

**Argentina / Brazil / Chile / Colombia / Costa Rica / Panama / Peru / Mexico / Uruguay / OECD / International**

## **Multinational Enterprises, Transfer Pricing and Value Chain Analysis in Latin America following the OECD/G20 Base Erosion and Profit Shifting Initiative**

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In this article, the authors examine the implications of the proposals in relation to the OECD/G20 Base Erosion and Profit Shifting initiative for the transfer pricing practices of a number of Latin American countries, with special emphasis on value chain analysis.

### **1. Introduction**

#### **1.1. In general**

This article examines the holistic transfer pricing approach that a number of Latin American countries have been implementing into their laws following the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative. In this context, a value chain analysis (VCA) approach aligns business models, finance and/or tax positions and the governance of multinational enterprises (MNEs) with best practice under the OECD/G20 BEPS initiative.

#### **1.2. Scope and purpose of the article**

The article is structured as follows. [Section 2](#) considers the transfer pricing standards introduced by the OECD/G20 BEPS initiative. [Section 3](#) provides a general description of the origin, development and approaches regarding transfer pricing practice in Latin America, which are primarily derived from the US Transfer Pricing Regulations and OECD and UN recommendations. [Section 4](#) considers the changes brought about in Latin America by the OECD/G20 BEPS initiative from a transfer pricing perspective. In particular, the new transfer pricing documentation rules that have been implemented by Argentina, Brazil, Chile, Colombia, Costa Rica, Panama, Peru, Mexico and Uruguay, are addressed. The effects of the new transfer pricing rules for MNEs undertaking activities in Latin America are also examined. [Section 5](#) covers the transfer pricing transactional approach described by reference to the Mexican transfer pricing system. [Section 6](#) analyses the holistic approach introduced by the OECD/G20 BEPS initiative and explains the role of the VCA as a tool in the identification of the key value drivers and processes of an MNE and establishing if these factors are aligned with the allocation of profits. [Section 7](#) demonstrates how the transactional and holistic approaches can be combined to align the business models, finance and/or tax positions and governance of MNEs with the OECD/G20 BEPS initiative. In this respect, the authors address the applicability of the VCA in the context of a transactional and a holistic approach to transfer pricing. The article ends with some conclusions in [section 8](#).

### **2. The OECD/G20 BEPS Initiative – A Holistic Approach to Tax and Transfer Pricing**

#### **2.1. Transfer pricing, standards and the OECD/G20 BEPS initiative**

The OECD/G20 BEPS initiative is based on the following three fundamental pillars: (i) coherence in the international tax rules related to cross-border activities; (ii) strengthening the substance requirement in the international standards; and (iii) global improvement of transparency. On the basis of these three pillars, the OECD/G20 BEPS initiative consists of 15 actions that should be implemented into domestic tax legislation, provisions in tax treaties and the updating of the OECD Transfer Pricing Guidelines for Multinational Enterprises

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and Tax Administration (the “OECD Transfer Pricing Guidelines”).<sup>[1]</sup> These new orientations seek to minimize or eliminate double non-taxation, to facilitate the better alignment of the taxation of MNEs with their economic activities and value creation, and to improve the information available to the tax authorities to apply tax laws effectively.

Action 8-10, “Aligning Transfer Pricing Outcomes with Value Creation”,<sup>[2]</sup> of the OECD/G20 BEPS initiative focuses on strengthening the guidance on applying the arm’s length principle in ensuring that transfer pricing outcomes better align with the value creation of an MNE group. Consequently, Action 8-10 re-enforces the importance of looking beyond mere formal contracts when a comparability analysis is undertaken and, instead, calls for the focus to be on the accurate delineation of a transaction, the conduct of the parties and the economically relevant circumstances. As a result, the guidelines suggest disregarding the allocation of profits with regard to locations where no contribution is made to the profits and where transactions between associated enterprises lack commercial rationality. It also determines that the risks contractually assumed by a party that cannot exercise control over the risks and does not have the capacity to assume the risk should be allocated to the party that has the control and financial capacity. In addition, it clarifies that the legal ownership of intangibles alone does not necessarily generate the right to a return on the exploitation of the intangible. Instead, the companies undertaking important functions, controlling economically significant risks and contributing assets, as determined through the actual delineation of the accurate transaction, should be entitled to an appropriate return reflecting the value of their contributions. Further, it addresses situations in which an entity of the group provides funding but performs limited activities without having control of the financial risks. The guidance, therefore, entails that group entities should be entitled to no more than a risk-free return. Finally, the guidance states that transfer pricing methods should allocate profits to the most important economic activities.

Action 13, “Transfer Pricing Documentation and Country-by-Country Reporting”<sup>[3]</sup> of the OECD/G20 BEPS initiative introduced a new three-tier global standard regarding transfer pricing documentation requirements, including a common template for country-by-country (CbC) reporting and blueprints for the Master File and the Local File. In general, the CbC report requires the ultimate parent entity of a multinational group to set out financial global data by country for the relevant fiscal year in a prescribed template, together with a list of entities by country of residence and indication of the business activities and financial data, such as profits, revenue, the allocation of income, taxes paid, employees, capital, retained earnings, tangible assets and the business activities in respect of each of the jurisdictions in which an MNE has presence.

The Master File encompasses all of the major types of intercompany transactions entered into between the group companies, a description of the business, including the drivers of profit, the supply chain for large products and/or services, market descriptions, and a brief functional analysis indicating the principal contributions to value creation. A section on intangibles includes a description of the strategy adopted, the location of the principal research and development (R&D) facilities and R&D management, and a list of intangibles showing legal ownership. A similar section on financial activities covers financing arrangements with third parties, group financing companies and their location and transfer pricing policies. It also incorporates financial and tax information, including annual consolidated financial statements and a list and brief description of unilateral advance pricing agreements (APAs), and other tax rulings relating to allocation of income among countries.

The Local File contains detailed entity and transactional level information as functional and economic analyses and a selection on the most appropriate transfer pricing method, local management information, an organizational chart, and a description of the individuals to whom local management reports. In addition, the amount of intra-group payments and receipts for products, services, royalties, interest, etc. by tax jurisdiction of the payer and/or recipient, information on the financial data used to calculate the arm’s length amounts in the tax return, details of bilateral and unilateral APAs, and other rulings, which are “related to” the transactions of the entity and group’s financial and tax positions, should be provided.

More than 80 developing countries and other non-OECD and/or non-G20 countries participated in the discussions regarding the OECD/G20 BEPS initiative and, therefore, have joined the inclusive framework. These countries are entitled to the support of the OECD and G20 member countries to address their specific needs, thereby realizing the collaboration of 111 countries and jurisdictions working together at a global level to counter base erosion and profit shifting and carrying the obligation to implement a “minimum BEPS standard”, for example, Action 6<sup>[4]</sup> of the OECD/G20 BEPS initiative requires countries and jurisdictions to incorporate provisions into tax treaties to prevent treaty abuse, including treaty shopping, as a minimum standard by countering the use of conduit companies to channel investments through countries and jurisdictions with beneficial tax treaties to reduce or avoid taxation. The OECD is continuing to work on an equal footing to complete the objective of a modern international tax framework under which profits are taxed where economic activity and value creation occurs. Consequently, during 2017, the OECD has published documents such as the OECD Transfer Pricing Guidelines (2017),<sup>[5]</sup>

1. Most recently, OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration* (OECD 2017), International Organizations’ Documentation IBFD [hereinafter: *OECD Transfer Pricing Guidelines* (2017)].
2. OECD, *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Report* (OECD 2015), International Organizations’ Documentation IBFD [hereinafter: *Action 8-10 Final Report* (2015)].
3. OECD, *Transfer Pricing Documentation and Country-by-Country Reporting – Action 13: 2015 Final Report* (OECD 2015), International Organizations’ Documentation IBFD [hereinafter: *Action 13 Final Report* (2015)].
4. See OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2015 Final Report* (OECD 2015), International Organizations’ Documentation IBFD [hereinafter: *Action 6 Final Report* (2015)] which is intended to prevent the granting of treaty benefits in inappropriate circumstances. *Action 6 Final Report* (2015) addresses treaty shopping and other type of treaty abuse. It also highlights the importance of countries identifying and reviewing the tax policy considerations before concluding a tax treaty with another country.
5. *OECD Transfer Pricing Guidelines* (2017), *supra* n. 1.

guidelines on the implementation of the CbC report,<sup>[6]</sup> and public discussion drafts on the implementation of hard-to-value intangibles<sup>[7]</sup> and profit splits.<sup>[8]</sup>

### 3. Historical Transfer Pricing Developments – A Global Versus a Latin American Perspective

In 1968, the United States issued the first significant regulation that expanded the arm's length principle<sup>[9]</sup> as a result of the substantial growth in the business of MNEs. According to this principle, the prices charged by related parties should be consistent with the price that would have been charged had both parties been unrelated. Consequently, the arm's length principle was established to prevent profit shifting by MNEs to tax-favoured jurisdictions through the manipulation of intercompany transactions pricing.

The general transfer pricing regulation of the United States is contained in the US Internal Revenue Code (IRC),<sup>[10]</sup> which authorizes the Internal Revenue Service (IRS) to distribute, apportion or allocate the income of related parties under common control. The regulation is based on the following two assumptions: (i) transfer pricing should be based on the arm's length standard; and (ii) the arm's length standard should be determined on a transaction-by-transaction base. As a result, the arm's length standard, based on a transactional approach, became entrenched in various international tax systems of the trading partners of the United States, in the tax treaties that the United States concluded with developed and developing countries and in article 9 (Associated Enterprises) of the OECD Model<sup>[11]</sup> and the UN Model,<sup>[12]</sup> which deals with adjustments to profits that may be made for tax purposes when related parties enter into transactions that are not at arm's length.

Various countries implemented the international arm's length principle into their domestic tax provisions based on the OECD and the UN Transfer Pricing Guidelines, which seek to harmonize the transfer pricing policies and practices in developed and developing countries. The OECD Transfer Pricing Guidelines (1995)<sup>[13]</sup> were the first published. This followed previous OECD reports on transfer pricing in 1979 and 1984.<sup>[14]</sup> Later, the OECD Transfer Pricing Guidelines (2010)<sup>[15]</sup> were reissued, the latest being the OECD Transfer Pricing Guidelines (2017),<sup>[16]</sup> which is intended to align the OECD Transfer Pricing Guidelines with the recommendations in the reports of the OECD/G20 BEPS initiative that were issued in 2015.<sup>[17]</sup> These reports seek to tax profits in the jurisdiction where the economic activity is performed and suggests a holistic approach for determining the arm's length price. In particular, the OECD Transfer Pricing Guidelines (2017) consider the substantial changes made as a result of Action 8-10<sup>[18]</sup> and Action 13.<sup>[19]</sup> The United Nations also issued a Transfer Pricing Manual in 2013<sup>[20]</sup> and published a second edition in 2017<sup>[21]</sup> that incorporates the recommendations of the OECD/G20 BEPS initiative.

Most Latin American countries delayed the implementation of comprehensive transfer pricing rules. Given the growth in the commercial links between the United States and Mexico, Mexico introduced transfer pricing rules in 1992<sup>[22]</sup> that initially only applied to *maquiladoras*,<sup>[23]</sup> which are entirely or partially owned by foreign companies that are typically located in the United States.<sup>[24]</sup> This first approach to transfer pricing in Mexico applied to the agreement of APAs for companies operating in this sector. Later, transfer pricing legislation was introduced that encompassed all taxpayers that undertook transactions with related parties in Mexico and abroad. However,

6. OECD, *Guidance on the Implementation of Country-by-Country Reporting, BEPS Action 13* (OECD 2018), available at [www.oecd.org/tax/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf](http://www.oecd.org/tax/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf).
7. OECD, *Implementation Guidance on Hard to Value Intangibles, 23 May-30 June 2017 – Action 8: Public Discussion Draft* (OECD 2017), International Organizations' Documentation IBFD, also available at [www.oecd.org/ctp/transfer-pricing/BEPS-implementation-guidance-on-hard-to-value-intangibles-discussion-draft.pdf](http://www.oecd.org/ctp/transfer-pricing/BEPS-implementation-guidance-on-hard-to-value-intangibles-discussion-draft.pdf).
8. OECD, *Revised Guidance on Profit Splits, 22 June-15 September 2017 – Action 10: Public Discussion Draft* (OECD 2017), available at [www.oecd.org/ctp/transfer-pricing/Revised-guidance-on-profit-splits-2017.pdf](http://www.oecd.org/ctp/transfer-pricing/Revised-guidance-on-profit-splits-2017.pdf).
9. C.H. Lowel, M. Burge & P.L. Briger, *US International Transfer Pricing* vol. 1, pp. 1-4 (Warren, Gorham & Lamont 1994).
10. Sec. 482 IRC. Some amendments have been made to sec. 482 of the IRC relating to procedural rules, pricing methods and cost sharing regulations.
11. Most recently, *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Models IBFD [hereinafter: *OECD Model* (2017)]. The text of art. 9 of the *OECD Model* (2017) is unchanged compared to *OECD Model Tax Convention on Income and on Capital* (26 July 2014), Models IBFD [hereinafter: *OECD Model* (2014)], but two modifications were made to *OECD Model Tax Convention on Income and on Capital; Commentary on Article 9* (21 Nov. 2017), Models IBFD.
12. Most recently, *UN Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2011), Models IBFD, also available at [www.un.org/esa/ffd/documents/UN\\_Model\\_2011\\_Update.pdf](http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf).
13. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration* (OECD 1995), International Organizations' Documentation IBFD [hereinafter: *OECD Transfer Pricing Guidelines* (1995)].
14. UN, *Practical Manual on Transfer Pricing for Developing Countries* p. 30 (UN 2017), available at [www.un.org/esa/ffd/wp-content/uploads/2017/04/Manual-transfer-pricing-2017.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2017/04/Manual-transfer-pricing-2017.pdf).
15. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2010), International Organizations' Documentation IBFD [hereinafter: *OECD Transfer Pricing Guidelines* (2010)].
16. *OECD Transfer Pricing Guidelines* (2017), *supra* n. 1.
17. OECD, *Final BEPS package for reform of the international tax system to tackle tax avoidance* (OECD 2015), available at [www.oecd.org/ctp/beps-2015-final-reports.htm](http://www.oecd.org/ctp/beps-2015-final-reports.htm).
18. OECD, *Action 8-10 Final Report* (2015), *supra* n. 2.
19. OECD, *Action 13 Final Report* (2015), *supra* n. 3.
20. UN, *Practical Manual on Transfer Pricing for Developing Countries* (UN 2013), available at [www.un.org/esa/ffd/documents/UN\\_Manual\\_TransferPricing.pdf](http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf).
21. UN, *supra* n. 14.
22. IDB & Deloitte Touche Tohmatsu, *Review and Comparison of Transfer Pricing Regulations*, in *Latin America, the United States and the OECD Guidelines* p. 34 (2011), available at [https://issuu.com/idb\\_publications/docs/catalogs\\_en\\_4719](https://issuu.com/idb_publications/docs/catalogs_en_4719) and J.D. Barbosa Mariño, *El Régimen de Precios de Transferencia en Colombia: Un Análisis de su Desarrollo, del Principio de Plena Competencia y de la Vinculación Económica (The Transfer Pricing Regime in Colombia: An Analysis of Its Development, The Arm's Length Principle and the Economic Link)* p. 41, Javeriana University (2006), available at <http://revistas.javeriana.edu.co/index.php/vnijuri/article/viewFile/14657/11825>.
23. A *maquiladora* is a Mexican subsidiary company, usually 100% foreign-owned, whose primary role is that of assembly.
24. OECD, *Peer review of Mexican Transfer Pricing Regulation and Practices* p. 45 (OECD 2003).

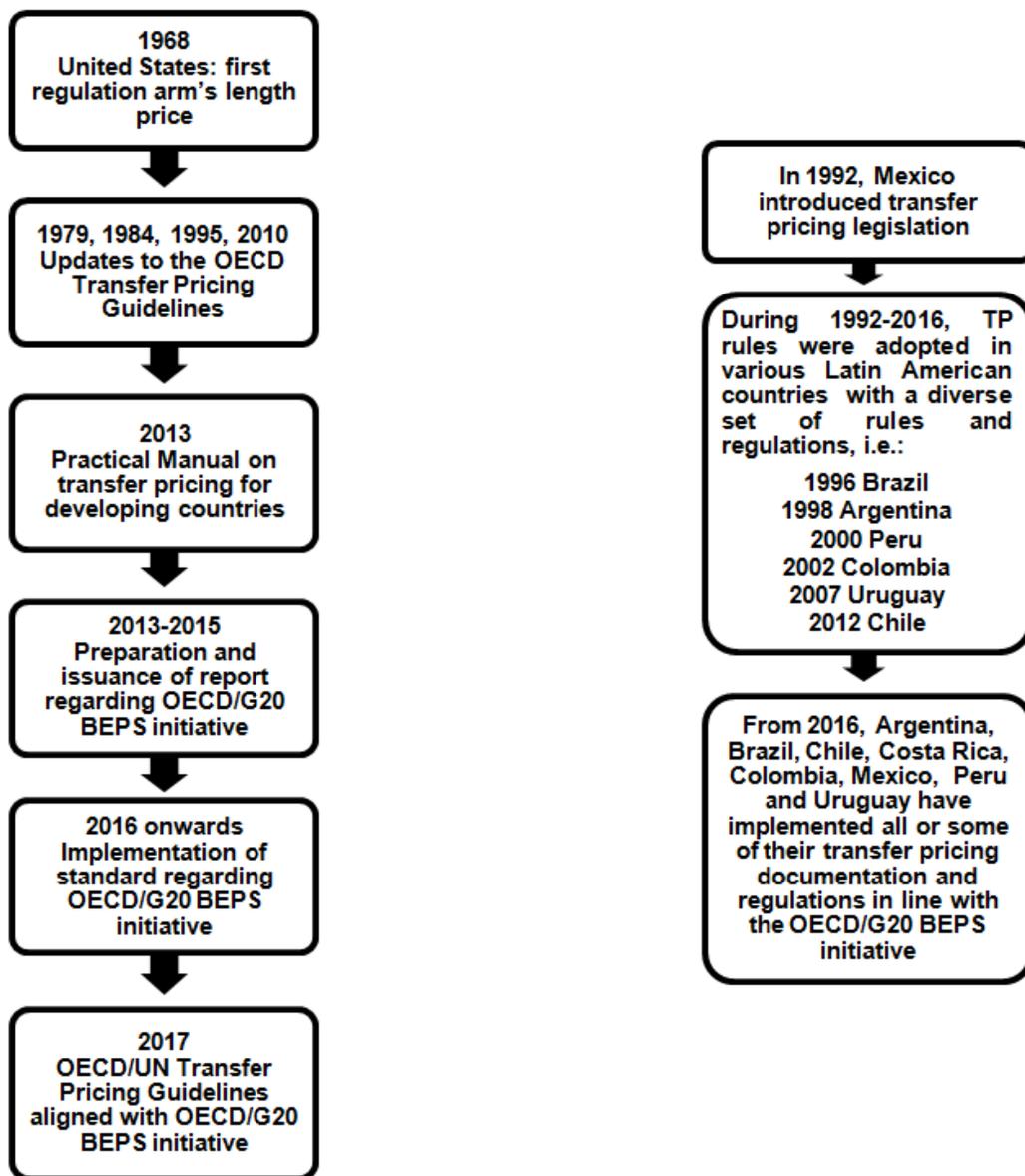
specific rules continued to apply to *maquiladoras*. Subsequently, other Latin American countries, such as Brazil<sup>[25]</sup> in 1996 (in force from 1997), Argentina<sup>[26]</sup> in 1998, Peru<sup>[27]</sup> in 2000 and Colombia<sup>[28]</sup> in 2002, introduced transfer pricing regimes. All of the Latin American countries with transfer pricing legislation in force, except for Brazil, follow the OECD Transfer Pricing Guidelines. In this context, it should be noted that Chile and Mexico are OECD member countries, and Peru, Colombia and Costa Rica have been invited to become members. On 31 May 2018, Colombia and the OECD agreed on final procedures at the national level. Hence, its membership will take effect once Colombia has taken the appropriate steps at the national level to accede to the OECD Convention and deposited its instrument of accession with the French government, the depository of the Convention. In May 2017, Brazil submitted a formal letter to the OECD,

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25. BR: *Lei sobre a legislação tributária federal, as contribuições para a seguridade social, o processo administrativo de consulta e dá outras providências* (Law on federal tax legislation, social security contributions, administrative process of consultation and other measures), *Lei* (Law) 9.430 of 27 Dec. 1996, available at [www.planalto.gov.br/CCivil\\_03/leis/L9430.htm](http://www.planalto.gov.br/CCivil_03/leis/L9430.htm).
  26. AR: *Ley sobre modificaciones en los Impuestos al Valor Agregado, a las ganancias y sobre los Bienes Personales, en el Régimen de los Recursos de la Seguridad Social y el Código Aduanero* (Law on Modifications in Value Added Taxes, profits and Personal Assets, in the Regime of Social Security Resources and the Customs Code), Law 25.063 of 7 Dec. 1998 introduced transfer pricing rules into Argentina, available at <http://servicios.infoleg.gob.ar/infolegInternet/anexos/55000-59999/55190/norma.htm>.
  27. C.A. Barrante, *Precios de transferencia en Peru*, Peruvian Magazine of Tax Law, San Martin de Porras University p. 12 (2008), available at <http://studylib.es/doc/7370772/precios-de-transferencia-en-el-per%C3%BA---facultad-de-derecho>.
  28. Barbosa Mariño, *supra* n. 22, at p. 41.

expressing its interest in initiating an accession process with a view to it becoming an OECD member country. Diagram 1 sets out the historical development of transfer pricing guidelines globally and in Latin America (see also [section 4.2.](#)).

**Diagram 1: Historical development of transfer pricing (TP) guidelines globally and in Latin America (LATAM)**

**Historical developments regarding transfer pricing      Relevant for Latin America**



## 4. How the OECD/G20 BEPS Initiative Changed the Transfer Pricing in Latin America

### 4.1. Introductory remarks

This section describes the changes that have been introduced into transfer pricing practice in Latin American countries as a result of the adoption of the recommendations of the OECD/G20 BEPS initiative. In particular, the new transfer pricing documentation requirements in Argentina, Brazil, Chile, Colombia, Costa Rica, Panama, Peru, Mexico and Uruguay are addressed (see [sections 4.2.2.](#) to [4.2.10.](#)). Here, it should be noted that the effects of the new rules on MNEs that operate in Latin America are very significant.

## 4.2. Are Latin American countries aligned with the transfer pricing recommendations of the OECD/G20 BEPS initiative?

### 4.2.1. Opening comments

Most Latin American countries are aligned with transfer pricing recommendations as proposed in the OECD/G20 BEPS initiative, especially regarding CbC reporting as included in Action 13.

### 4.2.2. Argentina

Transfer pricing rules were incorporated in Argentina in 1998.<sup>[29]</sup> The Argentinian *Administración Federal de Ingresos Públicos* (Tax Administration, or AFIP) requires the annual submission of the transfer pricing Local File, as provided for by *Resolución General AFIP* (General Resolution, GR) 1122/2001,<sup>[30]</sup> and Informative Returns relating to transactions carried out with related companies from abroad, transactions with local companies, and transactions with companies located in countries that are considered to be uncooperative, which relate to export and import transactions undertaken with independent third parties.

GR 4130-E/2017,<sup>[31]</sup> issued by the AFIP, also introduced the following: (i) an annual reporting regime consisting of the submission of a CbC report regarding certain taxpayers who are members of MNEs; and (ii) the obligation to provide the AFIP with information of a more general nature in respect of all the entities resident in Argentina that are part of an MNE, providing information as to what is the ultimate parent entity of the MNE where the MNE is subject to the CbC report that is the reporting entity. These new rules are in addition to the existing obligations relating to transfer pricing noted previously in this section. GR 4130-E/2017 applies for the fiscal years of each ultimate parent entity of MNEs from 1 January 2017 onwards. Here, it should be noted that the changes have been made within the framework of the recommendations established in Action 13, to which Argentina adheres. Similarly, Argentina signed the Multilateral Competent Authority Agreement on the Automatic Exchange of Country-By-Country Reports (CbCR MCAA)<sup>[32]</sup> on 30 June 2016. However, the legislation in Argentina does not require taxpayers to include the Master File as part of the relevant transfer pricing documentation.

### 4.2.3. Brazil

The transfer pricing regulations in Brazil date back to 1996.<sup>[33]</sup> A new version of the regulatory framework was introduced in 2012 by *Lei* (Law) 12.715/2012<sup>[34]</sup> and the *Instrução Normativa* (Normative Instruction) RFB 1.312/2012.<sup>[35]</sup> The regulation on transfer pricing in Brazil does not clearly follow the arm's length principle as set out in the OECD Transfer Pricing Guidelines, except for the transfer pricing method applied to commodities, the so-called "sixth method",<sup>[36]</sup> and to loans. However, Brazil and the OECD have initiated a 15-month long joint transfer pricing work project to seek alignment with the arm's length standard, within the framework of Brazil potentially becoming an OECD member country.<sup>[37]</sup>

However, Brazil implemented the CbC reporting requirement for fiscal years from 1 January 2016, as a separate form ("Block W") in the Annual Corporate Income Tax Return (the "CIT Return"), and under the rules contained in Action 13. This rule applies if the MNE has annual consolidated revenues exceeding BRL 2,260 million, if the ultimate parent entity is resident in Brazil, or EUR 750 million if it is resident abroad.<sup>[38]</sup>

As an active member, Brazil has implemented various measures of the OECD/G20 BEPS initiative, i.e. the minimum standard, and, as per Action 13, in addition to CbC reporting, the Brazilian authorities may also evaluate the implementation of the Master File and the Local File in line with the OECD/G20 BEPS initiative, given Brazil's intention to become an OECD member country. There is a high expectation from MNEs worldwide regarding Brazil becoming a full OECD member country. This expectation relates to a view of reducing the recurring adverse effects caused by the differences between Brazilian transfer pricing rules and international standards on a holistic approach.

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29. Law 25.063 of 7 Dec. 1998.

30. See AR: *Resolución General AFIP* (General Resolution, GR), Annex II of the GR 1122 of 29 Oct. 2001, which sets out the content of the transfer pricing Local File, available at [http://biblioteca.afip.gob.ar/dcp/REAG01001122\\_2001\\_10\\_29](http://biblioteca.afip.gob.ar/dcp/REAG01001122_2001_10_29).

31. AR: GR 4130-E/2017 of 20 Sept. 2017.

32. *OECD Multilateral Competent Authority Agreement on the Automatic Exchange of Country-By-Country Reports* (27 Jan. 2016), Treaties IBFD [hereinafter: CbCR MCAA].

33. BR: *Lei Dispõe sobre a legislação tributária federal, as contribuições para a seguridade social, o processo administrativo de consulta e dá outras providências* (Law on federal tax legislation, social security contributions, administrative process of consultation and other measures), Law 9.430 of 27 Dec. 1996, available at [www.planalto.gov.br/ccivil\\_03/Leis/19430.htm](http://www.planalto.gov.br/ccivil_03/Leis/19430.htm) as regulated by *Supremo Tribunal Federal* (Federal Supreme Court, SRF) in BR: SRF, 27 Dec. 1996, *Instrução Normativa* (Normative Instruction), amended by BR: SRF, 11 Nov. 2002, Normative Instruction 243.

34. BR: (Law) 12.715 of 17 Sept. 2012.

35. BR: Normative Instruction RFB 1.312 of 28 Dec. 2012.

36. Quotation price method on Exports ("Pecex") and Quotation price method on Imports ("PCI").

37. On 28 Feb. 2018, the OECD and Brazil launched a joint project to examine the similarities and differences between the Brazilian and OECD approaches to valuing cross-border transactions between associated firms for tax purposes. See OECD, *OECD and Brazil launch project to examine differences in cross-border tax rules* (OECD 2018), available at [www.oecd.org/tax/oecd-and-brazil-launch-project-to-examine-differences-in-cross-border-tax-rules.htm](http://www.oecd.org/tax/oecd-and-brazil-launch-project-to-examine-differences-in-cross-border-tax-rules.htm).

38. BR: *Dispõe sobre a obrigatoriedade de prestação das informações da Declaração País-a-País* (Normative instruction on the obligation to file country-by-country report), RFB 1681 of 28 Dec. 2016, available at <http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=79444&visao=anotado>.

#### 4.2.4. Chile

Chile, despite having been an OECD member country since 2010, only adopted transfer pricing rules until 2012. To this end, Chile enacted *Decreto-Ley* (Decree-Law) 824/1974,<sup>[39]</sup> which contains provisions that follow the OECD Transfer Pricing Guidelines.<sup>[40]</sup> Chilean law does not require taxpayers that are subject to the transfer pricing rules to create a Local File or the Master File. However, MNEs must file a CbC report for fiscal years 2016 onwards.<sup>[41]</sup>

#### 4.2.5. Colombia

Colombia adopted a transfer pricing regime for the fiscal years 2004 onwards. In this regard, the following two formal obligations were established and are in effect: (i) an Informative Return regarding controlled transactions undertaken with a related party that is resident abroad or a third party resident in a tax haven; and (ii) supporting documentation<sup>[42]</sup> that demonstrates proper compliance with the arm's length principle for transactions that exceed the amount set out in regulatory decree.<sup>[43]</sup> From the fiscal year 2013<sup>[44]</sup> onwards, the transfer pricing regime was updated in line with the 2010 edition of the Guidelines.

The tax reform of December 2016,<sup>[45]</sup> which has effect from 2017, determines that the applicable method for analysing commodities trading should be the comparable uncontrolled price (CUP), as suggested in the OECD Transfer Pricing Guidelines (2017).<sup>[46]</sup> The definition for commodities contained in the OECD Transfer Pricing Guidelines (2017) was adopted in respect of "physical products for which a quoted price is used as a reference by independent parties in the industry to set prices in uncontrolled transactions".<sup>[47]</sup> It should be noted that this definition disregards a fundamental characteristic of a commodity, which is that a commodity must be a standardized product.

The 2016 tax reform also adopted three levels of transfer pricing documentation, according to the wording in Action 13. As a result, a taxpayer must submit to the tax authorities the Master File and the Local File in respect of any controlled transactions that reach an annual amount of 45,000 *Unidad de Valor Tributario* (Tax Value Unit, UVT), approximately USD 500,000. With regard to transactions with parties located in a tax haven, the amount in question is reduced to 10,000 UVT, around USD 110,000. The CbC report must be submitted by the ultimate parent entity of an MNE that is resident in Colombia whenever the MNE's global revenues exceeds 81 million UVT, approximately EURO 730 million. In February 2018, the taxpayers so obligated filed the first CbC reports, corresponding to fiscal year 2016, and by December 2018, these taxpayers must have submitted a CbC report for the fiscal year 2017.

#### 4.2.6. Costa Rica

The formal obligation to submit a transfer pricing return was introduced in Costa Rica in 2013.<sup>[48]</sup> Recently, Costa Rica added the obligation to its legislation to prepare the Master File and the Local File suggested by the OECD/G20 BEPS initiative. This requirement must be fulfilled by all taxpayers that enter into operations with related parties and these documents must be available for the tax authorities on request.<sup>[49]</sup> Recently, Costa Rica has also introduced the CbC report,<sup>[50]</sup> the first reports in respect of which must be filed by 31 December 2018.

39. CL: *Decreto-Ley que aprueba texto que indica de la ley sobre impuesto a la renta* (Law that approves the text indicating the law on income tax, LIRC), *Decreto-Ley* (Decree-Law) 824 of 1974, available at [www.leychile.cl/Navegar?idNorma=6368](http://www.leychile.cl/Navegar?idNorma=6368).

40. Id., at art. 41 G.

41. CL: *Resolución que deroga y refunde lo dispuesto en la resolución del servicio de impuestos internos ex. n° 14 de 2013 que establece la obligación de presentar declaración jurada anual informativa de precios de transferencia y establece la obligación de presentar declaración jurada anual denominada reporte país por país* (Resolution that repeals and recasts the provisions of the internal tax service Resolution ex. No. 14 of 2013 that establishes the obligation to submit an annual informative transfer pricing return and establishes the obligation to file an the country report by country), Res. Ext. 126 SII of 27 Dec. 2016, available at [www.sii.cl/documentos/resoluciones/2016/reso126.pdf](http://www.sii.cl/documentos/resoluciones/2016/reso126.pdf).

42. The content of the documentation required up to 2016 is similar to the information described in *OECD Transfer Pricing Guidelines* (2017), *supra* n. 1, at ch. V, annex II (Local File content). This is interesting, as the decree that determined the content of the documentation that was issued in 2003, and updated in 2013, while OECD, *Action 13 Final Report* (2015), *supra* n. 3 was published in Oct. 2015.

43. CO: *Decreto por el cual se reglamenta el parágrafo 2° del artículo 260-2, los artículos 260-3, 260-4, el parágrafo 2° del artículo 260-6, y los artículos 260-8 y 260-9 del Estatuto* (Decree that regulates paragraph 2 of article 260-2, articles 260-3, 260-4, paragraph 2 of article 260-6, articles 260-8 and 260-9 of the Tax Code), *Decreto* (Decree) 4349 of 22 December 2004, available at [www.alcaldiabogota.gov.co/sisjur/normas/Norma1.jsp?i=15513](http://www.alcaldiabogota.gov.co/sisjur/normas/Norma1.jsp?i=15513). With regard to the fiscal year 2004, it was mandatory to document yearly transactions over approximately USD 75,000. This amount was increased in 2012 to 32,000 UVT (between USD 350,000 and USD 450,000, depending on the exchange rate). Since 2017, according to Decree 2120/2017, transactions exceeding 45,000 UVT in the year (approximately USD 500,000) must be documented. The UVT is the *Unidad de Valor Tributario* (Tax Value Unit, UVT), which for 2017 was COP 31,859 (approximately USD 11).

44. CO: *Ley por medio de la cual se expiden normas en materia tributaria y se dictan otras disposiciones* (Law through which tax and other regulations are issued), Law 1607 of 26 Dec. 2012, available at <http://wsp.presidencia.gov.co/Normativa/Leyes/Documents/LEY%201607%20DEL%2026%20DE%20DICIEMBRE%20DE%202012.pdf>.

45. CO: *Ley por medio de la cual se adopta una reforma tributaria estructural, se fortalecen los mecanismos para la lucha contra la evasión y la elusión fiscal, y se dictan otras disposiciones* (Law through which a structural tax reform is adopted and the mechanisms for the fight against tax evasion and avoidance are strengthened), Law 1819 of 29 Dec. 2016, available at [www.gydconsulting.com/userfiles/Ley-1819-29-dic-16-Reforma-Tributaria-Diario-Oficial-50101.pdf](http://www.gydconsulting.com/userfiles/Ley-1819-29-dic-16-Reforma-Tributaria-Diario-Oficial-50101.pdf).

46. *OECD Transfer Pricing Guidelines* (2017), *supra* n. 1, at para. 2.18.

47. Id.

48. CR: *Disposiciones sobre Precios de Transferencia* (Regulations on Transfer Pricing), Decree 37898-H of 5 June 2013, available at [www.imprentanacional.go.cr/pub/2013/09/13/COMP\\_13\\_09\\_2013.pdf](http://www.imprentanacional.go.cr/pub/2013/09/13/COMP_13_09_2013.pdf).

49. CR: *Resolución sobre documentación de Precios de Transferencia* (Resolution on Transfer Pricing Documentation), DGT-R-16-2017 of 30 Mar. 2017, available at [http://196.40.56.20/SCIJ\\_MHDA/docjur/mhda\\_docjur.aspx?nBaseDato=1&nDocJur=18045](http://196.40.56.20/SCIJ_MHDA/docjur/mhda_docjur.aspx?nBaseDato=1&nDocJur=18045).

50. CR: *Ley sobre el suministro de información de empresas residentes en Costa Rica para el intercambio automático de información tributaria, conforme al reporte País por País de la OCDE* (Law on the provision of information of resident companies in Costa Rica for the automatic exchange of information in accordance with the country-by-country report of the OECD), Resolution No. DGT-R-001-2018 of 11 Jan. 2018, available at [www.pgrweb.go.cr/scij/Busqueda/Normativa/Normas/nrm\\_texto\\_completo.aspx?param1=NRTC&nValor1=1&nValor2=85788&nValor3=111068&strTipM=TC](http://www.pgrweb.go.cr/scij/Busqueda/Normativa/Normas/nrm_texto_completo.aspx?param1=NRTC&nValor1=1&nValor2=85788&nValor3=111068&strTipM=TC).

## 4.2.7. Mexico

The first transfer pricing regime in Mexico was introduced in 1992 and applied to *maquiladoras*. In 1994, Mexico became an OECD member country – describing itself as the 25th global state and first Latin American country to join the OECD. In 1997,<sup>[51]</sup> Mexico implemented the OECD Transfer Pricing Guidelines (1995). Formal obligations have been in force from the financial year 2000 onwards.

The *Ley del Impuesto sobre la Renta* (Law on Income Tax, LISR) determines that taxpayers who undertake transactions with related parties should submit the Master File and the Local File and CbC reports.<sup>[52]</sup> The CbC report must be filed by the Mexican parent of MNEs with consolidated revenue in excess of MXN 12,000 million. The content of the documentation is consistent with the provisions included in Action 13 of the OECD/G20 BEPS initiative.

## 4.2.8. Panama

A transfer pricing regime has existed in Panama since 2010.<sup>[53]</sup> Although Panama did not implement Action 13 of BEPS, Resolution No. 201 of 2 April 2018 modified the TP informative return (Form 930), adding a questionnaire that has some elements of BEPS and aims to collect information of the taxpayer as well as the MNE. Panama is also a member of the inclusive framework of BEPS.

## 4.2.9. Peru

A transfer pricing regime has been in place in Peru since 2004.<sup>[54]</sup> In this context, Peruvian legislation currently adopts the OECD Transfer Pricing Guidelines (2017),<sup>[55]</sup> which, according to the law, can be used as an interpretative source.<sup>[56]</sup> In 2016, Peru adopted the recommendations of the OECD/G20 initiative that relate to transfer pricing, including:<sup>[57]</sup> (i) compliance with the arm's length principle in commodity transactions, which is evaluated by way of the CUP method; and (ii) a maximum margin in low value-added intra-group services was implemented, as suggested in the Final Report on Action 8-10.<sup>[58]</sup> For the purpose of the latter, the margin that can be obtained from a related party that delivers services to a Peruvian taxpayer was limited to 5% and, therefore, the maximum expense that a taxpayer can deduct.<sup>[59]</sup> The definition of low value-added service adopted also accorded with the Guidelines.<sup>[60]</sup>

The Peruvian government adopted three levels of documentation, as suggested in the Final Report on Action 13.<sup>[61]</sup> Consequently, taxpayers subject to the Peruvian transfer pricing regime must comply with documentation requirements, depending on their annual income, as follows: (i) the Local File, for taxpayers with an income exceeding 2,300 UIT;<sup>[62]</sup> and (ii) the Master File, for MNEs with income in excess of 20,000 UIT.<sup>[63]</sup> The CbC report may only be submitted by the ultimate parent entity that is resident in Peru, provided the MNE's annual consolidated revenue is PEN 2,700 million or more, approximately USD 830 million.<sup>[64]</sup>

## 4.2.10. Uruguay

In 2007, transfer pricing rules<sup>[65]</sup> were introduced in Uruguay in the context of a global tax reform and were followed by other rules in 2009. A requirement to file a local transfer pricing Informative Return was already in force before the OECD/G20 BEPS initiative as was the obligation to prepare and, in some cases, submit a transfer pricing study on an annual basis.<sup>[66]</sup> Uruguay is not a member of the OECD, but the *Ley de Transparencia Fiscal Internacional, Prevención del Lavado de Activos y Financiamiento del Terrorismo* (Law on

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51. P. Cervantes García, *Declaraciones informativas de precios de transferencia: Un medio para prevenir la erosión de la base fiscal a través de la transferencia de utilidades* pp. 114-120 (Thomson Reuters 2017), available at [www.ccpm.org.mx/avisos/declaraciones-informativas-de-precios-de-transferencia.pdf](http://www.ccpm.org.mx/avisos/declaraciones-informativas-de-precios-de-transferencia.pdf).
  52. MX: *Ley del Impuesto sobre la Renta* (Law on Income Tax), art. 76-A, added by a decree published in the Official Gazette of 18 Nov. 2015, with effect from the fiscal year 2016, available at [www.diputados.gob.mx/sedia/biblio/prog\\_leg/Prog\\_leg\\_LXIII/009\\_DOF\\_18nov15.pdf](http://www.diputados.gob.mx/sedia/biblio/prog_leg/Prog_leg_LXIII/009_DOF_18nov15.pdf).
  53. PA: *Ley que adiciona un capítulo al código fiscal sobre normas de adecuación a los tratados o convenios para evitar la doble tributación internacional, y adopta otras medidas fiscales* (Law that adds a chapter to the Tax Code regarding rules for adaptation to international non-double taxation agreements and adopts other measures), Ley 33 of 30 June 2010, available at <http://www.tribunaltributario.gob.pa/marco-normativo/leyes-y-decretos/36-ley-33-del-30-de-junio-de-2010/file>.
  54. PE: *Modificación de la Ley del Impuesto de Renta* (Modification of the Law on Income Tax), Decree 945 of 22 Dec. 2003, art. 22, available at [www.sunat.gob.pe/legislacion/reforma\\_2003/dleg/dleg945.pdf](http://www.sunat.gob.pe/legislacion/reforma_2003/dleg/dleg945.pdf).
  55. In 2003, the year in which the transfer pricing legislation was introduced in Peru, the *OECD Transfer Pricing Guidelines* (1995), *supra n. 13* were then the current edition. The *OECD Transfer Pricing Guidelines* (2010), *supra n. 15* were then issued. Further revision were made as according to OECD, *Action 8-10 Final Report* (2015), *supra n. 2*, which resulted in the *OECD Transfer Pricing Guidelines* (2017), *supra n. 1*.
  56. PE: *Texto único Ordenado de la Ley del Impuesto de Renta* (Unique text – Law on Income Tax), art. 32-A(h), *Decreto Supremo* (Supreme Decree) 179 of 8 Dec. 2004, available at [www.sunat.gob.pe/legislacion/renta/ley/fdetalle.htm](http://www.sunat.gob.pe/legislacion/renta/ley/fdetalle.htm).
  57. PE: *Decreto Legislativo que modifica la Ley del Impuesto de Renta* (Legislative Decree that modifies the law on Income Tax), Decree 1312 of 30 Dec. 2016, available at <http://busquedas.elperuano.pe/normaslegales/decreto-legislativo-que-modifica-la-ley-del-impuesto-a-la-re-decreto-legislativo-n-1312-1469407-1>.
  58. *OECD Transfer Pricing Guidelines* (2017), *supra n. 1*, at para. 7.61.
  59. PE: *Ley del Impuesto de Renta* (Law on Income Tax), art. 32-A(h).
  60. *OECD Transfer Pricing Guidelines* (2017), *supra n. 1*, at para. 7.45.
  61. *Id.*, at ch. V, para. C.
  62. The UIT is the *Unidad Impositiva Tributaria* (Fiscal Tax Unit), which is PEN 4,150, approximately EUR 1,000 for 2018.
  63. PE: *Decreto Legislativo* (Legislative Decree 1312 of 30 Dec. 2016, with effect from 1 Jan. 2017).
  64. PE: *Decreto Supremo que modifica la Ley del impuesto de Renta* (Supreme Decree that modifies the Law on Income Tax), Decree 333-2017 of 15 Nov. 2017-EF, available at [www.mef.gob.pe/es/normatividad-sp-9322/por-instrumento/decretos-supremos/16660-decreto-supremo-n-333-2017-ef-1/file](http://www.mef.gob.pe/es/normatividad-sp-9322/por-instrumento/decretos-supremos/16660-decreto-supremo-n-333-2017-ef-1/file).
  65. UY: *Texto Ordenado* (Tax Code), ch. VII, Title 4 of the Ordered text, 1996, available at [www.dgi.gub.uy/wdgi/page?2,principal,TextoOrdenadoVigente,O,es,0](http://www.dgi.gub.uy/wdgi/page?2,principal,TextoOrdenadoVigente,O,es,0).
  66. UY: *Régimen de precios de transferencia – Aspectos y obligaciones formales* (Transfer Pricing Regime – Aspects and formal Obligations), Resolution 2.084 of 2 Dec. 2009, available at [www.dgi.gub.uy/wdgi/page?2,principal,\\_Ampliacion,O,es,0,PAG;CONC;40;16;D;resolucion-no-2-084-009;0;PAG](http://www.dgi.gub.uy/wdgi/page?2,principal,_Ampliacion,O,es,0,PAG;CONC;40;16;D;resolucion-no-2-084-009;0;PAG).

International Tax Transparency and Prevention of Money Laundering and Financing of Terrorism),<sup>[67]</sup> introduced the requirements of filing a Master File and CbC report to align Uruguayan tax law with international standards.

#### 4.2.11. Interim conclusions

Table 1 summarizes the transfer pricing documentation that have been introduced into Latin America that are in line with Action 13 of the OECD/G20 BEPS initiative.

**Table 1: Transfer pricing documentation requirements in Latin America per country based on the Action 13 Final Report**

Country	Master File	Local File	CbC report
Argentina	No	Yes	Yes
Brazil	No	Yes	Yes
Chile	No <sup>[1]</sup>	No	Yes
Colombia	Yes	Yes	Yes
Costa Rica	Yes	Yes	Yes
Mexico	Yes	Yes	Yes
Panama	No <sup>[1]</sup>	No	No
Peru	Yes	Yes	Yes
Uruguay	Yes	Yes	Yes

1. These countries have adopted a transfer pricing documentation requirement that consists of some elements of the Master File as recommended by the OECD.

Source: TPA Global.

Even though no new rules were introduced in respect of the Local File following the OECD/G20 BEPS initiative in Argentina, Brazil and Uruguay, these countries already had in their legislations obligations relating to the preparation and/or submission of a transfer pricing Information Return and/or a transfer pricing study and/or a Local File.

### 4.3. Effect of the OECD/G20 BEPS initiative on MNEs operating in Latin America

As described in section 4.2., the adoption of the recommendations of the OECD/G20 BEPS initiative, in particular those relating to transfer pricing documentation, are very recent. In most countries, the relevant regulations are only coming into effect in 2018. Consequently, it will take a few years to evaluate the real effect of the OECD/G20 BEPS initiative on MNEs with subsidiaries in Latin America. However, it is a fact that the OECD/G20 BEPS initiative has standardized global transfer pricing documentation and that, given tax transparency, the information relating to MNEs contained in the transfer pricing reports, such as their key value drivers and the jurisdictions in which the value is created that are reflected in the Master File, will no longer be secret and instead will be shared with the tax authorities of the jurisdictions involved.

After receiving the files and reports, tax administrations must analyse them, perform audit processes when suitable and, where appropriate, initiate administrative and judicial action against the MNE in accordance with any transfer pricing irregularities detected. All this could take several years before a final decision is reached. For this reason, the legal consequences resulting from the implementation of the BEPS Action 13 Final Report will not be known in the short run.

The implementation of the Actions of the OECD/G20 BEPS initiative gives tax administrations stronger and more complex audit tools and scopes. At the same time, the new regulations could make tax systems even more complex. All this could result in local and international tax controversies.<sup>[68]</sup>

Some consultants and academics have noticed a psychological effect on Latin American entities of MNEs caused by the issue of the new transfer pricing regulations, especially regarding the Master File, the CbC report, and the CbCR MCAA. Most local entities in Latin America have stated that the entities of MNEs located abroad are concerned with the implementation of the Actions of the OECD/G20 BEPS initiative. For instance, with regard to the following issue regarding the use of the CbC report in respect of an effective tax risk assessment provided in the Handbook on Effective Tax Risk Assessment<sup>[69]</sup> issued by the OECD, taxpayers in Latin America have identified the need to undertake an outlier analysis (see Table 2).

67. UY: *Ley de Transparencia Fiscal Internacional, Prevención del Lavado de Activos y Financiamiento del Terrorismo* (Law on International Tax Transparency and Prevention of Money Laundering and Financing of Terrorism), Law 19.484 of 5 Jan. 2017, ch. IV, available at [www.dgi.gub.uy/wdgi/page?2,principal,dgi--normativa--leyes-2017,O,es,0](http://www.dgi.gub.uy/wdgi/page?2,principal,dgi--normativa--leyes-2017,O,es,0).

68. G. Patón García, *Claves de fiscalidad internacional en américa latina: entre las recetas BEPS y el pragmatismo en la lucha contra la evasión fiscal*, 67 Mag. Faculty L. Mex. Autonomous Natl. U. 269, pp. 83-106 (2017), available at [www.revistas.unam.mx/index.php/rfdm/article/view/62436](http://www.revistas.unam.mx/index.php/rfdm/article/view/62436).

69. OECD, *Handbook on Effective Tax Risk Assessment* p. 77 (OECD 2017), available at [www.oecd.org/ctp/beeps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf](http://www.oecd.org/ctp/beeps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf).

**Table 2: Key ratios per country**

Name of the MNE Group: MNE SA Fiscal year concerned: 31 Dec. 2017 Currency used: EUR										
Tax jurisdiction	Proportion of revenues from unrelated parties (%)	Proportion of revenues from related parties (%)	Revenues generated per employee	Pre-tax profit generated per employee	Revenues generated per EUR of tangible assets	Pre-tax profit generated per EUR of tangible assets	Pre-tax return on equity (%)	Post-tax return on equity (%)	Profit margin (%)	Effective tax rate (%)
	Unrelated-party revenues / Total revenues	Related-party revenues / Total revenues	Total revenues / Total employees x 1000	Profit before tax / Total employees x 1000	Total revenues / Tangible assets x 1000	Profit before tax / Tangible assets x 1000	Profit before tax / (Stated capital + retained earnings) x 1000	(Profit before tax – Income tax accrued) / (Stated capital + accumulated earnings)	Profit before tax / Total revenues	Income tax accrued / Profits before tax
A	54	46	126	13	1.29	0.13	21	14	10	34
B	99	1	114	14	4.97	0.62	19	12	12	33
C	25	75	1,691	220	24.80	3.22	21	18	13	15
D	30	70	130	14	0.99	0.11	28	20	11	28
E	91	9	114	12	6.47	0.65	16	13	10	22
F	55	45	124	14	1.08	0.12	24	18	11	25
G	90	10	163	17	6.18	0.66	19	17	11	11
H	3	97	92	2	0.58	0.01	11	8	2	30
I	2	98	562	22	7.25	0.28	11	9	4	16
J	92	8	119	13	5.08	0.56	13	11	11	16
K	34	55	172	24	1.31	0.18	30	25	14	16
L	98	2	101	10	6.52	0.63	26	17	10	36
M	40	60	108	10	1.26	0.12	28	19	10	35
N	16	84	3,629	1,714	86.72	40.97	425	425	47	0
O	91	9	103	9	7.73	0.69	23	17	9	25
P	99	1	105	12	6.23	0.70	31	23	11	24
Q	47	53	129	13	0.85	0.09	27	18	10	35
R	99	1	112	6	9.62	0.51	20	15	5	27
S	39	61	111	5	12.89	0.62	20	15	5	25
T	10	90	696	226	15.29	4.97	102	97	33	5
U	5	95	1,027	598	8.86	5.16	378	267	58	4
V	31	69	108	6	1.28	0.07	24	17	5	29
W	95	5	142	5	17.42	0.57	23	16	3	31
X	82	18	152	7	10.57	0.48	22	17	4	23
Y	89	11	135	5	10.51	0.41	17	12	4	33
Z	2	98	2,200	642	10.44	3.05	172	152	29	12

Source: OECD, *Handbook on Effective Tax Risk Assessment* p. 77 (OECD 2017), available at [www.oecd.org/ctp/beps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf](http://www.oecd.org/ctp/beps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf).

Table 2 reflects the key ratios by tax jurisdiction. The data points are a summary of a value chain creating the need for MNEs to perform an outlier analysis of the CbC report draft data points generated to capture the inconsistencies in the relevant data points and/or potential transfer pricing risk areas and, therefore, be able to identify areas that could potentially be challenged by tax authorities. In order to apply an efficient analysis, taxpayers need to define which ratios are normal for the group and/or for the industry, as well as what is considered an outlier and what could be treated as an acceptable standard deviation. In addition, it is necessary to select an applicable statistical methodology, for example, an interquartile range.<sup>70</sup> This situation will probably push MNEs into taking decisions more consciously when structuring international business, even to the extent of preventing them to establish entities in low-tax or non-cooperative jurisdictions.

70. S. Huijbregtse, *Country-by-country report Outliers Analysis in practice* (5 July 2016), available at <http://www.shuibregtseprofile.com/media2/english/articles/55-country-by-country-report-outliers-analysis-in-practice/file>.

Compliance costs are not particularly significant in Latin America, taking an MNE group as a whole. First, the Master File and the CbC report contain reasonable and appropriate information. Second, these documents must be prepared only by one entity of the MNE given the full adoption of the suggestions in the Final Report on Action 13. However, Latin American companies, which are part of MNEs, face significant compliance costs associated with local transfer pricing documentation to be able to fulfil different obligations in different countries.

Action 13 of the OECD/G20 BEPS initiative has no effect on the competition to attract foreign investment between Latin American countries that have adopted their transfer pricing documentation guides and those countries that have not, and, as a consequence, cannot exchange CbC information, may be considered to be non-cooperative jurisdictions. Argentina, Brazil, Chile, Colombia, Mexico and Uruguay have signed the CbCR MCAA and all have mutually enabled the exchange of information. Costa Rica has signed the CbCR MCAA but has not activated it in relation to any other country.<sup>[71]</sup> Panama and Peru have not signed the CbCR MCAA, but have signed the Convention on Mutual Administrative Assistance in Tax Matters.<sup>[72]</sup>

The list of non-cooperative jurisdictions prepared by the G20 Leaders' Summit in Hamburg in July 2017 includes 15 countries, of which four are in Latin America, i.e. Costa Rica, the Dominican Republic, Guatemala and Panama.<sup>[73]</sup> This classification could have an effect on MNEs with subsidiaries in these countries, in particular following the OECD/G20 BEPS initiative, as their operations would be closely reviewed with higher chance of scrutiny. As a result, it is essential to evaluate the substance, economic reality, functions performed, assets used, risk assumed and transfer pricing policies in place to assess whether the activities and transactions performed in these jurisdictions adhere to the recommendations of the OECD/G20 BEPS initiative.

#### 4.4. Issues and challenges faced by MNEs and tax authorities

Following the introduction of the new transfer pricing documentation requirements according to Action 13 of the OECD/G20 BEPS initiative by Latin American tax authorities, i.e. the Master File, the Local File, the CbC report and transfer pricing forms, depending on the obligations imposed in each country, it is important to note that Latin American tax authorities will be receiving a very large amount of transfer pricing information and documentation from local taxpayers and from other tax authorities from jurisdictions that have signed the multilateral competent authority agreement for the automatic exchange of information. As such, they will have to deal with it in an appropriate manner. This information could be used for the assessment of transfer pricing risks and base erosion and profit shifting. And the tax authorities involved will have to preserve the confidentiality of information.

In this sense, Latin American tax authorities will face increased information technology (IT) costs regarding the updating of their systems to make these adequate for their purposes. Further, they will need to invest in the training of auditors and meet additional auditing costs. What can be seen is that most countries are starting to set up their IT infrastructure to deal with such a massive amount of data and data analytics. For instance, Brazil, as a leading country in terms of tax technology, has already implemented a very comprehensive IT system to deal with numerous tax declarations and serve as an example for Latin American exchange of information in the future.

There are widely differing interpretations among tax authorities in respect of transfer pricing and/or guidance regarding the OECD/G20 BEPS initiative. This situation can give rise to some tax authorities requesting the submission of considerable transfer pricing documentation and information by the taxpayers and to double taxation of profits. In particular, Latin American countries have introduced new transfer pricing rules in the last few years, thereby requiring that MNEs have new and more obligations to file a significant amount of transfer pricing documentation and transfer pricing forms in different countries and with different deadlines.

Consequently, MNEs face significant additional compliance costs associated with transfer pricing documentation to fulfil different obligations in different countries with different deadlines and to avoid penalties for failing to comply with these obligations. As a result, data analytics and the implementation of effective IT systems may be the way to deal with and manage effective global transfer pricing documentation.

There are significant challenges for Latin American entities that are now required to file transfer pricing documentation and information due to the large amount of information they need to collect from all of the member entities of an MNE group. This information must be coherent and consistent among the group entities and over fiscal years.

MNEs are also being challenged to apply a holistic approach to their value chains. A holistic VCA supporting the intercompany transfer pricing policies and intercompany transactions of the MNE should reduce the probability of disputes between MNEs and the tax authorities.

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71. For a more complete reference on the status of the list of signatories countries to the CbCR MCAA and the signing dates, see OECD, *Signatories of the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA) and Signing Dates* (OECD), available at [www.oecd.org/tax/automatic-exchange/about-automatic-exchange/CbC-MCAA-Signatories.pdf](http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/CbC-MCAA-Signatories.pdf).

72. *Convention between the Member States of the Council of Europe and the Member Countries of the OECD on Mutual Administrative Assistance in Tax Matters* (25 Jan. 1988) (as amended through 2010), Treaties IBFD. Panama and Peru signed the Convention on Mutual Administrative Assistance in Tax Matters on 27 Oct. 2016 and 25 Oct. 2017, respectively. See OECD, *Jurisdictions Participating in the Convention on Mutual Administrative Assistance in Tax Matters Status* (OECD), available at [www.oecd.org/ctp/exchange-of-tax-information/Status\\_of\\_convention.pdf](http://www.oecd.org/ctp/exchange-of-tax-information/Status_of_convention.pdf).

73. See ECOFIN, Outcome of Proceedings, 15429/17, FISC 345 ECOFIN 1088 (5 Dec. 2017), available at, available at [www.consilium.europa.eu/media/33082/council-conclusions-non-cooperative-jurisdictions-5-december-2017.pdf](http://www.consilium.europa.eu/media/33082/council-conclusions-non-cooperative-jurisdictions-5-december-2017.pdf) for a list of non-cooperative jurisdictions for tax purposes at 5 Dec. 2017.

## 5. A Transfer Pricing Transactional Approach – The Mexican Regime

As the transfer pricing framework in Latin America evolved from the US Transfer Pricing Regulations established in the IRC,<sup>[74]</sup> the implementation of the arm's length standard in the legislations of Latin American countries has been effected primarily on a transaction-by-transaction bases. For instance, Mexico is the first country to have incorporated the transfer pricing rules into its LISR in 1992.<sup>[75]</sup> As with the United States, Mexico described exhaustively the transactions considered for this purpose to be financial transactions, the provision of services, the use, enjoyment and alienation of tangible assets, the exploitation or alienation of intangibles, and the alienation of shares.<sup>[76]</sup> These transactions remain in the current LISR.<sup>[77]</sup> In this context, in determining the arm's length price in respect of intercompany transactions, parties analyse the economic circumstances on the transaction bases exhaustively regulated. However, such an analysis is more complex following the issuing of the Final Report on Action 8-10, which requires a holistic approach in determining the arm's length principle.

The ex post, or the outcome testing, approach is another feature of the Mexican transfer pricing regime. As noted, the OECD Transfer Pricing Guidelines (2017) require prices in intercompany transactions to be set as if they would have been set between unrelated parties. In general, prices in third-party transactions are set ex ante when the transaction is first negotiated. On this basis, some taxpayers establish the prices of their intercompany transactions on an ex ante, or arm's length price, approach. Despite the OECD Transfer Pricing Guidelines (2017) and the fact that the transfer pricing rules of certain countries may place a greater emphasis on the arm's length nature of the price-setting process, most documentation focuses on testing the arm's length nature of the transfer prices after the results of the transaction are known. This practice is referred to as the outcome testing approach. The timing issue is addressed in the OECD Transfer Pricing Guidelines (2017), as it is recognized that some taxpayers might test the actual outcome of their controlled transactions to demonstrate that the conditions regarding the transactions in question are consistent with the arm's length principle on an ex post approach, which takes place generally as part of the process of compiling a tax return at year-end.<sup>[78]</sup> Since the Mexican tax authorities, as in the United States, prefer to test after-the-fact results, such a situation creates a need for taxpayers to implement a price checking mechanism that involves periodic monitoring to realize an arm's length price in respect of their intercompany transactions and avoid double taxation and adjustments derived from different outcomes from the two approaches.<sup>[79]</sup>

## 6. A Holistic Approach to Transfer Pricing

### 6.1. In general

The substance requirement in the international standards and the improvement of the transparency at a global level are two of the main drivers of the various reports on the Actions of the OECD/G20 BEPS initiative. In this context, all of the measures issued by the OECD relate to the level of the genuine economic activity undertaken by MNEs, for example, by the filing and disclosure of new transfer pricing documentation.

As stated in section 4.2.7., Mexico is an OECD member country. Consequently, the OECD Transfer Pricing Guidelines are a significant point of reference for Mexico and other Latin American countries that are trading partners of the United States. Even though the transfer pricing regime in Mexico and other Latin American jurisdictions are based on a transactional approach as influenced by the United States, the development of the transfer pricing regulations as well as the resulting tax disputes has been supported by the OECD Transfer Pricing Guidelines, which, following the OECD/G20 BEPS initiative are characterized by a holistic approach to transfer pricing in determining the arm's length principle, thereby considering the tax profits in the jurisdiction where the economic activity is performed. For this purpose, the OECD has highlighted the importance of understanding how value is generated in a group as a whole, the interdependencies of the functions performed by associated enterprises with the rest of the group and the contribution that associated enterprises make to that value creation,<sup>[80]</sup> rather than focusing solely on the transactions in question.

Diagram 2 illustrates an example of the potential multiple intercompany transactions to be covered under the BEPS holistic approach as proposed in the OECD/G20 BEPS initiative. The example considers a value chain in the mining industry, as Latin America has a large

74. Sec. 482 IRC.

75. The transfer pricing regime is contained in arts. 64, 64-A and 65 LISR.

76. H. Bettinger Barrios, *Investigación y Desarrollo en la Reforma Fiscal* p. 18, (2002), Nacional Autónoma University of Mexico, Online Library, Legal Investigation Institute, available at <https://archivos.juridicas.unam.mx/www/bjv/libros/1/337/6.pdf>.

77. Art. 179 LISR.

78. OECD *Transfer Pricing Guidelines* (2017), *supra* n. 1, at para. 3.70.

79. TPA Global, *Transfer Pricing Adjustments (Operational TP, VAT and Customs)* (2015), available at <http://vdma.org/documents/105628/7900207/Transfer%20Pricing%20Adjustments%20Final%2030Mar2015.pdf/19d9caca-5e68-463f-b319-ba67351a0fe0>.

80. OECD, *Chapter Guidelines for Applying the Arm's Length Principle of BEPS Action 8-10* para. 1.51 (OECD 2015).

share in global mining and exploration.<sup>[81]</sup> Diagram 2 also provides an overview of the activities carried out by an entity operating in the region as a fully vertically integrated mining operation.

**Diagram 2: Multiple intercompany transactions in the mining industry**

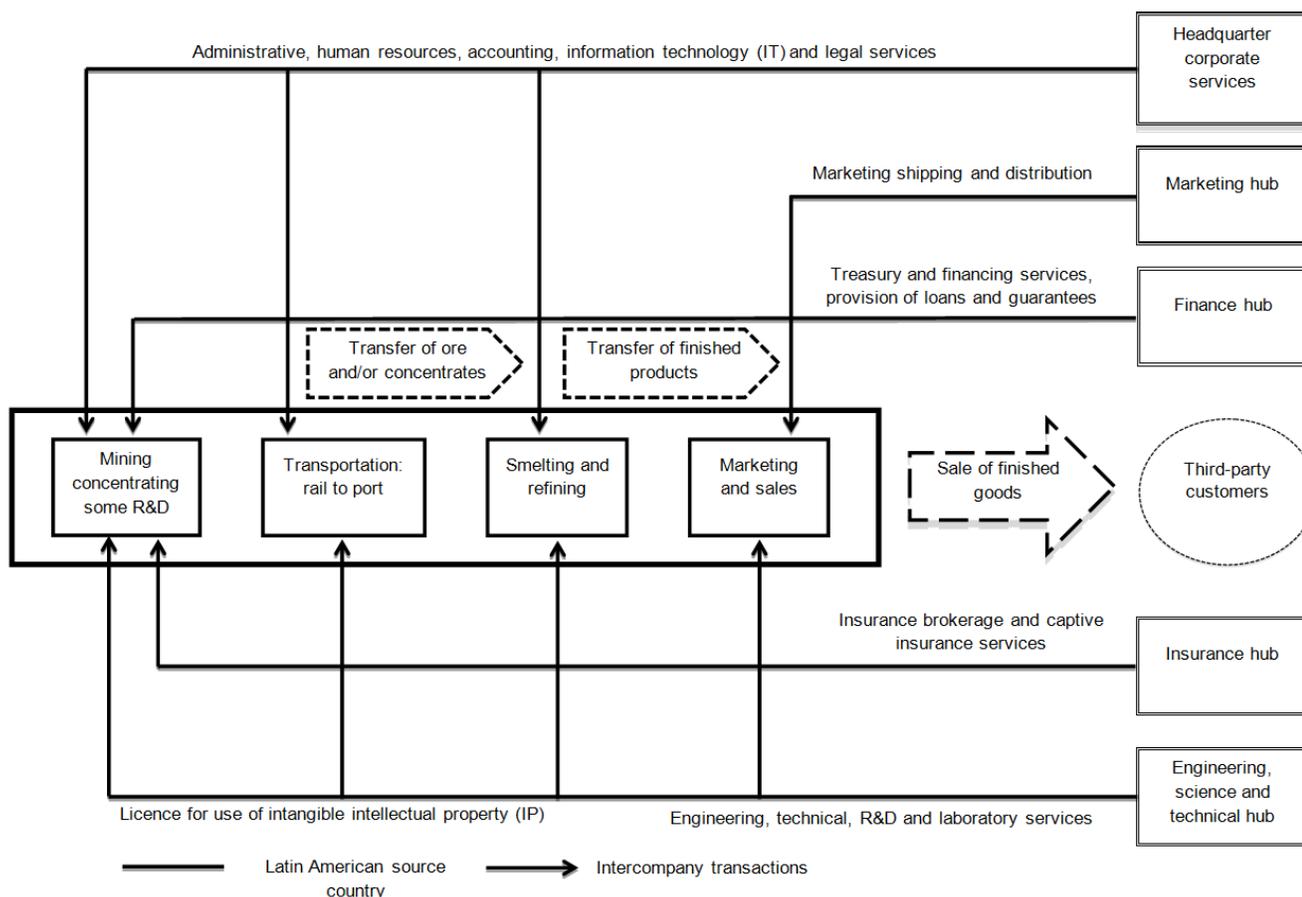


Diagram 2 reflects intercompany transactions that could generate value to the activities of the group operating in the mining sector in Latin America that must be analysed from a holistic perspective to reveal the economic reality. An appropriate outcome of a VCA would be a sound alignment between value creation, economic activities and the allocation of profits.

## 6.2. The role of a VCA

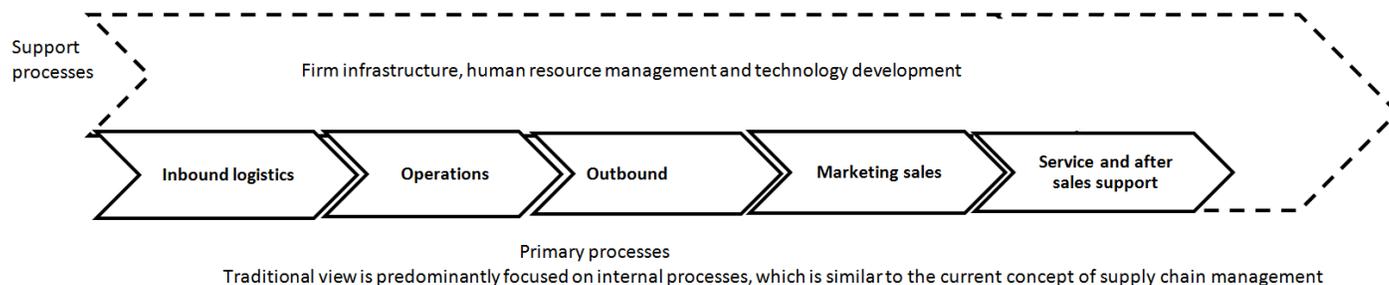
A VCA that became part of the annual transfer pricing documentation required for MNEs following the OECD/G20 BEPS initiative dates back to 1985, when Porter first introduced it in his book titled “Competitive Advantage”.<sup>[82]</sup> In the simplest terms, a VCA refers to the entire performance process of a company, which begins with R&D and ends with the delivery to the end consumer. The value chain of

81. Global Mining, *Mining activity in Latin America: 2015* (30 Sept. 2015), available at <http://www.miningglobal.com/operations/infographic-mining-activity-latin-america-2015>.

82. M.E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (Simon & Schuster 1985).

a company takes into account all of the support and core activities carried out by related or unrelated parties in making the company function. Diagram 3 presents a simplistic model of a value chain.

**Diagram 3: The traditional view of a value chain as developed by Porter**



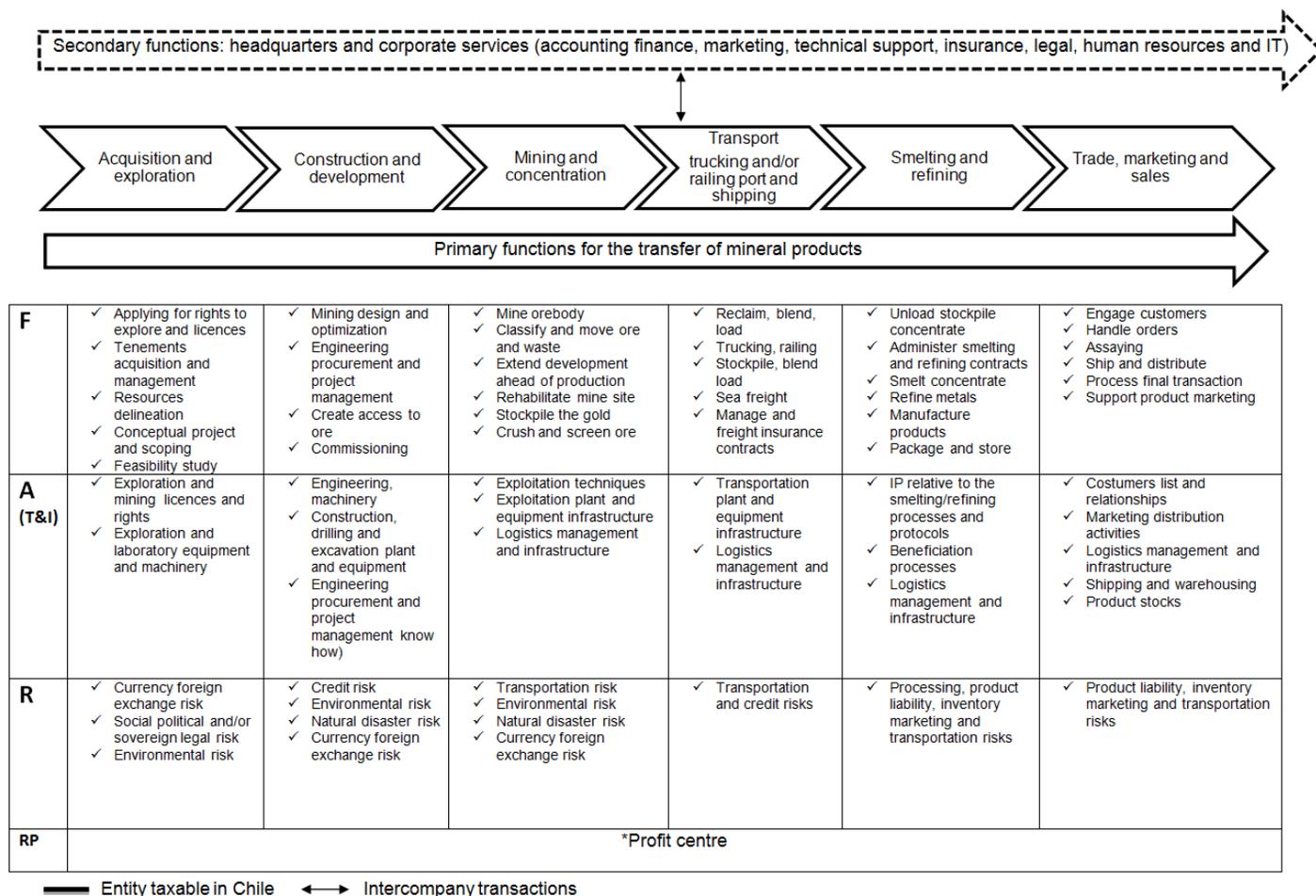
VCA has gained the interest and attention of economists and lately of the OECD when it was incorporated as part of the regulations stemming from the OECD/G20 BEPS initiative. In this respect, Action 8-10 reveals the importance of a VCA in its title, “Aligning Transfer Pricing Outcomes with Value Creation”. While the reports in respect of the OECD/G20 BEPS initiative provide additional guidelines regarding related-party transactions, a VCA is an important tool in the interpretation of the arm’s length nature of intercompany transactions and ensures that they are aligned with the operating, strategic and governance models of an MNE.

According to BEPS, in transactions between two associated enterprises, compensation should reflect the functions performed, assets used, and risk assumed (“FAR analysis”) by each party as indicators of the real substance of a company and its operations that are determined by performing a functional analysis. For this purpose, a VCA assists in understanding the structure and organization of an MNE group and how these factors influence the industry in which the MNE operates. Consequently, a VCA facilitates the detailed FAR analysis.

The foregoing represents a call for MNEs to take the necessary actions to establish if their business structures, tax positions and governance policies align with their economic activities and value creation. For this purpose and in order to avoid tax disputes following implementation of the results of the OECD/G20 BEPS initiative, it is necessary to conduct a VCA that breaks down the value-creating activities and processes of an entity and indicates if the allocation of income is made in a BEPS-proof manner. From this perspective,

MNEs could also benefit from this tool to prevent, assess and mitigate (potential) tax and transfer pricing risks. Diagram 4 illustrates a VCA in the mining sector in respect of a company operating in Latin America.

**Diagram 4: VCA in the mining sector for a company operating in Latin America**



\* In this example, it was assumed that the entity operating in LATAM has a high degree of independent decision-making authority over the different stages on the mining value chain. Therefore, it was identified as a profit centre.

Source: S. Huibregtse et al., *Transfer Pricing in Mining with Focus on Africa* (TPA Global 1 Jan. 2017).

## 7. Harmonizing the Transactional with the VCA Approach

As noted, it is essential for MNEs, when preparing the Master Files and other transfer pricing documentation, to have an adequate and complete functional analysis and VCA to be able to determine the value created by the activities performed by each entity of the MNE and how those activities are remunerated. As such, a proper VCA with a holistic approach contributes to determine how the group profit is allocated between each group entity. Such an approach requires understanding of the industry, the typical value chain being used by MNEs and the relative weight in value creation given to each of the functions performed, risks being managed and assets being employed.<sup>[83]</sup>

In this sense, it is necessary to separate residual profit from the compensation in respect of the more routine types of operations as follows:

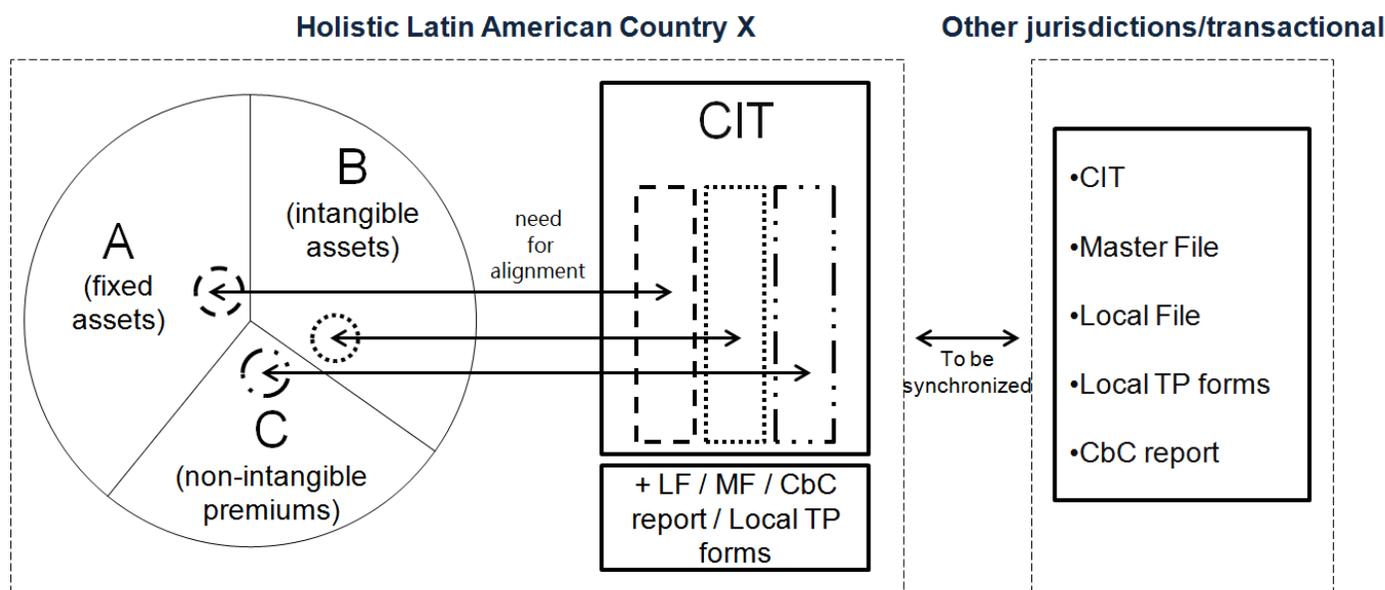
- Routine types of operations should be remunerated according to each of the arm's length margins obtained through the performing of adequate benchmarking studies per type of activity and per relevant region. As such, each type of routine activity, including the intercompany transactions involved, can be remunerated in the following way:
  - manufacturing activities on a markup on total costs (MOTC) basis;

83. S. Huibregtse & M. Grigoryeva, *Slicing the Pie – A Quantitative Value Chain Analysis*, Bloomberg BNA (Nov. 2016), available at <https://s3-eu-west-1.amazonaws.com/3eeb8fe9-6553-11e7-b33e-0287636382f5/ae03c317-ae6a-11e7-b33e-0287636382f5/upload/yzbg7jn3qpha9jpiiipe7m87zamkig/161122-slicing-the-pie-a-quantitative-value-chain-analysis.pdf>.

- services on MOTC basis;
  - sales on operating margin basis; and
  - other functions, such as financing activities, based on a mixed approach.
- When routine functions are compensated, the remainder of the profits can be attributed to the residual profit.
  - The residual profit should be allocated between the entities of the MNE that have profit centre profiles, for example, supply-demand optimization centres, and entities that have investment centre profiles, for example, the owners of intellectual property (IP), as they perform the main and complex functions and manage a large portion of the financial and operational risks, thereby assuming an entrepreneurial role and performing the development, enhancement, maintenance, protection and exploitation (DEMPE) functions relating to different types of intangibles.
  - Many group entities could have the right to claim a portion of residual relating to investment centre DEMPE functions according to how those functions are effectively controlled and/or performed by the group entities.
  - Some entities performing routine functions could argue for an additional uplift if these functions are involved in the non-intangibles premiums, such as location-specific factors, synergies and cheap labour.

Consequently, starting from a holistic perspective, using a VCA and with the support of transfer pricing methods to evaluate the compensation for the routine functions and the intercompany transactions in order to split the residual profit, synchronization between the transactional and holistic allocation of group profits can be successfully obtained. Diagram 5 illustrates the relationship between a holistic perspective in respect of a VCA and the set of intercompany transactions that determines domestic taxable income.

**Diagram 5: Matching a VCA (holistic arm’s length principle) with the arm’s length principle (transactional)**



The following should be noted with regard to Diagram 5:

- the scenario divides the assets and activities of an MNE into the following three categories: (i) managing tangible and/or fixed assets; (ii) managing intangible assets; and (iii) managing non-intangible premiums as location savings, assembled workforce and synergies and allocating the profits of an MNE on the basis that each entity of the group has control over certain assets or performs certain activities; and
- the respective allocations between A, B and C are reported in the income tax return in respect of Latin American country X as well as in the new transfer pricing documentation introduced by the OECD/G20 BEPS initiative, i.e. the Master File, the Local File and the CbC report, that should support the allocation between A, B and C as reported in the income tax return.
- an overview of the need for an MNE to adopt the same approach in the other Latin American countries as well as the other jurisdictions in which the MNE operates;

- the view that the OECD/G20 BEPS initiative effectively integrates international tax and transfer pricing and emphasizes economic reality; and
- the need for synchronization as well as transparency at a global level following the OECD/G20 BEPS initiative resulted in a VCA being used by tax authorities and MNEs to comply with the increasing demand for complete transparency where a holistic approach to taxation by MNEs must be fully synchronized with the local allocation of total profits.

It should be noted that undertaking a VCA does not automatically result in the application of a profit split method. Rather, it is a tool to identify the features of the relationships between parties, as noted by the OECD, “[a]ll business operations can be expressed through a value chain and many MNE groups operate through a global value chain”.<sup>[84]</sup> In relation to one of the profit split drafts, it was also stated that:

[t]his alone does not imply that the transactional profit split should be applied. If that were the case, then a profit split would apply in almost every case and risk producing results contrary to the arm’s length principle. Instead, the purpose of the VCA is to identify the features of the commercial or financial relations between the parties.<sup>[85]</sup>

Consequently, considering the new transfer pricing environment following the OECD/G20 BEPS initiative in Latin America, companies operating in the region should take into account the need to combine their business operations with a holistic and/or a VCA approach to intercompany transactions on a global basis due to the full transparency required in the world post the initiative.

## 8. Conclusions

The OECD/G20 BEPS initiative brought about a set of transfer pricing standards and documentation that aims for the taxation of MNEs to be aligned with economic reality and value creation as well as transparency at a global level. MNEs are required to disclose how value is generated in the group as a whole, the interdependencies of the functions performed by the related enterprises and the contribution that each associated entity makes to that value creation. This new transfer pricing and tax environment gives rise to the need for taxpayers to assess their business operations from a holistic perspective to determine if their operational conduct, as well as their tax and transfer pricing practices and policies, adhere to the OECD/G20 BEPS initiative.

Latin America is part of this new tax and transfer pricing era to its full economic extent. As noted in [section 4.2.](#), various Latin American countries have introduced some or all of the three-tiered transfer pricing documentation requirements suggested by Action 13 of the OECD/G20 BEPS initiative into their legislations, and have signed the CbCR MCAA and/or other mechanisms to realize the effective exchange of information between the tax authorities of different jurisdictions. In this context, a holistic and/or a VCA approach contributes first to the urgent need for MNEs operating in the region to align their transfer pricing documentation, business models, finance and/or tax positions and governance with the standards of the OECD/G20 BEPS initiative and, second, to manage the risk of the transfer pricing and/or tax audits arising from the exchange of information and financial information across multiple jurisdictions.

<sup>84.</sup> OECD, *Revised Guidance on Profit Splits 4 July-5 September 2016 – Actions 8-10: Public Discussion Draft* para. 25 (OECD 2016), available at [www.oecd.org/tax/transfer-pricing/BEPS-discussion-draft-on-the-revised-guidance-on-profit-splits.pdf](http://www.oecd.org/tax/transfer-pricing/BEPS-discussion-draft-on-the-revised-guidance-on-profit-splits.pdf).

<sup>85.</sup> *Id.*