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LATIN AMERICA TRANSFER PRICING OUTLOOK

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ARGENTINA

Transfer Pricing Case: Stiefel Argentina S.A.

-Fiscal Periods 2005 to 2009-

The National Court of Appeals for Federal Administrative Litigation upheld the decision of the National Tax Court that the proceeds from credit notes issued by Stiefel Laboratories Inc. for commercial assistance under an agreement entered into between the parties were not of an operational nature and, therefore, they were not linked to Stiefel's economic activity.

Stiefel is a dermatological pharmaceutical company specializing in skin care, engaged in the marketing and distribution of products imported from its related company.

In the context of the Transfer Pricing Study, Stiefel chose to apply the "Net Transaction Margin Method" (MMNT) as it was the most appropriate approach to evaluate its finished goods import operations. Operating Margin over Total Costs (MOTC) was chosen as the key profitability indicator.

The main challenge was to determine whether the amounts received by Stiefel, through the commercial assistance agreement with Stiefel Laboratories Inc., should be taken into account in the calculation of the company's operating profit in the transfer pricing analysis. The tax authority questioned whether this income was considered operating, since it had been recorded in the accounts under the heading "Other Income". This raised the question of whether they were related to the economic activity of Stiefel Argentina SA.

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Stiefel argued that the credit notes should be considered as part of the operating results of the year, as they supplemented the difference in profit necessary for the company's balance sheet to show operating profit within the interquartile range defined by comparable companies. They argued that this income was tied to the company's gross business expenses.

The tribunal found that the credit notes did not have a direct impact on the sales prices of Stiefel Argentina SA's medicines and therefore could not be considered as a determinant of its profitability.

This case highlights the importance of accounting harmonization in the publication balance sheet, where an economic analysis is carried out to determine whether certain items are considered operational and, therefore, related to the company's commercial activity.

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PERSPECTIVAS PRECIOS DE TRANSFERENCIA LATINOAMÉRICA

COLOMBIA

Ruling on transfer pricing penalties

Last August, the Council of State, which is the highest tax tribunal in Colombia, invalidated a concept issued by the DIAN regarding penalties for formal transfer pricing obligations.

In the annulled concept, a penalty for omission was imposed on taxpayers who submitted the master report late. The DIAN justified this doctrine by arguing that transfer pricing documentation consists of three elements: the local report, the master report, and the country-by-country report. Therefore, it considered these reports to constitute a unit of information, requiring them to be submitted in their entirety and in a timely manner. The delayed submission of any of these reports was deemed a sanctionable omission, with a fine equivalent to 2% of the total operations subject to documentation.

The Council of State invalidated this concept, arguing that behavior and its corresponding penalty should be based on the current regulations, rather than relying on the interpretation of the Tax Administration.

Therefore, despite Article 1.6.3.1.4. of Decree 1625 of 2016 establishing that the local and master reports are considered a unit for sanctioning purposes, this does not imply that the belated submission of the master report constitutes an omission in the documentation. The late submission of the master report does not imply a failure to submit information or to report operations subject to transfer pricing rules.

The tribunal acknowledged that the DIAN's interpretation was incorrect in imposing a penalty that did not correspond to the facts addressed in the mentioned consultations. As a result, this ruling clarifies the implications of the transfer pricing penalty regime in Colombia.

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MEXICO

Nearshoring Effects in Mexico in 2023

Due to the geopolitical factors of recent years and the repercussions of the COVID-19 pandemic, difficulties arose in the supply chain model between companies and complications were generated beneath their operation and the fulfillment of activities. The above promotes the change of strategies to effectively combat the constant challenges in the global economic environment.

For this reason, the Nearshoring commercial strategy has gained relevance since it offers a response to companies interested in promoting optimization and cost reduction in their operations and establishing a competitive and intelligent position in the market.

Nearshoring involves the relocation of commercial and production activities with the aim of identifying closer destinations and with a time zone comparable to where each company's market is located. It is for this reason that companies may recognize Mexico as a favorable destination to establish their operations due to the privileged location and commercial relationship with the United States.

In consideration of this new trend, on October 11, 2023, through the Official Gazette of the Federation (DOF by its acronym in Spanish), fiscal incentives were published aimed at exporting companies in identified key sectors, with the aim of increasing productivity, promoting competitiveness and promote investment in the country.

The incentives are offered to companies that seek to optimize their operations through the Nearshoring strategy and to those companies that are currently located in Mexico, which belong to the sectors identified as key in the export industry.

Among the key sectors identified are the semiconductor, automotive (especially electromobility), electrical and electronics, medical devices and pharmaceuticals, agribusiness, human and animal food industries, among others.

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Fiscal Incentives in Mexico

The published incentives consist in choosing to make the following deductions:

1. Immediate deduction of the investment in new fixed assets, acquired from the date of entry into force of the decree and until December 31, 2024. Below are the maximum percentages applicable to deduct investments by type of asset:

- 86% for electric vehicles and agricultural aircraft.
- 88% for computers and peripherals.
- 89% for the research of new products and technologies .

2. The additional deduction will be equivalent to 25% of the increase in the expense incurred for training. For these purposes, the increase will be the positive difference between the expense spent for training in the fiscal year in question and the average expense that the taxpayer has spent for the same concept in the fiscal years of 2020, 2021 and 2022.

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Transferer Pricing considerations for Nearshoring in Mexico

The implementation of this business strategy entails important aspects regarding Transfer Pricing. This is because Nearshoring generally implies that companies establish subsidiaries in Mexico to manage a part of their operations. This gives rise to commercial transactions between them, and it is essential to ensure that these transactions comply with transfer pricing regulations in both Mexico and the parent company's home country. Below are some of the considerations that interested companies should take into account:

- Obligation to document and prove that transactions between related companies are carried out at market prices.
- Maintain solid and complete records that support the transfer pricing policies. Failure to comply with these requirements may result in tax penalties and increased attention from tax authorities.
- Risk assessment to identify potential threats and adjustments in transfer pricing policies accordingly to differences in tax rates, local regulations and changes in market prices.
- Understand and take advantage of international tax treaties that can influence the taxation of companies that participate in Nearshoring.

In summary, Nearshoring in Mexico presents great opportunities, but it also imposes significant transfer pricing challenges for companies that plan to implement this modality. It is important to have a solid strategy and comply with local and international regulations. Specialist advice and proactive transfer pricing management are crucial to ensuring success and compliance in this evolving business environment.

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PARAGUAY

Paraguay expands list of jurisdictions considered to have low or no taxation.

Through Art. 1 of General Resolution No. 118/2023 (the "RG 118"), the National Directorate of Tax Revenue ("DNIT"), the Paraguayan tax authority, expanded, through the publication of an additional and exhaustive list of 111 jurisdictions, those countries, territories and others, considered to have low or no taxation ("BONT Jurisdiction").

It is important to note that the fact of being resident in a BONT jurisdiction has a direct effect on the transfer pricing obligations of taxpayers of the Corporate Income Tax ("IRE", Paraguayan corporate tax), since, if said taxpayer carries out transactions (income or expenditure) with a resident of any of these territories, it is considered to correspond to a transaction between related parties, and, therefore, subject to transfer pricing rules.

Although the taxpayer has the right to distort the link, given that it derives from a presumption that admits evidence to the contrary, in practice, it is -at least- very difficult to rebut such linkage, since, in order to do so, the taxpayer must submit the following documents from its customers or suppliers:

a) Certificate of Tax Residency of the party residing abroad.

b) List of shareholders and final beneficiaries, together with the following data: tax identification number, company name and jurisdiction of domicile.

c) Functional organizational chart, identifying the full name and tax identification number of the directors or administrators.

d) Functional organizational chart of the IRE taxpayer, identifying the full name and the Unique Taxpayer Registry number of the directors or administrators.

PARAGUAY

If the presumption is not rebutted, the IRE taxpayer who entered into transactions with a resident of a BONT Jurisdiction, consequently, is obliged to prepare and submit a Technical Study of Transfer Pricing to the DNIT, with all that this implies.

It should be noted that, until the publication of the aforementioned additional list, in order to determine whether a customer or supplier resided in a BONT Jurisdiction, the IRE taxpayer had to confirm whether the following two conditions provided for in Article 5 of Decree No. 4644/2020 (text updated by Decree No. 7402/2022) met with respect to the territory:

a) That taxes the income at an effective taxation or an income tax rate lower than the tax rate that would be applied in Paraguay; and

b) There is no bilateral or multilateral agreement in force that allows for the effective exchange of information between Paraguay and that territory.

As of RG 118, in addition to verifying whether the customer or supplier resides in a jurisdiction for which these requirements are met, the taxpayer must also check if he or she does not reside in any of the 111 countries listed by the DNIT.

Special consideration by taxpayers is the fact that among the BONT Jurisdictions are Florida, Nevada and New Jersey in the United States, as well as Puerto Rico and Nicaragua, to name a few representatives in cross-border transactions.

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PERU

Latest trends in “Benefit Test” audit processes in Peru.

Currently, companies in inspection processes have received requests from SUNAT focused on verifying whether the expenses for services received from related parties support the need and the adequate provision of services. The SUNAT is quite formalistic with supporting documentation, so taxpayers must be prepared and keep a uniform accounting in accordance with these requirements.

What is the Benefit Test?

When a taxpayer receives contracted services from its related parties (intra-group services), such activity must be subject to verification of compliance with the Benefit Test. It is a condition applicable to taxpayers receiving business income so that they can deduct costs or expenses generated when determining the Income Tax for the year.

Benefit Test Regulations

The Benefit Test is regulated in subsection i) of Article 32-A of the Income Tax Law (ITL). The first paragraph of subsection i) of article 32-A of the ITL states that, without prejudice to the requirements, limitations and prohibitions provided by the aforementioned law, in the case of services provided to the taxpayer by its related parties, the taxpayer must comply with the benefit test and provide the documentation and information requested, as necessary conditions for the deduction of the cost or expense.

Initially, it applied both to services provided by related parties and to those received from countries or territories with low or no taxation.

As of fiscal year 2019, through Legislative Decree No. 1369, published on August 2, 2018, and in force since January 1, 2019, specific changes are introduced delimiting that the operations that are within this scope of obligation correspond only to the services received from related parties.

If the company does not comply with the Benefit Test, the remuneration for the services received will not be deductible for the determination of Income Tax.

PERU

In the case of low-value-added services (those that are not part of the company's core business), the deduction of the cost or expense for the service received is determined based on the sum of the costs and expenses incurred by the service provider, as well as its profit margin, which may not exceed five percent (5%) of such costs and expenses. If this limit is exceeded, the excess is considered a non-deductible expense.

Information reviewed in the latest processes of inspections in Benefit Test

In recent audit processes, SUNAT has been requesting the following information:

a) The identification of the persons who were responsible for the provision of services from the side of the provider, specifying names and surnames, as well as identity document numbers, positions and functions within the Company.

b) The documentation that evidences how the communication was carried out between the people indicated in the previous points, such as emails, telephones, visits, interviews, shared folders, intranet, among others.

c) The documentation that the taxpayer sent to the supplier to start the provision of services.

d) The documentation sent by the supplier that proves the effective provision of the services.

e) Documentation that proves the valuable intangibles used by the non-domiciled supplier in the provision of services, providing the documentation that proves the accounting in its accounting books.

f) The payroll or spreadsheet of the non-domiciled provider, in which it accredits the registration of the workers who carried out the provision of the services.

g) Provide the documentation that allows to support the application of the drivers applied in the distribution of costs and expenses of a service received.

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Usual observations made by SUNAT

In our experience we can observe that, in most cases, SUNAT has found the information provided by the Taxpayer dissatisfied, and its observations point out to the following points:

- The Company has not demonstrated with documents that the service was received (documentary insufficiency).
- Despite having submitted a "profit test" document, the Company has not demonstrated that the service received has generated a profit.
- There is no detail of costs and expenses.
- There is insufficient evidence of communication between the people who provided and the people who received the service.

Response time of the tax administration in the inspection process by the benefit test.

Finally, it should be noted that, in our experience, the inspection processes for the benefit test are more limited than a normal definitive or partial audit process, that is, only a few months may elapse from the sending of the first request to the issuance of the determination resolution by the Tax Administration.

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