transactions; and requires the fewest adjustments to eliminate differences and discrepancies in comparable facts and situations.

[9] The regulations defined a low-tax jurisdiction as a country, which in addition to a low tax rate, contained one of the following characteristics:

- Secrecy rules for banks, financial institutions and stock exchanges;
- Minimum requirements for accounting methods, organizational activities and business activities of the enterprise;
- Favorable tax rules or other advantages to nonresidents that are not available to residents;
- The tax authorities in the low-tax jurisdiction have the power to grant discretionary tax privileges or other advantages;
- Allowing ownership to be held in trust for the intended party;
- Not maintaining a registry or not requiring registration of corporations or partnerships; or
- No withholding taxes on dividends and interest paid to foreign residents.

A. Comparability

To establish comparability, the taxpayer may look at comparable transactions or comparable companies. The underlying premise of the Argentine regime is that transfer pricing is based on comparability between transactions. With that objective in mind, the following four factors determine comparability:

1. The financial structure of the transaction, such as whether the party is a principal or guarantor, terms, guarantees, whether the debtor is solvent and what is the interest rate;

2. The nature of the services, if appropriate, and whether or not the services involve expertise or technical knowledge;

3. The physical characteristics of the goods in the case of a purchase or lease, including their quality, reliability, availability and volume; and

4. The type of intangible, including the type of transaction (*i.e.*, lease or sale), duration of the intangible, degree of protection and anticipated benefits.

The regulations rely on a functional analysis, which encompasses the assets employed and risks assumed to determine comparability. They take into account contractual terms where those terms reflect price or margin, economic circumstances, including geographic location, size and type of the market, level of supply and demand, and the scope of competition. Business strategies are taken into account, including market penetration, permanence and growth, although the tax authorities might not accept a market share strategy as the best method.

The regulations permit multi-year data for comparability purposes. Multi-year data may be permitted when the business cycle relative to taxpayer's product or the commercial acceptance of the taxpayer's product covers more than one accounting period.

New Law 25,239 (in effect since December 31, 2000) provides for five methods that are currently defined by the new regulatory decree. Methods are very much the same as provided by the Law 25,063 with the exception of the residual profit split, which was eliminated.

One significant problem with the Argentine regime is the lack of guidance regarding what comparables should be used when the taxpayer is seeking to apply one of the profit-based methods that would require a comparison of companies. As is the case in many other countries, detailed and qualified public information about public companies, which might be used to make the comparison, is not available in Argentina. Under the legislation, the tax authorities may use “secret comparables” obtained from their records to challenge the taxpayer’s transfer pricing methodology. Aside from the legal issues raised by the use of secret comparables, including whether the taxpayer has access to the same information, the use of secret comparables creates considerable uncertainty. It is

therefore expected that the tax authorities will take a prudent approach with respect to secret comparables, as has been the case in Mexico.

If local information is unavailable, taxpayers can resort to foreign comparables from either the United States or Europe, which are available in various databases. It must be emphasized, however, that in most cases the use of foreign comparables will require the taxpayer to make adjustments to reflect the differences in the economic environment ("geographic market adjustments") in addition to the usual adjustments regarding inventories, receivables and payables.

The Argentine transfer pricing rules require the taxpayer to make adjustments in applying comparability, including adjustments for differences in payment terms, the value of interest accrued, differences in the amount or volume traded (including trade discounts or bonuses), and difference as to promotional activities, advertising, and publicity charges, taking the price per unit into account. The tax authorities are particularly concerned with the transfer pricing implications of advertising, publicity and promotional activities for comparative purposes. Therefore, the regulations contain a special accounting procedure: expenses must be apportioned pro rata among the goods or assets, services or rights applied in promoting the company's brands. The pro rata apportionment is to be made on the basis of product sales.

Prices of goods, assets, or services are to be adjusted to take into account the packaging, freight and insurance costs for comparative purposes. Similarly, prices are to be adjusted, depending on costs incurred, to reflect the physical nature of the goods, assets, services or rights that are comparable with each other. Comparable transactions are to be adjusted if the transactions take place on different dates -- the wholesale price index can be used for this purpose.

The regulations also provide guidance for when the currency lacks an exchange rate against the Argentine currency. Currency should be first converted into dollars and then into Argentine currency. In a similar manner, changes in the price of commodities can be demonstrated by reference to commodity exchange listings.

B. Documentation Requirements

Taxpayers are required to maintain documentation analogous to that required by the U.S. contemporaneous documentation provisions. The Argentine requirements are onerous even when compared to the U.S. transfer pricing regulations. The taxpayer must justify both the transfer pricing reflected and the comparison of the methods. Records must be maintained in accordance with the Procedural Tax Act and retained for 10 years (*i.e.*, until expiration of the statute of limitations). While no provision is made for APAs, the information required is similar to what taxpayers in Mexico must submit when requesting an APA.

Law 25,239 clarifies that the transfer pricing documentation rules apply to related party transactions with nonresidents and to import and export transactions if the parties are unable to prove the wholesale price in the country of origin or destination.

Taxpayers must maintain extensive and detailed records, including a wide variety of documents, records and other information, as supporting documentation:

- Detailed description of the taxpayer's functions and activities, assets used, risks assumed and organizational structure;
- Identity of all affiliated parties and documentation outlining the nature of the relationships;
- Information on transactions with related parties;
- Information on activities of each member in a group of companies;
- Financial statements of the taxpayer, financing information and the cost structure of the taxpayer;
- Copies of contracts (*e.g.*, warranties, know-how, cost sharing, R&D, advertising, etc.) between the taxpayer and foreign related parties;
- Information on the particular industry, anticipated changes in the industry, market size, competition, etc.;
- Methodology used to determine transfer prices and information on comparable transactions or companies; and
- Information on transfer pricing regimes applicable to foreign related parties and whether those affiliates are involved in a transfer pricing dispute with the foreign tax authorities.

The November 2000 decree includes a requirement of information similar to that previously required by General Resolution 702/99. Interestingly, the requirement for information relating to marketing strategies and start-up situations that might justify initial enterprise losses has been eliminated. It is expected, however, that regulations to be issued under the new law might reinstate such a requirement.

C. Penalty Provisions

No special penalties have been established for noncompliance with the transfer pricing documentation rules other than the penalties imposed by procedural law. However, if noncompliance gives rise to tax fraud, penalties range from two to 10 times the amount evaded. Adjustments related to transfer pricing also would increase the tax base. Tax losses carried forward from previous years can be used to offset those adjustments.

In the case of transactions between related parties, the taxpayer must be able to demonstrate that transactions are carried out under arm's length conditions. If the arm's length standard is not met, the tax authorities may recharacterize the transactions as a capital contribution or the payment of a dividend. If taxes are due as a result of adjustments, even though no penalties will be imposed, the taxpayer will be subject to an interest charge of 3% per month as a late payment. Compared to Argentina's negligible rate of inflation (less than 1% per year), this constitutes a real penalty.

Failure to file the transfer pricing tax return will subject the taxpayer to a failure to file penalty.

V. Tax Treaties, MAP and Competent Authority

Argentina has concluded tax treaties with the following countries:

- Australia
- Austria
- Belgium
- Bolivia
- Brazil
- Canada
- Chile
- Denmark
- Finland
- France
- Germany
- Italy
- Netherlands
- Spain
- Sweden
- United Kingdom

All of the treaties include provisions for the competent authority process. In the case of the treaties with Chile, Bolivia and Brazil, which are based on the Cartagena model, this procedure is not entirely clear.

VI. Application (Best Practices and Methods)

A. Taxpayer Obligations

The Argentine transfer pricing regulations require resident taxpayers engaged in transfer pricing transactions to file an annual income tax return and a supplemental transfer pricing return (Form 662) that reflects all related-party transactions. The return must be filed electronically. The return is due within the first 10 days of the fifth month following the accounting year-end (this coincides with the date a corporate taxpayer must file its annual tax return).

B. Tax Administration

The Argentine tax administration is headed by a General Director who interprets the law and who is responsible for issuing General Resolutions that are binding on taxpayers. For example, the Tax Office issued in October 1999 General Resolution No.702/99, which sets forth the documentation requirements for a taxpayer to properly document its transfer

pricing in Argentina. Another resolution is expected in the near future to provide guidance on Law 25.239.

C. Examination, Dispute Resolution, APAs

Transfer pricing examinations are just beginning in Argentina. Initially, the tax office focused primarily on requesting information to build up a transfer pricing database. Later, while conducting tax audits, tax inspectors would request the transfer pricing study. The tax authorities are now conducting specific transfer pricing audits.

There are no specific dispute resolution procedures other than those stated in the Tax Procedural Law. In this respect, when a transfer pricing audit is carried out and an adjustment made, the taxpayer may opt to pay the tax determined or appeal to the tax court without paying the amount determined by the tax authorities. If the tax court rules in favor of the authorities, the taxpayer must pay the amount due to appeal to the higher courts, and ultimately to the Supreme Court. If the taxpayer prevails in court, the Tax Office also has the right to appeal up to the Supreme Court.

Argentine legislation does not authorize APAs although it is expected that in the near future such agreements with be allowed as the Tax Office and taxpayer become more mature in handling transfer pricing issues.

D. Compliance With OECD Guidelines

The Argentine transfer pricing rules as originally adopted generally adhered to the OECD Guidelines. However, the resolutions issued in 1999 and 2000 appear to have introduced certain provisions that focus on a transactional analysis rather than a company analysis.

VII. Conclusions and Recommendations for Improvements

The Argentine transfer pricing rules follow many provisions in the U.S. and Mexican transfer pricing regulations as well as the OECD Guidelines, but the implementation of the Argentine rules differs in several respects. The Argentine rules do not specifically impose a Spanish language requirement for the principal and background documents. Such a requirement, if imposed, would increase the heavy burden already imposed on foreign-owned U.S. businesses.

Compliance with the Argentine rules remains an issue. For example, foreign related parties, particularly if they are related to each other and not to the Argentine entity, may refuse to provide the information requested. The Argentine taxpayer could be held accountable for not producing data that is not within its control.

Since Argentina is not a member of the OECD, regulations should specifically state that the OECD Guidelines should be used to interpret the legislation.

Argentine public information on unrelated transactions or independent companies is scarce. The tax authorities should allow the use of foreign comparables with the corresponding economic adjustments to permit their application in transfer pricing analysis.

Argentina must consider introducing APAs and cost sharing arrangements.

The recent decree indicates a trend towards analyzing transactions rather than companies although the transactional net margin method remains a valid method to determine transfer pricing. Especially troublesome is the 5 % limit introduces by the new regulatory decree. The new provision states that if during an audit the tax authorities consider that more than one method should be applied and the transactions are within a normal range of prices or results a 5 % deviation will be deemed as acceptable. This provision was taken from the Brazilian legislation whereby there are plenty of fixed margins and safe harbors. It is difficult to envision how more than one method could be applied. If the tax office does not apply this provision very prudently we foresee a lot of controversies coming up.

CHAPTER 3: BRAZIL

I. History of Transfer Pricing

In the mid-1990s, the Brazilian government embarked on an effort to modernize the country's income tax laws by adopting a worldwide system of taxation and by introducing rudimentary transfer pricing rules. These changes were introduced in part to address previously conducted government studies, which found that some multinational companies doing business in Brazil were manipulating transfer prices between their related entities and using subsidiaries domiciled in tax havens to avoid reporting taxable income.

In 1996, legislation introducing formal transfer pricing rules was presented to the Brazilian Congress and a detailed transfer pricing regulation, effective January 1, 1997, was officially published in May 1997. The transfer pricing rules were altered in 1999 to include a modified method of calculating gross margin on imported raw materials pursuant to the application of the RR method and limit the concept of "tax haven country" to countries listed by Brazil's competent authority.

In 1998, a Department of International Taxation was created as part of Brazil's Ministry of Finance. That department includes personnel who are responsible for administering the current transfer pricing rules, conducting transfer pricing audits and serving as Brazil's competent authority in transfer pricing matters.

II. Legislation and Regulations

As contained in Law 9430/96, Brazil's transfer pricing rules generally are based on the OECD Guidelines but also contain some substantial deviations. The rules themselves are relatively simple and flexible, and allow companies domiciled in Brazil to implement a variety of tax planning strategies. Nevertheless, the rules also are designed to prevent multinational companies from manipulating prices between related parties in a manner that allows for the inappropriate transfer of otherwise reportable income from Brazil to a low or no-tax country; or artificially transferring profits from one related party to another related party with tax losses. To this end, the rules call for the imposition of significant penalties in some instances.

The transfer pricing rules determine the extent to which costs, expenses and charges relating to goods, services and rights stated on import or acquisition documents pertaining to transactions between related parties will be deductible in computing taxable income. Insofar as the transfer pricing rules refer to adjustments to Brazil's income (IRPJ) and social contribution on corporate net profits (CSLL) tax bases, they are strictly tax-related provisions and are not to be construed as a monetary policy, since they do not set any limit on amounts required for the payment of import or export operations.

Brazil's transfer pricing rules target transactions between a Brazilian entity and its overseas related parties involving the import and export of goods, services and rights, without distinguishing between tangible property or services.

The rules provide for two safe harbors. First, export transactions between related parties will not be subject to a transfer pricing adjustment if the average export price in those transactions equals or is greater than 90% of the average sale price involved in transactions between unrelated parties in Brazil[10]. Second, if a company can show either that its net profit from export sales to related parties equals (before tax) at least 5% of all such sales or that its net revenue from exports has never exceeded 5% of total net revenue over the same period, it is not obliged to fully disclose its intercompany transactions to the Brazilian authorities or apply any transfer pricing method. These safe harbors do not apply to export transactions with companies located in tax havens, however.

Definition of Related Parties

Like Argentina and Venezuela (to some extent Mexico as well), Brazilian law provides for a broad definition of the term "related party." For transfer pricing purposes, Brazil considers the following businesses and individuals to be related to an entity domiciled in Brazil:

- a nonresident parent company;
- a nonresident branch or subsidiary;
- a nonresident individual or business that has a capital participation and is deemed to be a controlling or "associated shareholder" (10% of capital);
- a nonresident business deemed to be its controlled or affiliated entity;
- a nonresident business under common administrative or equity control, or when the same shareholder holds at least a 10% capital participation in both companies;
- a nonresident individual or business that, together with the Brazilian company, holds a capital participation in a third company that renders them controlling or "associated shareholders;"
- a nonresident individual or business that is associated with the Brazilian company in a consortium or joint venture (as defined under Brazilian law);
- a nonresident individual who is related to the third degree, spouse or common-law spouse of any officer, controlling partner or shareholder;
- a nonresident individual or business that is its exclusive agent, distributor or concessionaire for the purchase and sale of services, goods or rights; or
- a nonresident individual or business for which the Brazilian company is an exclusive agent, distributor or concessionaire for the purchase and sale of goods, services or rights.

These rules also apply to operations carried out by a company domiciled in Brazil through unrelated third parties with nonresident parties that are related to the Brazilian company.

[10] Venezuela has adopted a similar rule.

III. Transfer Pricing Methodologies

Unlike many transfer pricing regimes, the Brazilian transfer pricing rules are not based on a specific arm's length principle. Nevertheless, taxpayers to which the transfer pricing rules apply generally are expected to engage in transactions with related parties that would be consistent with transactions that occur between unrelated parties under similar circumstances. Just as there is no specific arm's length principle on which Brazil's transfer pricing rules are based, so there is no strict priority imposed on the taxpayer regarding which transfer pricing methodology to use in a given situation. Taxpayers are free to choose any method or combination of methods from those specified in the regulations and can apply them to tangible property or services, just so long as, whatever method is chosen, the taxpayer provides all of the information necessary to apply the method or methods chosen. All of the approved Brazilian transfer pricing methods involve price comparisons or reconstruction rather than a determination of profit margins.

A. Methodologies for Import Transactions

Taxpayers may use the following transfer pricing methods for import transactions: the CUP method (also known as the comparable independent prices method), the resale price less profit method; or the production cost plus profit method.

1 Comparable Uncontrolled Price Method

Under the CUP, the importer must determine the average sales prices for similar goods, services or rights in Brazilian or foreign markets under similar conditions and compare those to its own sales prices. In making the comparisons, the prices must be compared with the prices of similar tangible or intangible property or services sold by the same exporter to unrelated parties, purchased by the same importer from unrelated parties or in sales between other, unspecified, unrelated parties. No fixed gross margin is applicable under this method.

2 Retail Price Less Profit

Under the Retail Price Less Profit Method, the importer determines the average resale prices of goods, services or rights after reducing the resale prices to reflect (1) unconditional discounts, sales taxes or contributions and brokerage costs; and (2) a 60% profit margin in the case of raw materials or 20% profit margin in other cases, calculated based on the resale price. A transaction between unrelated parties is the only standard for comparison under this method.

3 Production Cost Plus Profit

Under this method, the importer calculates the average cost of goods, services or rights based on what they would be in the country where they were produced. To this figure the importer adds any export taxes imposed by the producing country and a 20% profit margin calculated on the costs. A range of factors may be used to determine costs under this method.

B. Methodologies for Export Transactions

Taxpayers may use the following transfer pricing methods for export transactions: the export sales price method, the wholesale price in the country of destination less profit method, the retail price in the country of destination less profit method or the acquisition or production cost plus taxes and profit method.

1 Export Sales Price Method

Under the Export Sales Price Method, the exporter determines the average prices of exports it has made to unrelated third parties as a comparison standard or, as an alternative, the average prices of similar goods, services or rights exported by other Brazilian companies during the same time period and under similar conditions.

2 Wholesale Price in the Country of Destination Less Profit Method

Under the Wholesale Price in the Country of Destination Less Profit Method, the exporter calculates the average wholesale price of similar goods. These averages are determined based on the wholesale price in the country of destination but do not include any taxes imposed by the country of destination. Finally, a 15% profit margin is subtracted from the average wholesale price.

3 Retail Price in the Country of Destination Less Profit Method

Under the Retail Price in the Country of Destination Less Profit Method, an average retail price for similar goods, based on prices in the country of destination is arrived at. From this price is subtracted any taxes imposed by the country of destination and reflected in the average price and a 30% profit margin calculated on the retail price.

4 Acquisition or Production Cost Plus Taxes and Profit Method

Under this method, the average cost of producing or acquiring similar exported goods, services or rights is determined. To this figure is added any taxes and contributions levied in Brazil and reflected in the cost and a 15% profit margin, calculated on an amount that includes the costs, contributions and taxes.

C. Documentation

Although specific requirements relating to documentation are not explicitly delineated in Brazilian tax law, practical necessity dictates that taxpayers subject to the transfer pricing rules must collect, develop and maintain documentation adequate to support their reported income, expenses and deductions from operations with related parties. To this end, they must prepare a transfer pricing study prior to paying the last installment of their income tax or, in case of losses during the tax year, prior to filing their tax returns.

There is an enormous amount of information about imports, exports, debts, credit not registered at the Central Bank and transactions or operations with related parties that is

subject to scrutiny pursuant to Brazilian tax and transfer pricing law. At a minimum, a taxpayer's transfer pricing study should include any and all documentation necessary to support the statements made on the taxpayer's tax return.

Depending on the transfer pricing method or methods utilized, the taxpayer must keep a documentary record of how average prices and comparables were arrived at. This record would reasonably include invoices, inventories, a record of costs and prices and payroll information among other necessary documentation, consistent with OECD Guidelines in this area. Adequacy of documentation is routinely evaluated by the competent authorities as part of the transfer pricing audit process.

D. Penalty Provisions

Although there are no specific penalty provisions included in Brazil's transfer pricing rules, any taxpayers that fail to provide adequate information on their tax returns are subject to penalties under Brazilian income tax laws. These penalties range from 75% to 150% of the unpaid tax amount. In addition, such a taxpayer is liable for interest on any tax due in accordance with the established monthly national interest rate. In some instances, taxpayers may have their penalties reduced.

IV. Tax Treaties, MAP and Competent Authority

Brazil has concluded tax treaties with the following countries:

- Argentina
- Austria
- Belgium
- Canada
- China
- Czechoslovakia
- Denmark
- Ecuador
- Finland
- France
- Germany
- Hungary
- India
- Italy
- Japan
- Korea
- Luxembourg
- Netherlands
- Norway
- Philippines
- Portugal

- Spain
- Sweden

There are no treaties between Brazil and any other country that deal exclusively with transfer pricing issues. Furthermore, none of the current treaties include a mutual agreement provision similar to Article 25 of the OECD Model Tax Convention dealing with transfer pricing. All of the existing treaties, however, contain a mutual agreement provision (MAP) similar to that in Article 9 of the OECD Model Convention addressing associated enterprises. Under the MAP provision, the signatory countries may tax certain income that, except for arrangements that cause "two enterprises" to differ in their relations from those of "independent enterprises," otherwise would have accrued to one of the enterprises.

In addition, there is a process under Brazilian law whereby an individual company or group of companies may petition the Brazilian competent authority to prove that a gross profit margin maintained by a particular company is excessive in regard to a specific good, right or service. To date, however, no company has petitioned the Brazilian competent authority to reduce the gross profit margin.

V. Application (Best Practices and Methods)

A. Taxpayer Obligations

Taxpayers that carry out business activities with a nonresident related party must adhere to all existing transfer pricing laws and regulations. Most importantly, taxpayers who find themselves subject to the transfer pricing rules must prepare a transfer pricing study by the end of each calendar year for each transaction it maintains with a nonresident related entity. By June 30 of each year, companies must file their tax returns, including all required information. All documents used to support the information contained in the return must be kept for a period of six years.

Those companies chosen to be audited under rules established by the Secretary of Federal Revenue must be prepared to present their transfer pricing analysis supporting the information contained in their tax returns, as well as all of the documentation used to support the analysis and the return.

B. Tax Administration

The Federal Revenue Secretariat, which is subordinate to the Minister of Finance, is the agency of the Brazilian government responsible for administering the tax regime and collecting income tax.

C. Examinations, Dispute Resolution, APAs

Within the Federal Revenue Secretariat's International Department is a special transfer pricing team that is responsible for conducting transfer pricing audits and investigations,

as well as imposing penalties for failure to adhere to transfer pricing rules. Taxpayers may dispute the findings of the auditors initially through an administrative process. If no relief is granted as a result of that process, the taxpayer may then dispute the findings of the auditors in court.

Brazilian law does not have explicit advance pricing agreement regulations, however taxpayers may request a ruling from the tax authorities allowing them to use a different gross margin to the fixed ones provided in the different transfer pricing methods.

D. Compliance with OECD Guidelines

The current Brazilian transfer pricing rules are based, in large part, on the OECD Guidelines. Although the Brazilian rules do not explicitly adopt the arm's length standard for determining the valid taxable income of a taxpayer subject to the transfer pricing rules, they essentially agree with the OECD that transactions between related parties should be consistent with transactions that would have occurred between unrelated parties under similar circumstances.

The methodologies adopted by Brazil to determine comparable prices are similar to those recommended by the OECD, except that the Brazilian methodologies place a greater emphasis on seeking a comparison or reconstruction of prices than on profit margins. The prescribed profit margins in the legislation have been subject to criticism since they do not adopt the arm's length standard, however at this point there is no indication of taxpayers submitting a request for authorization of a different margin.

The Brazilian concept of "related party" actually is broader than the OECD's in that it includes companies domiciled in tax haven countries and exclusive distributors and agents.

VI. Conclusions and Recommendations for Improvement

The transfer pricing regime in Brazil is a relatively new creation and, as such, is still incomplete and somewhat flexible. Most of the rules as they currently exist are relatively simple and easy to understand. The system is not without problems, however. Although the fixed gross margin concept makes it possible to use traditional methods of determining comparables and arm's-length values, this system does not work well for all taxpayers in all situations; it may actually benefit companies located in Brazil more than it does nonresident related companies. As with many countries that have only recently instituted a transfer pricing regime, Brazil is now discovering that it must institute additional laws that will require more Brazilian companies to maintain and publish more complete information about their business processes and transactions. Once that is accomplished, Brazil will be better able to more closely comply with the OECD's Guidelines.

CHAPTER 4: MEXICO

I. History of Transfer Pricing

Mexico adopted general legislation on transfer pricing in 1997. Before this legislation was introduced, transfer pricing regulation was generally limited to the *maquiladora* industry.[11] The 1997 law expanded the reach of transfer pricing rules to all types of transactions with Mexican and nonresident related parties, although the documentation rules only apply in the case of transaction between a Mexican resident and a nonresident related party. The salient aspects of the transfer pricing law and Miscellaneous Tax Provisions (MTP) may be summarized as follows:

- The arm's length principle is endorsed (although certain global formulary apportionment procedures are retained);[12]
- The burden of proof is shifted to the taxpayer to demonstrate that the arm's length standard was met. If not, the tax authorities (SAT) may determine the price or amount of consideration based on their own findings rather than by reviewing the documentation of the taxpayer;
- Transactions with low-tax jurisdictions (tax havens) are discouraged;
- Transfer pricing compliance is emphasized and its observance is connected to the criteria used to determine whether or not a permanent establishment exists since under Mexican legislation a independent agent may be instituted as a result of a non arm's length dealing;
- Definitions are provided for related party, comparable transactions and comparable companies. The law allows certain adjustments to be made to the comparables as well as the formula for calculating the interquartile range when more than one comparable is used;
- The adoption of OECD transfer pricing methods without the imposition of a specific hierarchy;
- Recognition of an arm's length range so that income or profit margin within the specified range is deemed to be at arm's length. If the taxpayer is outside the range, the median is deemed to be the arm's length point;
- Documentation is required to evidence arm's length transactions and to be eligible for reduced penalties in the case of a transfer pricing adjustment;
- Specific provisions allow the tax authorities to use secret comparables;

[11] Maquiladoras are in-bond industries that manufacture, process, assemble and/or repair raw materials and components. The finished or semi-finished products are typically exported back to the county of origin. A separate section on maquiladoras is included in the chapter since the rules applicable to those companies are very specific.

[12] See Article 4 of the Income Tax Law for permanent establishments and fixed bases and Article 23 for companies engaged in international air and land transportation. Safe harbors are also provided for the maquiladoras providing minimum levels of taxable income.

- Bilateral APAs and multi-year rulings are authorized and guidelines are provided for audits and corresponding adjustments;
- Specific rules apply to maquiladoras to avoid permanent establishment treatment for foreign principals;
- As from 2001, a new obligation to file a transfer pricing return has been introduced as well as the focus on having transfer pricing analysis carried out on a transaction by transaction basis.

The foreword to the legislation provides that the intent when drafting the provisions was to ensure that the authorities should rely on traditional transactional methods to the extent possible. This objective is confirmed in the legislation passed for 2001 requiring that taxpayers apply profit methods on a transactional basis rather than bundling transactions for analysis, specifically in the case of the Transactional Operating Profit Margin Method (TOPMM).

II. Legislation and Regulations

Until 1996 (*i.e.*, before the transfer pricing regime was introduced), Article 64-A of the Income Tax Law (ITL) granted powers to the tax authorities to determine the prices of related party transactions when those transactions were not carried out on arm's length terms. The 1997 transfer pricing regime codified the arm's length principle as set forth in the OECD Guidelines and shifted the burden of proof from the tax authorities to the taxpayer to demonstrate that its transactions with related parties were consistent with the arm's length principle.

The Mexican legislation has been amended numerous times to include in later years the use of secret comparables by SAT, reduction in the term of an APA, the obligation to file a transfer pricing return and most recently the obligation to carry out transactional analysis.

A. Definition of Related Parties

The related party definition enacted in 1997 is based on the OECD Guidelines as well as Article 9 of the OECD Model Tax Convention on Income and on Capital (OECD Model Tax Convention), although the definition is more encompassing than the OECD definition especially in the case of individuals. Under the Mexican rules, two or more parties are related when one directly or indirectly participates in the management, control or capital of the other, or when a person or group of persons participates directly or indirectly in the administration, control or capital of both (all) of those parties. There is no minimum percentage requirement for control or participation, nor is there a definition of direct or indirect participation, management, control or capital.[13]

[13] Under wording of ITL Article 74, which governs the taxation of individuals, the definition of related party is extended to cases where "linkage exists among them (the parties) in accordance with customs legislation."

The Mexican rules also contain a rebuttable presumption that transactions entered into with a party located or resident in a low-tax jurisdiction are related party transactions and not carried out on arm's length terms. The legislation includes a provision making all payments to recipients located or resident in a low-tax jurisdiction non-deductible unless the taxpayer can demonstrate that the transactions are at arm's length. In the case of transactions with low-tax jurisdictions, the tax authorities have the power to determine the price, consideration or profit margin unless the taxpayer can prove through documentation that arm's length prices were used or that the transactions were between independent parties. This provision exceeds the scope of the OECD Guidelines, which state: "tax administrators should not automatically assume that associated enterprises have sought to manipulate their profits." Clearly, there is a risk that taxpayers may be exposed to double taxation where they deal with related parties resident in countries included in the list of countries published on an annual basis that are not tax havens from a tax and economic perspective but that nevertheless are considered by Mexico as tax havens. MTP have been published for the case of bona-fide non related party transactions with taxpayers from a low tax jurisdiction.

B. Transfer Pricing Methodology

Six methodologies may be used in setting an arm's length price: CUP, RP, CP, Contribution Profit-Split, Residual Profit-Split and TOPMM methods. Unlike the OECD Guidelines that discourage the use of transactional profit methods and consider them methods of last resort, the Mexican rules allow application of any of the methods. There is no hierarchy of approaches or best method approach.

1 Comparable Uncontrolled Price Method

The CUP uses the same criteria as the OECD Guidelines, although the omission of the phrase "in comparable circumstances" may give rise to conflicts when establishing the criteria for applicability (and thus its reliability) and when determining adjustments that must be made to the transactions.

2 Resale Price and Cost-Plus Methods

The RP and CP methods require the use of gross margins for comparable transactions and do not offer the flexibility allowed by the OECD of applying net margins and projected costs (*i.e.*, actual costs must be determined under Mexican GAAP). For instance, in the case of the CP method, the OECD allows the costs and expenses of an enterprise to be grouped into three segments: direct costs, indirect costs and production and operating expenses.

A gross margin method would build a cost base including direct and indirect costs while a net margin approach would also include operating expenses. Under the OECD Guidelines, net margins may show more tolerance than gross profits margins to certain functional differences between controlled and uncontrolled transactions. The Mexican cost-plus method expressly states that the "plus" will be computed by dividing gross profit by cost of goods sold, of the comparable operation or company.

3 Profit-Split Methods

Under the Profit-Split and Residual Profit-Split Methods, consideration should be given to assets, costs and expenses when determining how to divide the profits. Intangibles should be factored in for the application of the Residual Profit-Split Method. If these items are the only factors taken into account in a functional analysis, the approach is consistent with the OECD Guidelines; otherwise, this method could be viewed as a type of formulary apportionment.

4 Transactional Operating Profit Margin Method

The TOPMM is defined as a method that "determines [in related party transactions] the operating profit that would have been obtained by comparable companies or independent parties (sic) in comparable transactions, based on profitability factors which take into account variables such as assets, sales, costs, expenses or cash flows.

This definition theoretically parallels the definition of the TNMM in the OECD Guidelines but emphasizes the operating profit obtained from comparable transactions. This raises the question whether the TOPMM as it is based on comparable transactions is the same as the comparable profits method (CPM) under U.S. rules. The CPM evaluates whether the amount charged in a controlled transaction is arm's length, based on indicators from uncontrolled taxpayers, *i.e.*, companies rather than transactions. It appears that the Mexican TOPMM would be equivalent to CPM to the extent the tested party carries out one transaction or a group of segmented transactions.[14] Otherwise, it could be argued that the method is not consistent with the OECD Guidelines since it compares the consolidated global profits of different multinational enterprises.

Using a profit-based method gives rise to practical problems when determining the tested party in a cross-border analysis, since a literal reading of the rules leads to the conclusion that the tested party must be the Mexican taxpayer. Therefore, in a highly complex transaction involving a full-fledged Mexican manufacturer with intangibles and a simple distributor abroad, testing the "simple" party may not satisfy the SAT.

No specific profit level indicators are required but it appears that the tax authorities have accepted indicators, including the Berry ratio, operating margin and return on assets.

For purposes of determining income, costs, gross margins, net sales, expenses, operating profit, assets and liabilities, Mexican GAAP should be followed.

[14] In dealing with Mexico and U.S. transfer pricing issues, specifically with respect to the TOPMM method, it will depend on the level of aggregation of the transactions that the Mexican authorities will accept to determine whether the CPM is equal to the TOPMM method. The provisions of paragraphs 1.42, 1.43 and 3.26 of the OECD Guidelines should be taken into account when determining the level of aggregation of transactions. The Guidelines provide that "there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis."[14] As mentioned in the text, Mexico has adopted measures, such as the proposed 2001 reform, that stress a transaction-by-transaction analysis.

C. Comparability Analysis

Mexican taxpayers that carry out related party transactions must determine their income and deductions by considering the prices that comparable companies would have used in comparable transactions. Companies or transactions are considered comparable when differences may be eliminated through reasonable adjustments. To identify differences between controlled transactions and the comparables, a number of factors must be considered, including characteristics of the transactions,[15] functional analysis, contractual terms, economic circumstances and business strategies.[16]

A functional analysis of the taxpayer will have to be performed before deciding which method would be best to apply or which factors to take into consideration. This analysis takes into account the functions or activities, including the risks assumed and assets of each party. The functional analysis is the starting point on which then economic analysis will be based, and will include a determination of whether there are any internal comparable unrelated party transactions. External transactions or companies may be necessary. The functional analysis provides the decision-making factors for deciding which will be the best method to ensure the arm's length nature of the transactions.

The use of "inexact" comparables has become established practice in countries such as Mexico, where there is limited access to information on public comparable transactions or companies and that lack reliable databases from which to derive transfer pricing information.

The items of the tested company should be determined based on Mexican GAAP. Where non-Mexican comparables are used to determine the transfer price, compliance with this rule will require careful analysis. Generally, the use of non-Mexican comparables will require adjustments to the financial statements of the comparable companies in respect of the accounting/valuation method applied to certain transactions. These adjustments are necessary to bring the financial statements of the comparable companies in line with the Mexican GAAP. Where such adjustments are made, the taxpayer should be prepared to explain and justify them.

[15] Characteristics of the transactions include the following:

- For financing operations, the amount of the principal, term, guaranties, solvency of the debtor and interest rate;
- For the provision of services, the nature of the services, and whether the services involve technical experience or knowledge;
- For the use, enjoyment or sale of tangible goods, the physical characteristics, quality and availability of the goods;
- For the exploitation or transfer of intangibles, the length and degree of protection; and

For the alienation of shares, the updated shareholders' equity of the issuing company, the present value of profits or projected cash flows or stock market quotation of the day before the sale.

[16] Business strategies would include market penetration, permanence and expansion.

D. Documentation Requirements

Mexican companies engaging in transactions with related parties must obtain and retain contemporaneous documentation substantiating the arm's length nature of transactions with those parties. This requirement applies to transactions that take place on or after January 1, 1997. The documentation must include the following:

- Name, address and tax residence of the related parties, as well as documentation that discloses direct or indirect participation between the related parties;
- The functions and activities of the taxpayer, and assets used and risks assumed by the taxpayer for each type of transaction;
- Information and documentation on the related party transactions and amounts of the transactions for each related party and for each type of transaction pursuant to the classification and data established in Article 64-A of the ITL;
- Details of the methodology applied in accordance with Article 65 of the ITL, including information and documentation on comparable transactions or companies for each type of transaction.

Although the law does not explicitly state that documentation must be contemporaneous, it must be prepared by the due date of the Mexican tax return. The SAT may request documentation only for completed fiscal years. Taxpayers that make quarterly advance tax payments under ITL Article 12 and that do not enter into transactions with parties in low-tax jurisdictions are not subject to the documentation requirements.

The SAT has authority to determine income arising from related party transactions regardless of the country of residence of the taxpayers. It would appear that under the documentation rules, in principle, Mexican resident companies that do not enter into nonresident related party transactions (but instead transact with domestic related parties) are not required to document their related party transactions. It is unclear, however, whether these companies (those with domestic related party transactions) would be eligible to benefit from the reduced penalties if SAT issued an assessment and the taxpayers had prepared documentation.

E. Penalty Provisions

Tax penalties are imposed if a taxpayer underpays a tax liability due to transfer pricing adjustments. The penalties are generally 70 to 100% of the unpaid tax in addition to interest and update for inflation. No penalty is imposed for failure to comply with the documentation requirements although the taxpayer would not be eligible for the reduced penalty provisions, there is however a penalty for not filing or filing incorrectly the transfer pricing return. Reduced penalties may apply if an ajdustment is to be made but the taxpayer has complied with the documentation requirements. The penalties are reduced by 25% of the tax omitted when the payment of the tax on the adjustment is made before the tax authorities gives notification of the resolution of the assessment; in the case of overstated losses, 15% to 20% of the overstatement, and in other cases, 35% to 50% of tax.

Changes made to the rules on constructive dividends conflict with the OECD Guidelines, which state that an examination by the tax authorities should be based on the transaction actually undertaken by the associated enterprise, and only in exceptional cases should the transaction be disregarded or reconstructed. The OECD also believes that restructuring legitimate business transactions is arbitrary and could lead to double taxation. The constructive dividend provisions were amended to incorporate the definition of related party and to add three new situations that trigger a constructive dividend: interest that is nondeductible because paid to a related party (*i.e.*, non-arm's length interest), interest from back-to-back loans, even when granted through financial institutions resident in Mexico or abroad and the increase in the taxable income of the taxpayer that may result from a transfer pricing adjustment (this latter is considered as a secondary adjustment).

III. Treaties, MAP and Competent Authority

Mexico has concluded tax treaties with the following countries:

- Belgium
- Canada
- Chile
- Denmark
- Finland
- France
- Germany
- Ireland
- Israel
- Italy
- Japan
- Korea (Republic of)
- Netherlands
- Norway
- Singapore
- Spain
- Sweden
- Switzerland
- United Kingdom
- United States

These tax treaties contain a MAP similar to that in Article 25 of the OECD Model Tax Convention, as well as the provisions applicable to transfer pricing.

The SAT has discretion to allow a Mexican taxpayer to amend its return to reflect the application of a proposed adjustment by a foreign tax administration if Mexico has concluded a tax treaty with the country making the adjustment.

IV. Application (Best Practices and Methods)

A. Taxpayer Obligations

Taxpayers are allowed to obtain ranges of prices, considerations or profit margins through the adoption of any of the methods authorized under Article 65 when determining their transfer prices.

Article 65 states that the range may be adjusted by means of statistical methods No reason is given why this may be necessary, although it is understood that it is in order to obtain a statistically representative sample. Based on the MTP this means that the SAT will accept methods that use interquartile ranges.

Further, in conformity with the OECD Guidelines, the Mexican rules provide that the taxpayer will be found to have determined its transfer price on an arm's length basis, if the amounts are within the arm's length range. Otherwise, the median will be deemed to be the arm's length price or amount of consideration.

Mexico does not impose specific methods for intangible property as is the case in the United States, nor does it follow the OECD recommendations in "The Taxation of Global Trading and Financial Instruments." Further, Mexican law does not permit cost sharing arrangements because under domestic law any pro rata expense incurred abroad is non-deductible (except in the case of permanent establishments).

The 2000 tax reform introduced a requirement to file a transfer pricing return. The first filing is due in February 2001 to report fiscal year 2000 related party transactions.

B. Tax Administration

The SAT's General Administration of Large Taxpayers has a Central Administration of International Fiscal Audit that is in charge of transfer pricing matters. The Administration of Transfer Pricing Audits and Rulings generally deals on the day to day process of negotiating an APA (although it must obtain an authorization from the Government Committee to issue an APA) as well as audits.

C. Examinations, Dispute Resolution and APAs

A taxpayer will be notified in advance of an audit, but the audit may commence the day after notification. No time limit is specified for the length of a transfer pricing audit. The SAT may use secret comparables (*i.e.*, confidential third party information) in making adjustments. The taxpayer is entitled to appoint two representatives to view the confidential information, but only for a period of 45 days and the representative may not copy or disclose the information to anyone else (unauthorized disclosure may result in imprisonment). The identity of secret comparables may only be disclosed through court procedures.

If the taxpayer does not document its transactions, upon audit the tax authorities will determine the transfer pricing method(s) and comparable transactions or companies (probably by using confidential information). An adjustment will be proposed by reference to the median in the case of ranges of prices or amounts of consideration. The tax authorities are unlikely to make adjustments to account for special circumstances in the taxpayer's trade or business (such as start-up operations).

D. APAs

Mexico authorizes bilateral and multilateral APAs and allows the SAT to issue transfer pricing rulings covering up to five years. Taxpayers are encouraged to request an APA when the application of traditional methods is not straightforward or those methods are difficult to apply. An APA must be issued within eight months of the application or it will be deemed to be rejected.

Legal precedence is established for bilateral APAs by providing that transfer pricing rulings may arise from bilateral agreements with countries that have concluded a tax treaty with Mexico. In these cases, the SAT may totally or partially waive surcharges provided the tax authorities of the other country have not accrued interest in favor of the taxpayer of refunded the corresponding tax. As a result, the Mexican authorities through the MAP may be able to resolve disputes over juridical double taxation arising from transfer pricing adjustments.

It is important to note that transfer pricing rulings differ from APAs in the U.S. or under the OECD Guidelines. A Mexican ruling is not a binding agreement between the taxpayer and the SAT. It is a private letter ruling that creates rights for the taxpayer and is strictly limited to the real and concrete circumstances under which it was requested and issued. Any change in facts may invalidate a ruling and leave the taxpayer uncovered.

The tax authorities have published in the MTP guidelines regarding the contents of ruling requests as well as the minimal information that the taxpayer must produce and submit for consideration.

Prior to the formal filing of a ruling request, a taxpayer may, in conjunction with the Central Administration of International Fiscal Audit, analyze the information and methodology expected to be submitted for consideration by the Central Administration. This prefiling conference may be conducted on an anonymous or an identified basis and there is no cost for such meeting.

The Government Committee is the body of control, supervision and in its case, approval of all the functions and attributions conferred to the different legal ordinances that govern the SAT. Under the current organization it must approve the administrative rulings issued by SAT relating to the methodology utilized for the determination of prices or amounts of consideration in related party transactions (*i.e.,* APAs).

A nominal filing fee must be paid for first time requests and for the annual filing of the financial statements by means of which the taxpayer confirms to the tax authorities that

the methodology accepted in the transfer pricing ruling still applies to its facts and circumstances.

Generally, taxpayers (subject to certain exceptions) may only file two amended returns. Taxpayers will be allowed to file amended returns based on an adjustment resulting from a MAP irrespective of such limitation. Based on current experience the SAT may also waive surcharges for the unpaid taxes if the corresponding payment is made within the mandated time frame after the ruling is notified.

APA requests should be sent to the Central Administration of International Fiscal Audit, specifically to the Administration of Transfer Pricing Audits and Rulings.

E. Compliance with OECD Guidelines

The Mexican transfer pricing regulations generally conform with the OECD Guidelines however certain topics recently introduced such as global trading rules and most importantly cost sharing have not found their application in the Mexican rules yet.

F. Maquiladoras

Beginning fiscal year 2000 the Mexican tax authorities announced that it will no longer concede non permanent establishment (PE) status to foreign principals carrying out conventional maquiladora operations in Mexico, a solution was achieved between Mexico and the U.S. under MAP, and later Mexico decided to apply such rules for all nonresident with maquiladora operations.

The Ministry of Finance and Public Credit published June 30, 2000, amendments to the MTP issued March 6, 2000. The amendments provide additional guidance on the safe harbor rules and clarifications for start-up companies.

The MTP issued in March implement the October 1999 agreement with the United States that eliminates the PE exposure for U.S. companies that maintain maquiladora operations. The agreement contains safe harbors that are available for three years while the respective competent authorities decide upon rules or alternatively maquiladoras restructure their operations or take other steps to deal with the PE issue. Under the October 1999 agreement, a U.S. company with maquiladora operations in Mexico will not be deemed to have a PE in Mexico if the maquiladora meets one of two safe harbor tests or applies for a transfer pricing ruling (*i.e.*, APA) with the Mexican tax authorities. If the taxpayer chooses the safe harbor route, one of two tests must be satisfied. For tax years 2000, 2001 and 2002, the taxable income of the maquiladora must be equal to at least the greater of 6.9% of the value of the assets earmarked for maquiladora operations (except leased assets), or 6.5% of the deductions and costs associated with the maquiladora operations.

V. Conclusions and Recommendations for Improvement

Under Mexican legislation cost sharing or cost contribution payments are not deductible, therefore Mexico should look at the virtues of such arrangements in that although in the stage of generating the intangible property it may reflect a cost in the future upon having other parties benefit from the intangibles it may be transformed into an income generating activity for the Mexican taxpayer.

Transfer pricing adjustments have not been clearly legislated in Mexico, therefore a reform that would include rules determining how to deal in cases of having to recognize lower or higher profits in Mexico is advisable.

Other taxes should also be taking into consideration the treatment from a transfer pricing adjustment that may arise from the application of the provisions of the ITL, namely Value Added Tax and customs duties.

Having the SAT officials with the power to commit to APAs will also expedite the process instead of having to wait for the Government Committee to authorize the proceeding.

CHAPTER 5: UNITED STATES

I. Background

Section 482 has been in the Internal Revenue Code (the "Code") in one form or another since 1917, and is intended to ensure that transfers between related taxpayers take place on an arm's length basis.[17]

The only significant amendment to section 482 occurred in 1986, when Congress amended it to require that the transfer price for the use of intangible property in a controlled transaction be "commensurate with the income attributable to the intangible." This amendment was designed to halt the practice of U.S. multinationals transferring high-profit potential intangibles to offshore subsidiaries in low-tax jurisdictions for a small royalty that was not adjusted as the subsidiaries realized a disproportionately high proportion of the income attributable to the intangibles.

II. Section 482 Regulations – General Rules

A. Purpose

The purpose of section 482 is to ensure that taxpayers clearly reflect income attributable to controlled transactions and to prevent the avoidance of taxes with respect to those transactions. The Internal Revenue Service (hereinafter "Service") may make whatever allocations are necessary between or among controlled taxpayers, if it determines that the taxpayer has not reported its true taxable income. Taxpayers, however, may only use section 482 to report on a timely filed return an arm's length result that is different from the actual result. Taxpayers cannot compel the Service to apply section 482, nor can they file amended or untimely returns to decrease taxable income based on allocations or other adjustments to their controlled transactions.

B. The Arm's Length Standard

A controlled transaction will be arm's length if the results are the same as would have been realized by uncontrolled taxpayers engaged in the same transaction in the same circumstances. The regulations, however, state that "because identical transactions can

[17] Unless otherwise noted, all section references herein are to the Internal Revenue Code of 1986, as amended.

SEC. 482. ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS. In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

rarely be located, whether a transaction produces an arm's length result will be determined by reference to the results of comparable transactions under comparable circumstances."[18] This evaluation is to be made using a pricing method selected under the standards of the "best method rule" described below.

C. Best Method Rule

Transfer prices must be determined using the best method, *i.e.*, the method that, under the facts and circumstances, provides "the most reliable measure" of an arm's length result. There is no strict priority of methods and any method may be used without establishing the inapplicability of another method. In selecting a method, the factors to consider in identifying the best method are:

(i) The degree of comparability between controlled and uncontrolled transactions;
(ii) The completeness and accuracy of the data;
(iii) The soundness of the assumptions relied upon;
(iv) The sensitivity of results to deficiencies in data and assumptions; and
(v) Where two methods produce inconsistent results, the confirmation of the chosen results by comparison with a third method.

D. Comparability

The general standard of comparability requires that an uncontrolled transaction be sufficiently similar to the controlled transaction such that it provides a reliable measure of an arm's length result. The regulations do allow for a reasonable number of adjustments to the results of the uncontrolled transaction to account for material differences between the controlled and uncontrolled transaction, if such differences have a definite and reasonably ascertainable effect on prices or profits.
Under the regulations, all facts and circumstances that could affect prices or profits in arm's length dealings are taken into account when evaluating comparability. The general factors to be considered in evaluating comparability include:

- Functions performed and resources employed;
- Contractual terms;
- Risks assumed;
- Economic conditions; and
- Specific property or services involved.

E. Arm's Length Range

If there are no uncontrolled comparables for which it is likely that all material differences between the controlled and uncontrolled transactions can be identified and eliminated by adjustments, the regulations require that the controlled result fall within the interquartile

[18] Thus, under the regulations, controlled transactions may be evaluated by reference to uncontrolled transactions that are comparable, but not necessarily identical.

range of all of the uncontrolled results (*i.e.*, between the 25th and 75th percentiles of the results). However, if a taxpayer that uses this method has results that are not within the interquartile range for a given year, an adjustment ordinarily will be to the median of all the results.

F. Scope of Review

The scope of the Service's authority to adjust prices between controlled taxpayers is very broad, and extends to any case in which, either by inadvertence or design, the taxable income of a controlled taxpayer is other than what it would have been if the taxpayer had been dealing at arm's length with an uncontrolled taxpayer. Such authority allows the Service to make adjustments based on the reported *results* of controlled transactions, and does not require an evaluation of the correctness of the methods used by the controlled taxpayers to determine their transfer prices. The Service need not show any intent on the taxpayer's part to evade or avoid tax, and may make an allocation even if the income ultimately anticipated from a series of transactions has not been or is not ever realized.[19] The Service may also, if necessary to prevent the avoidance of taxes or to clearly reflect income, make an allocation under section 482 with respect to nonrecognition transactions (*e.g.*, section 1031). Finally, the rules under section 482 apply to all controlled taxpayers, whether they file separate returns or file returns on a consolidated basis.

III. Determination of Taxable Income for Loans, Services and Leases

A. Loans

When one member of a group makes a loan or advance to another member of the group, either directly or indirectly, that member must charge an arm's length rate of interest, from the day after the indebtedness arises to the day on which the indebtedness is satisfied, subject to certain exceptions. An arm's length interest rate is defined as the rate of interest that was charged, or would have been charged at the time the debt arose, in independent transactions with or between unrelated parties under similar circumstances. The regulations include a safe harbor rate based on the applicable federal rate, but this rate does not apply to any loan or advance expressed in a currency other than U.S. dollars.

B. Services

The regulations state that the Service may make adjustments under section 482 where one member of a group of controlled entities performs marketing, managerial, administrative, technical, or other services for the benefit, or on behalf of, another member of the group, for less than an arm's length charge. An arm's length charge for services is defined as the amount that was charged or would have been charged for the same or similar services in independent transactions with or between unrelated parties under similar circumstances considering all the relevant facts.

[19] See *also Eli Lilly & Co. v. Comm'r*, 84 T.C. 996, 1121, n.57 (1985).

For services that are not "integral" to the business activity of either the service provider or the recipient, the regulations includes a cost chargeback safe harbor. This safe harbor includes all direct and indirect costs of providing such services, and taxpayers may use any reasonable method of allocating and apportioning these expenses, (*e.g.*, allocation formulas or analysis of time spent). The cost chargeback safe harbor is not available for so-called "integral" services, which are subject to the arm's length standard.

Services are considered to be integral and, thus, do not qualify for the "cost only" safe harbor if any one of the following tests are met:

- The provider or the recipient of the services is in the business of providing similar services to unrelated parties.
- The services are either a principal part of the provider's business or do not constitute manufacturing, production, extraction, or construction. Services are presumed not to be a principal part of the business if the direct and indirect costs incurred to provide the service are less than 25% of the total costs of the service provider (excluding cost of goods sold).
- The provider of the service is "peculiarly capable" of rendering the service and the services are a principal element of the service provider's business operations. A service provider is peculiarly capable if, in rendering the service, the service provider makes use of special skills, reputation, influential customer relationships or intangible property. A service provider will not be considered to be peculiarly capable unless the value of the services substantially exceeds the costs attributable to the provision of the services.
- The provider's costs of providing the service exceeds 25% of the recipient's total costs (excluding cost of goods sold and payments made for the services received).

One significant issue that arises in the services area is whether the particular services performed are merely a duplication of a service that the related party is performing for itself, or are support services provided solely to the subsidiary. This distinction between "stewardship" services, for which no compensation is required, and support services that require an arm's length charge, often turns on whether the services involve the subsidiary's day-to-day operations.

C. Leases

When a member of a controlled group, by lease or other similar arrangement, transfers the use of tangible property to another member of the group, the lease must include an arm's length charge between the parties. Arm's length rent is defined as the amount of rent that was charged, or would have been charged, for the use of the same or similar property, in independent transactions between unrelated parties under similar circumstances. When determining the arm's length rent, the period and location of the use, the owner's investment in the property or rent paid for the property, expenses of maintaining the property, type of property involved, its condition and all relevant facts must be considered.

IV. Methods for Transfers of Tangible Property

Under the regulations, a taxpayer has available six methods for determining taxable income from the transfer of tangible property: the CUP, RP, CP, CPM, PSM and other unspecified methods. Both the CPM and the PSM apply to transfers of both tangible and intangible property, and therefore they are discussed in a separate section, below.

A. Comparable Uncontrolled Price Method

The CUP method evaluates whether the amount charged in a controlled transaction is arm's length by reference to the amount charged in a comparable uncontrolled transaction. Such transactions can involve third parties to the transaction at issue, but also can involve the same taxpayer making a sale to or purchase from an uncontrolled taxpayer. An uncontrolled transaction is considered comparable if the tangible property and contractual terms are substantially the same as those of the controlled transaction and, if any minor differences exist, they either have no effect on the price or have a definite and reasonably ascertainable affect on price that can be accounted for by a reasonable number of adjustments to the uncontrolled transaction. Where the products and circumstances are sufficiently similar (*i.e.,* the product comparability standards are met), the CUP method generally will be the most reliable measure of the arm's length result of the controlled transaction.

B. Resale Price Method

The RP method evaluates whether the amount charged in a controlled transaction is arm's length by reference to the gross profit margin realized in comparable uncontrolled transactions. The RP method ordinarily is used in cases involving the purchase and resale of tangible property in which the reseller has not added substantial value to the tangible goods (by physically altering the goods or through the use of an intangible) before resale.

C. Cost Plus Method

The CP method determines an arm's length charge by comparing the gross profit markup realized in controlled and uncontrolled transactions. The CP method is ordinarily used in cases involving the manufacture, assembly or other production of goods that are sold to related parties.

D. Unspecified Methods

Where none of the previously discussed methods can reasonably be applied, another method may be used to determine the arm's length price.

E. Coordination with Intangible Property Rules

The regulations provide guidance to taxpayers in determining transfer prices for tangible goods with intangible property "embedded" in them. According to the regulations, the arm's length price for the transfer of tangible property with an embedded intangible

should ordinarily be determined under the rules for tangible goods. However, if the controlled purchaser acquires rights to exploit the intangible beyond normal commercial practices associated with the resale of the product, an arm's length price for the intangible may need to be determined separately from the tangible property under the rules for transfers of intangible property. In the ordinary situation, however, an embedded intangible must be accounted for in the evaluation of the comparables.

V. Methods for Transfers of Intangible Property

A. Overview

If an owner of the rights to exploit an intangible transfers such rights to a controlled taxpayer, the owner must receive an arm's length consideration. An "intangible" is defined as an asset that has substantial value independent of the services of any individual, including: (i) patents, inventions, formulae, processes, designs, patterns or know-how; (ii) copyrights and literary, musical or artistic compositions; (iii) trademarks, trade names, or brand names; (iv) franchises, licenses, or contracts; (v) methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists or technical data; and (vi) other similar items that derive value from their intellectual content or other intangible properties, not from their physical attributes. The owner of a particular intangible is either the legal owner of the right to exploit the intangible if the intangible is legally protected, or the developer of the intangible if the intangible is not legally protected. However, if the owner received assistance (*e.g.*, loans, services, tangible or intangible property) in the development or enhancement of the intangible from a related party, then such related party may be entitled to an arm's length consideration for such assistance.

The arm's length amount to be charged for the use of intangible property may be determined under one of the following four methods: the comparable uncontrolled transaction method, the CPM, the PS and an unspecified method.

B. Comparable Uncontrolled Transaction (CUT) Method

The CUT method evaluates whether the amount charged for a controlled transfer of intangible property was arm's length by reference to the amount charged in a comparable uncontrolled transaction. For purposes of applying the CUT method, comparable intangible property must be used in connection with similar products or processes, within the same general industry or market, and have similar profit potential. Like the CUP method, the CUT method will generally provide the most reliable measure of an arm's length result is sufficient comparables are available.

C. Unspecified Methods

When none of the specified methods can reasonably be applied, an unspecified method may be used.

D. Implementation of the Commensurate with Income Standard - Periodic Adjustments

1. In General

If an intangible is transferred under a multi-year arrangement, the consideration charged in each year may be subject to adjustment to ensure that it is commensurate with the income attributable to the intangible. Such adjustment shall be made in accordance with the arm's length standard under the rules previously discussed.

2. Exceptions

No allocation will be made if:

- The controlled taxpayers entered into a written agreement that provided for an amount of consideration for each year and the agreement remained in effect for the taxable year under review;
- The consideration was an arm's length amount for the first year in which substantial periodic consideration was required to be paid, and supporting documentation was prepared at the time the agreement was entered into;
- There have been no substantial changes in the functions performed by the transferee since the agreement was executed, except changes that were not foreseeable; and
- The total profits actually earned or cost savings realized by the controlled taxpayer from the exploitation of the intangible in the year under examination and all past years is between 80 and 120% of the profits or cost savings that were foreseeable at the time of the agreement.

No adjustment is required if the taxpayers fail to meet the requirements of this exception solely because actual profits fall outside a band ranging from 80 to 120% of projected profits, or if the variation is caused by events that could not have been reasonably anticipated or known at the time the controlled agreement was entered into. In addition, for licenses for longer than five years, no periodic adjustments will be required after the fifth year if no adjustments were required during the first five years.

VI. Comparable Profits Method

The CPM evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances.

A reliable application of CPM requires the selection of a profit level indicator that will produce the most reliable measure of income that the tested party would have earned had it dealt with the related party at arm's length. Profit level indicators that may be used are: (i) the return on operating assets (ROA), and (ii) financial ratios that measure relationships between profit and costs or sales revenue, such as, but not limited to, the

operating margin or the Berry ratio.[20] The profit level indicators for CPM should be derived from a sufficient number of years of data to reasonably measure returns that accrue to uncontrolled comparables. Generally, a three-year period, encompassing the taxable year under review and the preceding two taxable years, is sufficient. Profit level indicators based on a taxpayer's internal data (*e.g.*, data from its other divisions) cannot be used. Furthermore, the profit level indicators should be applied solely to the tested party's financial data that is related to the controlled transactions.

The three profit level indicators identified in the regulations as reliable can be explained as follows:

Return on Operating Assets (ROA)

ROA is equal to operating profit divided by operating assets. Operating assets are defined as accounting-adjusted total assets minus investments, such as those in subsidiaries and tradable and non-tradable securities. Because the relationship between profit and operating assets is generally less affected by functional differences than the relationships between profit and sales or expenses, the regulations require lower functional comparability between the tested party and comparable companies than for an analysis using one of the other financial ratios.

Operating Margin

Operating margin is equal to operating profit divided by net sales. The operating margin is generally more sensitive to functional differences between the tested party and the comparables than ROA because such differences have a greater effect on the relationship between profit and sales than on that between profit and assets employed. Further, the reliability of the operating margin is reduced if the companies analyzed have different asset intensities (*i.e.,* if they employ different levels of assets to generate a dollar of sales).

Berry Ratio

The Berry ratio is equal to gross profit divided by operating expenses. According to the regulations, the Berry ratio is more sensitive than the ROA to functional differences between the tested party and the comparables, and its reliability is also lessened by differences in the level of capital employed relative to operating expenses. Further, this profit level indicator is very sensitive to differences in the classification of costs into costs of goods sold and operating expenses. In instances where the income statement reflects more accurately the functions and risks of the business analyzed than the balance sheet, the Berry ratio may be more accurate than the ROA.

[20] In a recent article, one commentator has suggested that in some circumstances the return on assets method is more reliable than either of the financial ratios. *See* Clark, R., "Choosing a Reliable Profit Level Indicator," 5 *Tax Mgmt Transfer Pricing Rpt* 807 (4/9/97).

Overall, the degree of functional comparability required to obtain a reliable result under the CPM is generally less than that required under the resale price or cost plus methods. However, because operating profits may be affected by varying cost structures (as reflected, for example, in the age of plant and equipment), differences in business experience (such as whether the business is in a start-up phase or is mature), or differences in management efficiency, these factors are more important in evaluating comparability under this method.

VII. Profit Split Method

The PSM compares the allocation of the combined operating profit or loss attributable to controlled transactions to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss. The allocation should correspond to the division of profit or loss in an uncontrolled transaction, where each party performs functions similar to those of the controlled taxpayers. The profit allocated to any particular member of a controlled group is not necessarily limited to the total operating profit of the group from the relevant business activity. Thus, in a given year, one member of the group may earn a profit while another member incurs a loss.

A. Comparable Profit Split

The comparable profit split method divides the total operating income of the transacting controlled taxpayers in a manner that is consistent with the manner in which comparable uncontrolled taxpayers divide their operating income in similar transactions. Reliable results under the comparable profit split method depend on a strong similarity between the contractual terms of the controlled and uncontrolled taxpayers. In addition, the comparable profit split may not be used if the combined operating profit (as a percentage of the combined assets) of the uncontrolled comparables varies significantly from that earned by the controlled taxpayers. As a practical matter, the comparable profit split method is most appropriate when there is very little difference between the tested party and the comparables, particularly regarding the existence of intangibles. Where the impact of intangibles on the transaction is minimal, the comparable profit split is preferable to the residual profit split.

B. Residual Profit Split

Under the residual profit split method, the combined operating profit or loss from the relevant business activity is allocated between the controlled taxpayers according to a two-step process. The first step allocates an arm's length return to each party to the controlled transactions for its routine contributions to the transaction. Routine contributions ordinarily include contributions of tangible property, services, and intangibles that are generally owned by uncontrolled taxpayers engaged in similar activities. Arm's length returns for the routine contributions are determined by reference to the returns achieved by uncontrolled taxpayers engaged in similar activities.

The second step comes into play where the controlled group owns valuable intangible property and similar property is not owned by the uncontrolled taxpayers. In cases where such intangibles are present, there nominally will be an unallocated residual profit, which should be divided among the controlled taxpayers based upon the relative value of their contributions of intangible property that were not accounted for as routine contributions. Market benchmarks that reflect the fair market value of such intangible property may be used to split this residual between the controlled taxpayers. Alternatively, the relative value of intangible contributions may be estimated by the capitalized cost of developing the intangibles and all related improvements and updates, less an appropriate amount of amortization based on the useful life of each intangible. Finally, if the intangible development expenditures of the parties are relatively constant over time and the useful life of the intangible property of all parties is approximately the same, the amount of actual expenditures in recent years may be used to estimate the relative value of intangible contributions.

VIII. Cost Sharing Arrangements

A. In General

Despite the addition of the "commensurate with income" standard to section 482 in 1986, the Conference Committee report to the 1986 Act made it clear that the change was not intended to preclude the common practice of related parties entering into bona fide research and development cost sharing arrangements for the development of intangibles.

The report stated, however, that for cost sharing arrangements to be consistent with the "commensurate with income" standard, a participant should be expected to bear its portion of all research and development costs, the allocation of costs generally should be proportionate to profit as determined before deduction for research and development, and to the extent one participant begins funding R&D at a much earlier point in time than another participant, that participant should receive an appropriate return on its investment.

B. Definitions

1 Cost Sharing Arrangement

A cost sharing arrangement is an agreement under which the parties agree to share the costs of development of one or more intangibles in proportion to their shares of reasonably anticipated benefits from their individual exploitation of the interests in the intangibles assigned to them under the arrangement. In order not to be subject to allocations under section 482, the cost sharing arrangement must be a "qualified cost sharing arrangement."

2 Qualified Cost Sharing Arrangement

A qualified cost sharing arrangement must: (1) include two or more participants; (2) provide a method to calculate each controlled participant's share of intangible development costs, based on factors that reflect that participant's expected benefits; (3)

provide for adjustment to the controlled participants' shares of intangible development costs to account for changes in economic conditions, the business operation or practices of the participants, and the ongoing development of intangibles under the arrangement; and (4) be recorded in a contemporaneous document that spells out all the terms and conditions of the arrangement.

3 Participant

A participant to a qualified cost sharing arrangement can be either a controlled taxpayer that meets certain conditions (a controlled participant) or an uncontrolled taxpayer that is a party to the cost sharing arrangement (uncontrolled participant).

4 Controlled Participant

A controlled taxpayer can be a controlled participant only if it: (1) reasonably anticipates that it will derive benefits from the use of the covered intangibles; (2) substantially complies with the accounting requirements of the cost sharing regulations; and (3) substantially complies with the administrative requirements of the cost sharing regulations.

5 Controlled Taxpayer that is not a Controlled Participant

If the activity of the cost sharing arrangement is carried out through another controlled taxpayer, who does not meet the definition of a controlled participant, that taxpayer must receive consideration from the controlled participants, which is treated as an operating expense.

6 Benefits

Benefits are defined as the additional income generated or costs saved by the use of covered intangibles.

7 Reasonably Anticipated Benefits

Reasonably anticipated benefits are defined as the aggregate benefits that a controlled participant reasonably anticipates it will derive from covered intangibles.

C. Intangible Development Costs

A controlled participant's intangible development costs include all the costs incurred by the participant related to the intangible development area, plus all the cost sharing payments made to other participants, minus all of the cost sharing payments it receives from other participants. Intangible development costs consist of the following items:

- Operating expenses, other than depreciation or amortization expenses; and
- The charge for the use of any tangible property made available to the qualified cost sharing arrangement.

Intangible development costs do not include the consideration for the use of any intangible property made available to the qualified cost sharing arrangement. If a

particular cost contributes to the intangible development area and other areas or business activities, the cost must be allocated between the activities on a reasonable basis. Costs that do not contribute to the intangible development area are not taken into account.

D. Cost Allocations

To determine whether a cost allocation included in a qualified cost sharing arrangement is appropriate for a taxable year, a controlled participant's share of intangible development costs for the taxable year must be compared to its share of reasonably anticipated benefits under the arrangement. In determining whether benefits were reasonably anticipated, it may be appropriate to compare actual benefits to anticipated benefits.

E. Buy-In/Buy-Out Payments

When a controlled participant makes intangible property available to a qualified cost sharing arrangement, it is treated as having transferred interests in such property to the other controlled participants, who must make buy-in payments in return for the transferred interests. Buy-in (or buy-out, as the case may be) payments are also required when there is any change in the controlled participants' interests in covered intangibles, either by reason of the entry of a new participant, or by reason of transfer of interests among existing participants. The buy-in payment is the arm's length charge for the use of the intangible under the general rules applicable to transfers of intangible property.

F. Character of Payments Made and Administrative Requirements for Qualified Cost Sharing Arrangements

Payments made under a qualified cost sharing arrangement (other than buy-in and buy-out payments) generally are considered costs of developing intangibles of the payor and reimbursements of the same kind of costs to the payee.

1 Documentation

All controlled participants to a qualified cost sharing arrangement must maintain sufficient documentation to establish that it has met the requirements of the regulations, and must provide such documentation to the Service within 30 days of a request.

2 Reporting Requirements

A controlled participant must attach a statement to its U.S. tax return or, if it is not obligated to file a U.S. tax return, to Schedule M of any Form 5471 or to any Form 5472 filed with respect to the participant. The statement must indicate that the filer is a participant in a qualified cost sharing arrangement and must identify the other controlled participants in the arrangement.

IX. Penalties and Recordkeeping

Section 6662 and Contemporaneous Documentation

1 Overview

Section 6662(e) and (h) sets forth penalties of 20 and 40% for certain increases in U.S. income tax attributable to section 482 adjustments. One significant objective of the so-called transfer pricing penalty was to improve taxpayer compliance with the arm's length standard by encouraging (some might say forcing) taxpayers to make reasonable efforts to determine and document arm's length prices for their intercompany transactions. However, the penalty will not apply to the extent that the taxpayer complies with specified contemporaneous documentation requirements.

2 Specified Method Exclusion

Under the specified method exclusion, adjustments are excluded from the net section 482 adjustment calculation if the taxpayer uses one of the transfer pricing methods enumerated in the section 482 regulations in a reasonable manner. The use of a specified method is reasonable only if the taxpayer concluded that it provided the "most reliable measure of an arm's length result under the principles of the best method rule." Whether the taxpayer's use of a particular method was reasonable is determined from all facts and circumstances.

3 Contemporaneous Documentation

In addition, a taxpayer can avoid the imposition of the transfer pricing penalty only if contemporaneous documentation is created by the time the taxpayer files its return for each specific year.

There are two categories of documentation that a taxpayer must maintain -- principal documents and background documents. The principal documents must include:

(1) An overview of the taxpayer's business, including an analysis of the economic and legal factors affecting pricing;

(2) A description of the taxpayer's organizational structure covering all related parties engaged in transactions potentially relevant under section 482;

(3) Any documentation specifically required by the section 482 regulations (*e.g.*, documents related to a qualified cost sharing arrangement);

(4) A description of the method selected and an explanation of why that method was selected;

(5) A description of the alternative methods that were considered and an explanation of why they were not selected;

(6) A description of controlled transactions and any internal data used to analyze those transactions;

(7) A description of the comparables that were used, how comparability was evaluated, and what adjustments (if any) were made;
(8) An explanation of the economic analysis and projections relied upon in developing the method;
(9) A description or summary of any relevant data obtained after the end of the tax year and before filing a tax return; and
(10) A general index of the principal and background documents and a description of the record keeping system used for cataloguing and accessing those documents.

The background documents, which support the assumptions, conclusions, and positions contained in the principal documents, may include the documents required under the section 6038A regulations, such as original entry books and records and profit and loss statements, another documents not specifically listed in either set of regulations, which the Service determines are necessary to establish that the taxpayer's method was selected and applied in a way that provided the most reliable measure of an arm's length result.

X. Competent Authority

A. In General

The United States and most of its trading partners maintain an extensive network of tax treaties, the stated purposes of which are to eliminate double taxation and prevent tax evasion. In situations where the application of United States and foreign tax laws would result in the taxpayer being subject to double taxation, a taxpayer may invoke a tax treaty's mutual assistance procedure to request relief from double taxation. The application of domestic transfer pricing laws fall under tax treaty jurisdiction pursuant to the "Associated Enterprises" articles contained in the various treaties. Generally, the "Associated Enterprises" provision allows the tax authority of one country to include in the income of one of its taxpayers the income of a related party located in another country if the two parties did not act at arm's length. Because unilateral transfer pricing adjustments will always result in double taxation, taxpayers may request competent authority assistance under the treaty's mutual assistance procedure whenever they are subject to a transfer pricing adjustment.

Once a taxpayer's request for relief is accepted, the competent authorities of both treaty countries will attempt to reach a settlement that eliminates double taxation through the mutual attribution of income, deductions, credits, or allowances between related taxpayers.

B. U.S. Competent Authority

A U.S. taxpayer's request for competent authority assistance must comply with Revenue Procedure 96-13. A request for competent authority assistance may be filed under the following circumstances:

- U.S. initiated adjustment: upon receipt of a proposed adjustment in writing;
- Foreign initiated adjustment: As soon as the taxpayer believes that such filing is warranted based on the actions of the country proposing an adjustment; and
- Transfer pricing related adjustment: when the taxpayer can establish that there is a probability of double taxation.

A request for competent authority assistance is made in the form of a letter addressed to the Assistant Commissioner (International) and must include a detailed statement of the relevant facts and a description of the relief requested. Once a taxpayer's request for assistance is granted, there is a substantial likelihood that its case will be resolved favorably. Historically, 95% of U.S. competent authority cases are resolved with either 100% or partial relief from double taxation.

XI. Advance Pricing Agreements

A. In General

The negotiation and execution of a bilateral or multilateral APA is the only way for a taxpayer to obtain prospective relief from double taxation. An APA is a binding, written contract between the taxpayer, the IRS, and, in the case of a bilateral APA, a foreign tax authority. In an APA, the parties agree on the best transfer pricing methodology (TPM) for determining the arm's length price for certain covered transactions and the proper application of such method to the taxpayer's particular facts and circumstances. Once an APA is finalized and executed by the parties, the IRS (and the foreign tax authority for a bilateral APA) will regard the results of applying the TPM as satisfying the arm's length standard provided the taxpayer complies with its terms. The duration of an APA is typically from three to five years, and can be renewed in future years. An APA can also be applied to previous years ("rolled back") in certain circumstances.

B. Procedure for Requesting an APA

1 Traditional APAs

The IRS's current procedures for requesting an APA are published in Revenue Procedure 96-53. In general, a taxpayer requesting an APA is required to submit to the APA staff a detailed factual analysis of the covered transactions and economic analysis of the proposed and alternative transfer pricing methodologies. The taxpayer must also pay a user fee with the filing of its APA request, the amount of which ranges from $5,000 to $25,000 depending on the size of the taxpayer.

2 SBT APAs

In 1998, the IRS addressed taxpayers concerns about time and expense in obtaining an APA by issuing procedures for small business taxpayers to obtain an APA that will be

negotiated under a streamlined process. The SBT APA program is designed to allow eligible taxpayers to obtain the compliance certainty of an APA at a cost that is reasonable relative to the size and complexity of the transactions involved. The SBT APA program is generally available to taxpayers with gross income of less than $200 million, determined by aggregating the worldwide gross income of all of the controlled entities (the “gross income test”). In addition, taxpayers that do not meet the gross income test may apply for the SBT APA program, on a case-by-case basis, if the transactions that are the subject of the APA (the “covered transactions”) involve either: (1) the transfer of tangible property or the provision of services valued at not more than $50 million per year, or (2) the transfer of intangible property for consideration not exceeding $10 million per year (the “small transactions test”). However, taxpayers engaging in intercompany transactions involving non-routine intangibles, including research and development cost sharing agreements, will generally not be eligible for the SBT APA program, regardless of whether they otherwise qualify, due to the complexity of valuing such intangibles.

CHAPTER 6: VENEZUELA

I. History of Transfer Pricing

Venezuela enacted its transfer pricing statute in October 1999, becoming the latest Latin American country to introduce rules regulating the pricing of transactions between related parties[21]. At the time of preparation of this report the regulations are still in draft format.

II. Legislation and Regulations

The Venezuelan transfer pricing rules focus primarily on import and export transactions of tangible property, although certain rules target interest charges between related parties. Royalties, technical assistance fees and technological service fees are specifically excluded from the transfer pricing legislation since these types of payments are covered by other provisions that limit the amount that may be deducted. In this respect, the Venezuelan transfer pricing rules resemble the rules in Brazil.

Following the trend in Latin America (*e.g.,* Argentina, Brazil and to some extent Mexico), Venezuela has adopted diverse and complex attribution rules in terms of indirect and family relationships. The legislation includes safe harbors in manner similar to that of Brazil as well as the arm's length standard similar to that of Mexico.

The preface to reform states that the legislation aims to address two main issues:

- The manipulation of prices between members of multinational groups of enterprises through the artificial transfer of profits from a high-tax country to a low or no-tax country; and

- The artificial transfer of profits by multinational groups of enterprises from profitable companies in the group to other group companies with tax losses.

A. Definition of Related Parties

The provisions determining related party status are very broad. Parties may be deemed related under the Venezuelan rules in situations where those parties would not be deemed

[21] Until the year 2000, Venezuela operated a territorial tax system, whereby residents of Venezuela are taxed only on their Venezuelan-source income. The country moves to a worldwide system of taxation as from January 1, 2001. The territorial principle of taxation is counter to the general spirit underlying transfer pricing legislation in that transfer pricing rules are founded on a worldwide system of taxation and a requirement that transfer pricing principles are observed to distribute the taxation of income among associated enterprises according to the arm's length standard.

related under the related party definitions used in most OECD countries. Businesses are deemed to be related in a variety of circumstances:

- Through a relationship with a legal entity domiciled in Venezuela;
- Through a relationship with a permanent establishment in Venezuela; or
- Through a relationship with a fixed base in Venezuela.

The transfer pricing law contains three types of attribution: attribution based on legal structure, family relationship and on both family relationship and legal structure.

1 Attribution Based on Legal Structure

The transfer pricing relationship applies between a Venezuelan entity and a parent company that is domiciled outside Venezuela or a brother/sister company or subsidiary that is domiciled outside Venezuela. A legal entity or resident domiciled outside Venezuela may be treated as a related entity when its participation in the Venezuelan company qualifies the business as controlling or controlled.

The relationship between the parties can be direct or indirect. A legal entity domiciled outside Venezuela falls within the transfer pricing rules when a party and the Venezuelan business domiciled in Venezuela are controlled by the same entity or by common administration. Indirect relationship status may apply to an individual or legal entity, whether resident or domiciled outside Venezuela. This person could be considered controlling or related if it, together with or separately from a legal entity domiciled in Venezuela, has any interest in a third company.

A related party also includes entities, such as partnerships and associations, whether through a consortium, joint venture or otherwise, that engage in business activities.

Entities are deemed to be related when one controls the other, directly or indirectly, by owning more than 50 percent of the voting stock, or having the ability to control the administration. Two or more legal entities or individuals are considered related when one participates directly or indirectly in the administration, control or capital of the other party, or when a person or group of persons participates directly or indirectly in the administration, control or capital of the other party. An entity will be considered a controlling entity when it has more than 50 percent of the voting stock, holding this power directly or indirectly or in combination, in a controlling entity or an entity that has the right to elect the majority of the administrators of the controlled entity. The indirect holding includes an entity that has control through an intermediary of another or though other entities, which in turn are controlling.

2 Attribution Based on Family Relationship

Unlike transfer pricing laws in other jurisdictions, the Venezuelan rules focus primarily on family relationships to establish ownership and control. Entities are considered related

if business is conducted among diverse relatives. A transaction is deemed to be between related parties if a taxpayer conducts business with an individual related by blood or marriage (to within the third degree). A Venezuelan individual has an obligation to know of all of his/her great grandmother's children, grandchildren and great grandchildren, and the same requirement applies to the spouse's family. The Venezuelan tax authorities conceivably could require the taxpayer or his/her spouse to provide the taxpayer family tree for four generations.

The transfer pricing rules may apply to an individual who resides outside Venezuela if that individual is related by blood or affinity to the third degree to directors, administrators, partners or shareholders of the business, or who is a spouse of any of such directors, administrators, partners or shareholders. If that nonresident person directly or indirectly exercises control over the business, he/she falls within the purview of Venezuela's transfer pricing statute.

Transactions between an entity and an individual are considered related if an individual is a spouse of any administrator, director, manager or shareholder who directly or indirectly controls an entity.

3 Attribution Based on Both Family Relationship and Legal Structure

Venezuela's transfer pricing rules include a legal entity or individual, whether resident or domiciled outside Venezuela, that is the exclusive agent, distributor, licensee, donee or concessionaire for the purchase or sale of goods, services or rights. Similarly, the rules include a legal entity or individual, whether resident or domiciled outside Venezuela, that has a relationship with a legal entity domiciled in Venezuela and that is the exclusive agent, distributor, licensee or concessionaire for the purchase and sale of goods, services or rights.

Parties are considered related if the foreign entity has control over the domestic entity or if the foreign entity and the Venezuelan entity are subject to the control or administration of the same foreign entity. Parties also are related if a foreign entity has, whether or not in conjunction with a Venezuelan entity, an interest in a third business that is controlling or related. A foreign entity that is a partner or associated with a consortium or other type of association that conducts business or activities with a Venezuelan entity will be treated as related.

4 Transactions with Low-Tax Jurisdictions

Additionally, Venezuela includes a rebuttable presumption that a Venezuelan entity conducting business with an entity in a low-tax or tax haven jurisdiction is conducting business with a related party. Unlike the rules in Argentina, the Venezuelan statute does not define "low-tax jurisdiction." Nevertheless, based on other sections of the tax reform, it is anticipated that the Venezuelan tax authorities will publish a list of countries considered low-tax jurisdictions following Mexico's practice.

B. Transfer Pricing Methodologies

Venezuela's transfer pricing rules are unique in that they specifically target only import and export transactions between a Venezuelan person and a related party. Specific transfer pricing provisions apply to imports from foreign affiliates or from operations conducted between related parties and to income from export activities between related parties. As mentioned above, the transfer pricing methods apply only to tangible property transactions and not to royalties, technical assistance and technology services, which are subject to the deductibility rules in the Income Tax Law.

1 Methodologies for Import Transactions

Taxpayers may use the following methods in computing an arm's length price for import transactions: CUP, RP, production cost method[22] and transactional operating profit margin method (TOPMM).[23] Costs and deductions are taken into account for income tax purposes up to the import value, as determined under one of these methods. The importer may not deduct as a business expense amounts paid in excess of the import value.

Although the preamble to the reform states that the transactional operating profit margin method is a method of last resort, the legislation does not include specific language to that effect. Similar to Brazil, the statute permits the importer to use the four methodologies but permits the importer to select the highest import price within these methodologies. An importing taxpayer may select the best method to increase the value of purchase deductions.[24] The law does not contain provisions for profit split methods.

a) Comparable Uncontrolled Price Method

The importer must determine the average price or cost in the open market as a comparison of its import cost. Import law concepts apply and the importer must determine the cost or price of "identical" or "similar" goods, services or rights and compute an average of these amounts. The importer may use either foreign or domestic markets taking payment financing into account. Allowing price averaging for comparison of controlled and uncontrolled transactions poses an additional deviation from the approach recommended in the OECD Guidelines, according to which any uncontrolled price within a range is recognized as evidence of an arm's length result.[25]

---

[22] This method is equivalent to the CP method in the OECD Guidelines.

[23] Brazil does not accept any profit-based methods, so the transactional net profit margin method is not included in its transfer pricing rules.

[24] The same principle applies to exports since taxpayers may apply the lowest export price computed under the four methods.

[25] The use of averages is general for all Venezuelan methods.

b) Resale Price Method

The importer determines the average resale price of the goods, services or rights after reducing the resale price by the following amounts: unconditional discounts, sales tax commissions, brokerage costs and factoring expenses, and a markup calculated on the resale price.

The legislation does not permit the importer to determine the markup – this is calculated by the Venezuelan tax authorities. The authorities will accept a different markup if the taxpayer proves the markup with publications, report or official bulletins.

Conceptually, the RP method provides the mechanism for establishing a resale price, which is typically an unrelated party transaction. Under the OECD Guidelines, however, the RP method begins with the price at which a product that has been acquired from a related party is resold to a third party, and is then reduced by an appropriate gross margin. Unlike the Venezuelan rules, that require the computation of the resale price, the OECD methodology seeks a determination of an arm's length price for the original transfer of property between the related parties. The same inconsistency of the method is also found in the Brazilian legislation.

c) Production Cost Method

The importer uses the average cost of goods, services or rights, regardless of whether these amounts are "identical" or "similar" under import law concepts. The amounts are determined in the country where the goods, services or rights would have been originally produced. The importer adds the export tax at the country of origin and a markup calculated on the cost as determined.

Venezuelan law does not determine how the cost-plus markup is to be determined, and the tax authorities reserve the power to calculate the cost-plus markup. However, as with the RP method, the tax authorities will accept a different cost-plus markup if the taxpayer proves the markup with publications, reports or official bulletins.

d) Transactional Operating Profit Margin Method

The TOPMM determines the profit of transactions between related companies. Arm's length profitability is obtained by comparable businesses or independent parties in comparable operations and activities. Earnings profitability takes into account variables such as assets, sales, costs, expenses or currency fluctuations. Unlike other countries, the TOPMM in Venezuela is not a method of last resort and can be chosen as the appropriate method without the taxpayer demonstrating that no other method was feasible.

2 Implementing Import Transfer Pricing

As mentioned above, the Venezuelan tax authorities determine the markup for the RP and production cost methods. That is not the case, however, when determining the allowable

profits under the TOPMM. The importer can use the highest amount as a deduction if more than one method applies, but the actual cost of the import limits the deduction.

The actual cost rule applies even if the price calculated by the transfer pricing methods is higher than the cost of acquiring the imports, as evidenced by import documentation. Costs and expenses exceeding this amount are non-deductible. The tax authorities reserve the power to unilaterally determine resale gross profit margins and gross cost plus margins based on the type of activity or conduct under consideration. The authorities may rely on official bulletins or other technical reports to determine the markup.

Specific requirements apply to transfer pricing methods. The CUP rules apply only to purchase and sales activities between unrelated parties. In applying the RP method, the importer may consider only transactions with unrelated buyers. In determining deductibility, the relevant costs include the cost of transportation and insurance paid by the importer as well as import duties. Excessive costs and deductions are taken into account by adding these to gross income in determining taxable income. Depreciation deductions or the amortization of assets are limited to the amount determined under the transfer pricing methods for each fiscal accounting period.

The transfer pricing legislation requires the use of averages. Prices determined under the CUP and the RP methods and costs determined under the production cost method are to be averages based on events in the fiscal period. This approach does not seem to adequately take into account inflation and devaluation of the Venezuelan currency, the Bolivar.

3 Methodologies for Export Transactions

Income derived by an exporter is subject to specified transfer pricing rules when the average sales price of exported goods, services or rights falls below 90% of the average price of the sales of the same goods, services or rights of unrelated parties. The average price is applied to the sales of the same goods, services or rights between unrelated parties in the domestic market during the same period and with similar methods of payment financing. If the exporter is unable to determine the average price in the Venezuelan domestic market, the exporter may use the average price of the sales of similar goods, services or rights between unrelated parties in the destination market during the same fiscal period and under similar methods of payment financing.

If the exporter's sales price fails to meet the 90% test, the exporter must determine its income by using one of the five official transfer pricing methods designated for exports. The permitted methodologies are as follows:

- Average Export Sales Price Method
- Wholesale Sales Price Method
- Retail Sales Price Method
- Production Cost Method Plus Profits
- TOPMM

The transfer price is determined based on comparables. If an exporter does not have sales operations in the Venezuelan domestic market, the exporter must apply the average prices used by other businesses that sell identical or similar same goods, services or rights in or to the domestic market. The transfer pricing rules determine the comparable for export purposes, requiring the exporter to make the following adjustments:

- Exclude sales tax and unconditional discounts in the domestic market in determining the sales price; and
- Include transportation and insurance in determining the sales price.

a) Average Export Sales Price Method

This method is the company's average sale price for other customers or another domestic exporter with identical or similar goods, services or rights.

b) Wholesale Sales Price Method

This method is based on sales to the country of destination less the wholesaler's profits, *i.e.*, the wholesale sales price is the average price of the goods, services or rights in the wholesale market in the country of destination. The wholesale sales price is based on similar payment conditions and is calculated by subtracting the sales tax included in the country of destination and subtracting a profit margin on the wholesaler's sales price. The Venezuelan tax authorities may establish this profit margin by issuing administrative regulations.

c) Retail Sales Price Method

The RP method is based on sales to the country of destination less the retailer's profits. The retail sales price is the average price of identical or similar goods sold in the country of destination. The tax authorities apply payment factors analogous to the wholesale sales price by subtracting the sales tax of the country of destination and the profit margin from the retail price. The tax authorities may establish this profit margin by issuing administrative regulations.

d) Production Cost Method Plus Profits Method

The Venezuelan tax administration may determine export sales income through the purchase price plus profits or production price plus profits method. This method consists of determining the average purchase or production price of the exported goods, services or rights, plus adjustments. The tax administration, through administrative regulations, is to add the taxes imposed on the sales activity by either country and add a profit margin based on the sum of the costs and taxes.

e) Transactional Operating Profit Margin Method

The TOPMM permits the taxpayer to determine the profitability that would have been obtained by comparable businesses or by unrelated parties in similar situations. This comparison could take into account factors such as profits that are based on other factors such as assets, costs, expenses or currency fluctuation.

4 Implementing Export Transfer Pricing

If more than one transfer pricing method is used, the lowest amount applies without impacting other transfer pricing rules. The cost of goods sold takes priority if the price calculated on the basis of any one of the methods established is less than the cost of goods sold as stated in the export documents. If the export price exceeds the value as stated in the documents of the business, that portion should be added to the gross income for purposes of determining taxable income. Export amounts are calculated in relation to the Venezuelan company's financial period.

5 Information Gathering

As noted above, Venezuelan law allows taxpayers to use various sources of information to support their transfer prices. Costs, average prices and profit margins are to be determined by taking into account the following:

- Official publications and bulletins, issued by a domestic or foreign recognized institution, of the buyer’s and seller’s countries. Declarations by the tax authorities may be used if that country has concluded a double tax treaty with Venezuela that provides for the exchange of fiscal information.

- Trade data collected by recognized companies or technical institutions, or technical publications that are specific to the relevant industry. This type of information must specify the period it relates to, companies included, etc.

The aforementioned information and data are considered evidence only if created according to internationally accepted standards and if they refer to the same fiscal period as the Venezuelan company reviewed. The Venezuelan tax authorities can disregard technical publications, reports or bulletins if considered unsuitable or inconsistent.

As is the case in other Latin American countries where public data of comparable transactions is scarce, the Venezuelan tax authorities seem to allow the use of foreign comparables provided corresponding economic adjustments can be made.

6 Interest Charges

The Venezuelan transfer pricing legislation reflects to some extent the reality of inflation and currency devaluation in the country. Interest paid or credited between related parties is deductible only for the purpose of determining taxable income up to the amount that does not exceed the value calculated based on Libor rates to deposit U.S. dollars for a

period of six months, increased by the annual percentage proportionate to the period to which the interest refers. The Venezuela tax authorities determine this percentage based on information from the Central Bank.

Interest is calculated based on the value of the debt or the rights expressed in the currency stated in the contract and converted into Venezuelan currency according to the exchange rate on the date of the final terms of the calculation of interest, in conformity with the publications of the Central Bank. Excess interest is not deductible. The value that exceeds the limit established in the law and profit determined according to rules in the preceding paragraph are added to the taxable income base.

C. Documentation Requirements

Although taxpayers are not required in the transfer pricing legislation to provide documentation, under the Income Tax Law, taxpayers must maintain documentation to prove that income, expenses and deductions from operations with related parties comply with arm's length principle by the filing date of the annual income tax return. Taxpayers must provide all information, reports, bulletins, publications, etc. requested by the tax authorities in the course of a direct audit. The tax authorities will accept that information if it was prepared in accordance with internationally accepted methods provided it refers to the same tax period as the Venezuelan company.

Although no specific categories of documentation are set forth, it is recommended that documentation follow OECD guidelines and include a business overview, organizational structure, method selected, analysis of controlled transactions, identity of comparables, and an economic analysis.

D. Penalty Provisions

There are no specific penalty provisions applicable to transfer pricing. However, Income Tax Act, Article 97 provides for a penalty of 10% to 200% of the unpaid tax and Article 59 establishes interest charges based on the maximum rate for loans in Venezuelan banks, plus 3%.

III. Tax Treaties, MAP and Competent Authority

Venezuela has concluded tax treaties with the following countries:

- Belgium
- Czech Republic
- France
- Germany
- Italy
- Mexico
- Netherlands
- Norway

- Portugal
- Sweden
- Switzerland
- Trinidad and Tobago
- United Kingdom
- United States

These treaties contain a MAP similar to that in Article 25 of the OECD Model Tax Convention, as well the provisions applicable to transfer pricing. However, the latter provisions are not identical to the OECD model, but were adapted to accommodate the circumstances of each country.

Venezuela also has signed a multilateral treaty, the Cartagena Agreement, with Bolivia, Colombia, Chile, Ecuador and Peru. This convention does not follow the OECD rules so it does not contain a MAP.

IV. Application (Best Practices and Methods)

A. Taxpayer Obligations

Taxpayers that carry out business activities with a foreign related party must use transfer pricing methods to determine their income, cost and deductions by the filing date of the annual income tax return. Taxpayers must provide all information, reports, books, records, etc. requested by the tax authorities in the course of a direct audit.

B. Tax Administration

The *SENIAT* is the government agency responsible for determining and collecting tax contributions and enforcing rules related to taxation.

C. Examinations, Dispute Resolution, APAs

Because transfer pricing rules are a relatively new initiative in Venezuela, the tax authorities have had no practical experience with transfer pricing audits. In fact, the SENIAT has not yet determined which authorities will be competent to conduct audits. Based on current legislation APAs are not admissible under Venezuelan rules.

D. Compliance With OECD Guidelines

As mentioned in the OECD overview, the OECD has recommended that its member countries adhere to the transfer pricing guidelines.

The Venezuelan transfer pricing rules fully incorporate the concept of the arm's length principle and contain basic guidance for taxpayers to comply with that principle. Venezuela has adopted transactional method with some modifications. An analysis of the

Venezuelan transactional methods leads to the conclusion that they are the same methods as in the OECD Guideline but with different names.

Venezuela has safe harbors rules similar to Brazil's, where the tax authorities will determine margins depending on the sector or economic activity. Safe harbors are not recommended in the OECD Guidelines.

Venezuelan transfer pricing rules cover services within the methods for imports and exports; interest charges are covered under a separate provision. Venezuelan law does not deal with the transfer of intangible property and does not authorize cost contribution arrangements between two or more associated enterprises.

V. Conclusions and Recommendations for Improvement

The preface to the reform introducing the transfer pricing rules states that the tax administration, for purposes of computing the statutory margins for the import and export RP and cost plus methods, will take into consideration economic analysis by industry sector, branch of activity and based on the current economic situation. Adjustment will be allowed when the economic circumstances necessitate adjustment. This flexibility is different from the Brazilian rules, which provide fixed margins for all economic activities unless the taxpayer establishes a different margin with data from official publications or research carried out by a qualified firm.

The TOPMM is the only method where the taxpayer may set its transfer pricing under a genuine arm's length approach rather than utilizing the prescribed margins which are expected to be published by the tax administration under the criteria above mentioned.

APA provisions and cost sharing would complement the Venezuelan statute with the most recent tendencies in transfer pricing to avoid or mitigate double taxation.

Appendix

Latin America, United States and OECD Transfer Pricing Matrix

Country	TAX AUTHORITY & LAW	REGULATIONS, RULINGS, GUIDELINES
OECD	Not applicable	Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations [1]
Argentina	Argentina Tax Office (Administración Federal de Ingresos Públicos); Article 8, Article 15 and new article added after Article 15 of law 25,063 [Effective for transactions entered into after December 31, 1998]	General Resolution No. 702 issued by the Argentina Tax Office (Administración Federal de Ingresos Públicos) [2]
Brazil	Fedral Revenue Secretariat (Secretaria da Receita Federal-SRF); Ordinary Federal Law 9.430/96 [Effective Janaury 1, 1997], complemented by law 9959/99.	Regulatory Instructions No. 38/97 and No. 164/99 and Administrative Act No. 95/97. [3]
Mexico	Servicio de Administración Tributario (SAT); Income Tax Law Articles 58 (section XIV and XV), 64, 64-A, 65, 65-A, 66 and 74, Federal Fiscal Code Articles 21, 34-A, 37, 46, 48, 76 and 81. [Latest amendment effective January 1, 2000]	Annual Miscellaneous Tax Provisions.
United States	Internal Revenue Service (IRS); IRC & 482 [Latest amendment effective for tax years beginning after December 31, 1986]	Reg. & 1.482, Reg. & 1.6662-6 [4]
Venezuela	National Integrated Tax Service Administration (SENIAT); Article 112 through 117 on Chapter III of Income Tax Law [Effective January 1, 2000]	As of June 1, 2000, SENIAT is drafting the regulations.

1 **OECD:** Chapter I-V published July, 1995: Chaoter I - The Arm's Length Principle, Chaoter II - Traditional Transaction Methods, Chapter III - Other Methods, Chapter IV - Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes, Chapter V - Documentation. Chapter VI- VII published March, 1996: Chapter VI - Special Considerations for Intangible Property, Chapter VII -Special Considerations for Intra-Group Services, Chapter VII published October, 1997: Chapter VIII - Cost Sharing Guidelines.

2 **ARG:** Effective from January 1, 1999

3 **BRZ:** Effective with respect to inbound and outbound transactions with related parties carried out as of January 1, 1997.

4 **US:** Reg. & 1.482-1 through -7, transfer pricing regulations, effective for taxable years beginning after October 6, 1994, excep Reg. & 1.482-7, cost sharing regulations, effective for taxable years beginning on or after January 1, 1996. Prop. Reg. & 1.482-8, governing global dealing operations, issued on March 2, 1998, will be effective when made final. Reg. & 1.6662-6, transfer pricing penalty and documentation regulations, effective February 9, 1996.

Country	ACCEPTABLE METHODS	PRIORITY OF METHODS
OECD	CUP, Resale Price, Cost Plus, Profit Split (e.g. Contribution Analysis or Residual Analysis), TNMM.	Reasonable method. Transaction.based preferred over profit based
Argentina	CUP, Resale Price, Cost Plus, Profit Split, Residual Profit Split, TNMM	Best Method
Brazil	CUP, Resale Price (statutory margin on imports: 60% for raw materials and 20% for other imports; statutory margin on exports: 15% for wholesale and 30% for retail), Cost Plus (statutory margin on imports 20%, statutory margin on exports 15%).[5]	Method that yields lowest taxable income.
Mexico	CUP, Resale Price, Cost Plus, Profit Split, Residual Profit Split, TOPMM (Transactional Operating Profit Margin Method)	No priority
United States	CUP, Resale Price, Cost Plus, Comparable Profit Split, Residual Profit Split, CPM	Best Method
Venezuela	For tangible property: CUP, Resale Price, Cost Plus, TOPMM. For loans, interest should be six month Libor plus statutory margin. Royalties, technical assistance and technological services are excluded from transfer pricing regulations.	No priority

5 **BRZ:** Safe harbor exceptions available for exports only. Refer to Regulation Instruction No. 38/97 and Administrative Act No. 95/97 for further guidance.

Country	PENALTY ON TRANSFER PRICING ASSESSMENT	REDUCTION IN TRANSFER PRICING PENALTIES
OECD	Notes that civil monetary penalties are frequently calculated as a percentage of the tax understatement, with the percentage ranging from 10 to 200 percent.	Reduction notr specified. However, imposition of sizeable penalties deemed unfair if taxpayers make reasonable effort in good faith.
Argentina	No specific transfer pricing penalties. Additional tax subject to 3% monthly interest rate.	No provision
Brazil	Ordinary penalties apply based on additional tax; 75-150% if all documantation available; 112.5-225% if documantation and information is not provided to authorities upon request.	Upon examination and assessment, the taxpayer may be granted a reduction in penalties for uncontested payment.
Mexico	Ordinary penalties apply - 50% of tax deficiency if paid before notice of deficiency issued, 70 to 100% in other cases (Fedral Fiscal Code, Article 76) adjusted for inflation and interest.	50% reduction if transfer price documented.
United States	Transfer pricing penalty of 20 or 40% of additional tax for adjustments exceeding objective thresholds	No penalty if transfere pricing method reasonably applied and documented. Contemporaneous obligation.
Venezuela	No specific transfer pricing penalties. Interest and penalties on tax deficiency ranges from 10% to 200%.	No provision

Country	TAX RETURN DISCLOSURES	DOCUMENTATION REQUIREMENT (see Table 1 - Categories of Documentation Required)
OECD	Should be limited to information suffient to allow tax administration to determine which taxpayers need further examination.	Pricing decisions should be documented in accordance with prudent business practices. Reasonable for tax authorities to expect taxpayers to prepare and maintain such material. Information in Table 1 is neither minimum requirement nor exhaustive list. No contemporaneous obligation.
Argentina	Transaction with associated enterprises should be dicloses. Form 662 should be completed with annual return.	Contemporaneous documantation must demostrate prices with non-resident related parties are arm's length. Required documents noted in Table 1. [Effective 1999]
Brazil	Identify parties and transactions within transfer pricing regime.	No contemporaneous obligation, but if no study prepared, government entitled to use the method that produces the highest taxable income (see priority of Methods). [Effective January 1, 1997]
Mexico	Tax return requires a profit/loss statement of related and unrelated transactions. The tax report (dictamen final) is signed by an independent CPA attesting to the existence of appropiate documantation and the amount of related party transactions. Beginning in 2001 a transfer pricing information return must be filed containing detailed information on non-resident related party transactions.	Contemporaneous documantation must show prices with non-resident related parties (or parties in tax haven countries) are arm's length. Required documents noted in table 1. [Effective 1997]
United States	Forms 5471 and 5472 require disclosure of detailed information on controlled transactions with foreign entities.	Must include documents in Table 1, as well as supporting background documents, contemporaneous documantation required. [Effective tax years beginning after December 31, 1993]
Venezuela	No specific disclosure.	Not statutory requirements. Recommended documantation should follow OECD Guidelines. No contemporaneous obligation.

Country	DEADLINE TO PREPARE DOCUMENTATION	DEADLINE TO SUBMIT DOCUMANTATION
OECD	No statutory deadline for preparation.	Timely manner when requested
Argentina	Prepared by filing date of annual income tax return.	Upon request
Brazil	Prepared by due date for paying income tax return, which is January 31 of the following year.	Upon request
Mexico	Prepared by due date for filing annual income tax return.	Upon request
United States	Prepared by filing date of annual income tax return.	Within 30 days of request.
Venezuela	Prepared by filing date of annual income tax return.	Upon request

Country	ADVANCE PRICING AGREEMENT (APA) AVAILABLE	APA FILING FEE
OECD	Chapter IV. F (unilateral and bilateral)	Not specified
Argentina	Not available	Not applicable
Brazil	Regulatory Instruction 38 and Ministerial Order 95	Not specified
Mexico	Federal Fiscal Code Article 34-A (unilateral and bilateral).	Approximately US $675 for filing of original request, US $130 for submission of annual report during APA term.
United States	Rev. Proc. 96-53 (unilateral and bileteral)	Generally, US$5,000 to US$25,000 for original request based on size of taxpayer (US$5,000-US$7,000 routine renewal)
Venezuela	Not available	Not applicable

Country	APA TERM OF AGREEMENT	SELF-INITIATED ADJUSTMENTS [7]
OECD	As long as methodology and critical assumptions apply.	Self-initiated adjustments are not recognized by most OECD member countries on grounds that the tax return should reflect actual transactions.
Argentina	Not applicable	No formal procedures.
Brazil	No stated term	There is no procedure.
Mexico	Up to 3 years forward, 1 year back, and issuing year.	No formal procedures.
United States	Generally up to 3-5 years forward; either taxpayer or IRS may seek rollback for longer period as appropiate.	Permits adjustment in filing original return after close of book year.end. Permits adjustment on amended return so long as adjustment does not provide for a decrease in income.
Venezuela	Not applicable	No formal procedures.

7 Self-Initiated adjustments are deemed pricing adjustments made by a taxpayes in filing its original tax return. These adjustments are made after the close of the books and represents a book/tax difference in income.

Country	TAX PAYER SET-OFFS FOR OTHER RELATED PARTY TRANSACTIONS	WHEN CAN TAXPAYER SUBMIT TAX ADJUSTMENT TO COMPETENT AUTHORITY (CA)?
OECD	Recognition of international set-offs does not change the fundamental requirement that the transfer prices for controlled transactions must be arm's length. Tax administrators have discretion to grant or deny a taxáyer's request for reduction in an adjustment based on unintentional over-reporting of taxable income.	Application for mutual agreement procedure under Article 25 of the OECD Model Tax Convention can be filed after notification of proposed adjustment and generally within 3 years of notification.
Argentina	No formal provision	Follows mutual agreement procedures for respective treaty provisions.
Brazil	No formal provision	Application for mutual agreement procedure can be filed after notification of the tax assesment.
Mexico	Not permited	Follows mutual agreement procedures for respective treaty provisions.
United States	Transactions with same taxpayer in same year taken into account if taxpayer: (1) determines appropiate arm's length charge; (2) documents all correlative adjustments; and (3) notifies district director w/in 30 days of notice of proposed adjustment or deficiency.	Request may be submitted after amount of proposed adjustment is communicated to taxpayer in writing.
Venezuela	Follows mutual agreement procedures for respective treaties.	Follows mutual agreement procedures for respective treaties.

Country	MAY CA DEVELOP NEW SETTLEMENT POSITIONS?	CAN TAXPAYER GO TO CA BEFORE PAYING TAX?
OECD	CA's are endeavored to reach agreement amiable to taxpayer. CA's power to compromise an adjustment depends on provisions of domestic law.	Countries are encouraged to suspend collection of tax and interest until mutual agreement procedures are completed.
Argentina	Yes	Generally, tax must be paid.
Brazil	Yes	Yes. Taxpayer may go to CA after receiving the tax assessment.
Mexico	Yes	Generally, tax must be paid.
United States	CA can negotiate agreement based on different position from US-initiated adjustment,unless taxpayer has entered into a closing agreement or has litigated the adjustment.	Yes. Taxpayer may go to CA after amount of proposed adjustment is communicated in writing to taxpayer, before paying tax.
Venezuela	Yes	Yes

Country	ADDITIONAL ASSESSMENT PAYMENT DEADLINE	COST CONTRIBUTION ARRANGEMENTS (CCA) OR COST SHARING ARRANGEMENTS (CSA) ACCEPTED
OECD	Not applicable	Yes. OECD Guidelines Chapter VIII.
Argentina	Additional payment due when assessment issued; interst assessed from due date of original filing.	No
Brazil	Generally 30 days from date of assessment. Deadline may vary if assessment is administratively and/or judicially contested.	No sepecific statutory authority but limited cost sharing may be possible.
Mexico	Forty.five days from notification in writing.	No
United States	Interest assessed from due date of original filing. Additional extensions for payment of tax available when filing protests.	Yes. Reg. 1.482-7.
Venezuela	Additional payment due when assessment issued.	No

Country	COST CONTRIBUTION OR COST SHARING PAYMENTS DEDUCTIBLE	COST CONTRIBUTION OR COST SHARING PAYMENT SUSCEPTIBLE TO WITHHOLDING TAX
OECD	Deductibility determined under laws of applicable country. Chapter VIII 23.	Generally no. However, tax treatment should be determined under laws of applicable country. Chapter VIII 23.
Argentina	Not applicable.	Not applicable.
Brazil	No.	Yes. Ordinary Federal Law 9779/99
Mexico	Not applicable.	Not applicable.
United States	Yes. Reg & 1.482-7 (h)	No. Reg & 1.482-7 (h) and IRC & 1441.
Venezuela	Not applicable.	Not applicable.

Country	PAYER'S TAX TREATMENT OF PAYMENTS TO A CONTRIBUTOR OF PRE-EXISTING INTANGIBLES TO A CCA OR CSA	STATUTE OF LIMITATIONS ON ASSESSMENT FOR TRANSFER PRICING ADJUSTMENTS
OECD	Balancing payments (including payments for pre-existing intangibles) should be treated as an addition to the costs of the payer (OECD Chapter VIII 25)	Determined under local law.
Argentina	Not applicable.	Generally 5 years from tax year end.
Brazil	Deductible	5 years from date of filing return.
Mexico	Not applicable.	Generally 5 years from date of filing return.
United States	Reg & 1.482-7 (g)(2). Buy-in deductible or amortizable over the appropriate useful life, see, e.g. IRC & 167, & 197.	3 years from original due date or filing date of return, whichever is later. For substantial understatements of tax, period is extended to 6 years. In case of non-filing or fraud, period is unlimited.
Venezuela	Not applicable.	4 years from date of filing return.

Country	COMMISSIONARE ARRANGEMENTS ALLOWED?
OECD	Determined under local law.
Argentina	Yes.
Brazil	Yes.
Mexico	Yes.
United States	No.
Venezuela	No.

TABLE 1: CATEGORIES OF DOCUMENTATION REQUIRED

	OECD	ARG	BRZ	MEX	US	VEN
Business Overview	X	X		X	X	X
Organization Structure	X	X		X	X	X
Method Selected	X	X	X	X	X	X
Alternative Method Rejected					X	
Analyze Controlled Transactions	X	X	X	X	X	X
Identify Comparables	X	X	X	X	X	X
Economic Analysis	X		X		X	X
Relevant Data Obtained After Year-End					X	
Index					X	
Other Documentation	X		X[6]		X	X

6 **BRZ:** Documantion includes transfer pricing study, related party and controlled transaction disclosure, and documents maintained in accordance with prudent business pratice.