Global Transfer Pricing

Arm’s Length Standard

October/November 2012

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Brazil Enacts Major Changes to Transfer Pricing Legislation

As part of long-awaited initiatives to stimulate gross domestic product growth, the Brazilian Executive on April 3 published Provisional Measure (PM) 563/2012, which included relevant changes to the country’s transfer pricing rules. PM 563/2012 has now been converted into law 12,715/2012, published on September 18, 2012. Law 12,715/2012 is significantly similar to PM 563/2012, which amended the transfer pricing rules applicable to importation of goods, services, and rights, set new profit margins for certain sectors, and created two new transfer pricing methods. Although law 12,715/2012 applies to fiscal years starting on or after January 1, 2013, taxpayers may opt to apply the rules from fiscal year 2012.

Highlights of the new Brazilian transfer pricing legislation include the following.

Changes to the Resale Price Minus Profit Method (PRL)

The PRL historically has been the most frequently used method to determine the deductible amount associated with an inbound intercompany transaction entered into by a Brazilian taxpayer. The PRL method takes into account certain statutory gross profit margins, which vary depending on the use of the imported products, services, or rights. The statutory gross profit margins in the old rules were 60 percent for inbound transactions entered into by the Brazilian taxpayer as an input to its production process and 20 percent in all other cases in which the inbound transaction is not used in the production process, but rather transferred/resold to an unrelated party, regardless of the taxpayer’s industry.

Law 12,715/2012 introduces the following changes to the application of the PRL method:

New gross profit margins – New gross profit margins will apply, depending on the taxpayer’s industry sector or the activities for which the inbound products, services, or rights are used. One of the major differences between PM 563/2012 and Law 12,715/2012 involves the exclusion of the word “manufacturing” from the description of several of the relevant industry sectors and activities for which the new gross profit margins should apply. Law 12,715/2012 clearly expands the scope of certain gross margins to extend their application to taxpayers in a given sector, irrespective of their involvement with manufacturing activities. Table 1 below compares the language to describe the gross profit categories between the original PM 563/2012 and Law 12,715/2012:

Gross profit margin	Sector or activity under PM 563/2012	Sector or activity under Law 12,715/2012
40%	Manufacturing of pharmachemicals and pharmaceuticals	Pharmachemicals and pharmaceuticals products
	Manufacturing of tobacco-related products	Tobacco-related products
	Manufacturing of optics, photography, and cinematographic equipment and instruments	Optics, photography, and cinematographic equipment and instruments
	Sale of medical and dentistry-related machinery and equipment	Medical and dentistry-related machinery and equipment
	Extraction of oil and natural gas	Extraction of oil and natural gas
30%	Manufacturing of chemical products	Chemical products
	Manufacturing of glass and glass-related products	Glass and glass-related products
	Manufacturing of cellulose, paper, and paper products	Cellulose, paper, and paper products
	Metallurgy	Metallurgy
20%	All other sectors	All other sectors

Freight and insurance and import tax costs – One of the most controversial issues with regard to import transactions is the treatment of freight and insurance costs and its impact on the Brazilian import tax cost for purposes of comparison with the price calculated using the PRL method. From an economic perspective, payments to third parties do not generate a transfer of profits to related parties and therefore should not be subject to the transfer pricing rules. Law 12,715/2012 now provides that, unless paid to related parties, freight and insurance expenses, as well as the import tax and other customs costs incurred by the local importer, should not be considered in the determination of the transaction price taken into account by the Brazilian transfer pricing rules.

PRL calculation formula – Law 12,715/2012 introduces a change to the PRL formula to the effect that the parameter price (which continues to have as its starting point a sale transaction entered into by the Brazilian taxpayer) must take into account the ratio of the products, services, or rights purchased from foreign related parties in the total cost of a given product, service, or right sold by the Brazilian taxpayer. This change enacts into law a calculation procedure that resembles the Brazilian tax authorities' regulations "PRL 60" method. Stated differently, and disregarding the new gross profit margins, the PRL formula provided by Law 12,715/2012 resembles calculation procedures the Brazilian tax authorities were imposing on taxpayers when applying the old PRL 60 percent method for goods, services, or rights applied in the production process since 2003 (i.e., under Normative Instruction 243/2002).

Table 2 below compares the old and new PRL formulas. Please note that for purposes of this article the "old" PRL formula (i.e., on the left side of the table below) corresponds to the formula provided by Normative Instruction 243/2002. The PRL method has been a source of controversy, and various interpretations of that method exist, some of which, depending of the facts and circumstances, can be more beneficial than the new PRL formula provided by Law 12,715/2012.

Old PRL formula/a	$
(A) Imported component CIF+II/b	50.00
(B) Cost of goods sold	80.00
(C) Net sales	100.00
(D) Ratio (A/B)	62.50%
(E) Base for PRL (C*D)	62.50
(F) PRL margin (E*60%)	37.50
(G) PRL price (E-F)	25.00
(H) Transfer pricing adjustment (A-G)	25.00

New PRL formula/c	$
(A) Imported component FOB/d	40.00
(B) Cost of goods sold	80.00
(C) Net sales	100.00
(D) Ratio (A/B)	50.00%
(E) Base for PRL (C*D)	50.00
(F) PRL margin (E*20%)	10.00
(G) PRL price (E-F)	40.00
(H) Transfer pricing adjustment (A-G)	0.00

Old PRL formula/a	$		New PRL formula/c	$

Notes:
/a – For tangible products applied in the manufacturing process, based on IN 243/2002.
/b – Old regulations require taxpayers to base the analysis on the cost plus insurance and freight (CIF), plus import tax prices for the purchased products.
/c – The new regulations make no distinction between manufacturing or resale. Gross profit margins should vary depending on taxpayers' industry sector. For "all other sectors," for instance, the gross profit margin under the PRL should be 20 percent. Depending on the taxpayer's sector or activity, higher gross profit margins apply (please refer to Table 1 above).
/d – The new regulations allow taxpayers to base the analysis on the freight on board (FOB) prices for the purchased products.

Changes to the comparable uncontrolled price method (PIC) – The PIC is defined as the weighted average of the uncontrolled prices of similar goods, services, or rights as calculated in the Brazilian market or in other countries, for purchase or sales transactions carried out under similar circumstances. Law 12,715/2012 provides that the application of the PIC method requires comparable transactions representing at least 5 percent of the importation cost of the tested transaction in cases in which the taxpayer substantiates its transfer prices with internal comparables (that is, transactions entered into by the Brazilian taxpayer with unrelated parties). Law 12,715/2012 did not set a threshold when the PIC method is applied solely based on comparable transactions entered into by parties other than the Brazilian taxpayer. Law 12,715/2012 also provides that the PIC method should be substantiated by transactions entered into during the same fiscal year as those under test. When transactions entered into during the same period are not available, the taxpayer can rely on transactions entered into in the prior year, as long as they make adjustments to the price of such transactions to account for foreign exchange rate fluctuations.

New transfer pricing methods for commodities – Law 12,715/2012 introduces two additional transfer pricing methods to the existing Brazilian methods: the commodity exchange import price and the commodity exchange export price for inbound and outbound transactions with commodities, respectively. Under the additional methods, the basis for comparison is the average commodity exchange price for the relevant items adjusted for upward or downward spreads. The commodity exchange price that should be used corresponds to the average price on the date of the transaction. In cases in which no commodity exchange price exists for the relevant date, the analysis should be based on the average commodity exchange price for the most recent date before the transaction date. For commodity products not negotiated in commodity exchanges, Law 12,715/2012 also allows the use of prices obtained from reputable institutions, to be identified in tax authorities' regulations. The new transfer pricing methods must be applied in intercompany transactions involving commodities. In other words, taxpayers would no longer be allowed to apply any of the remaining methods to assess the reasonableness of their transfer prices.

Inbound and outbound loan transactions – The law in effect provides that taxpayers are not subject to the Brazilian transfer pricing legislation if the loans are registered with the Brazilian central bank. Law 12,715/2012 specifically provides that interest expense paid to related parties will *not* be deductible if above the six-month London Interbank Offered Rate for dollar denominated loans, plus a 3 percent annual spread. The Brazilian Minister of Finance has the authority to change the spread rate. In practical terms, the new provision means that interest charges above such a threshold will not be deductible for corporate income tax purposes.

Limitation on ability to change transfer pricing method – Currently, domestic companies conduct an annual transfer pricing analysis and include the results on specific forms filed with the Brazilian income tax return. After tax authority's regulation and effective from fiscal year 2012, a taxpayer cannot change a previously chosen transfer pricing method once the Brazilian tax authorities initiate an audit. If the authorities conclude that the method originally chosen by the taxpayer should be disqualified, the taxpayer will be granted an additional 30-day period to prepare a new transfer pricing analysis that can be based on any of the other available methods.

Brazil's transfer pricing rules have been a source of controversy since they entered into effect. Unfortunately, the changes introduced by Law 12,715/2012 do little to align Brazilian transfer pricing legislation with international norms. The rules continue to lack the economic rationale provided under the U.S. transfer pricing regulations and the Organization for Economic Cooperation and Development (OECD) transfer pricing guidelines. Nevertheless, the changes are significant and will impact the majority of multinational companies in Brazil.

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India Issues APA Rules

India's Central Board of Direct Taxes on August 31 issued rules regarding the recently introduced advance pricing agreement (APA) scheme. The rules have been expected since March, when the 2012 budget introduced an APA regime effective July 1, 2012. Notification No. 36, dated August 30, 2012, provides that Rules 10F to 10T and Rule 44GA addressing APAs will be inserted in the Income-tax Rules, 1962.

The 28-page rules are summarized below.

Taxpayers may file for an APA for ongoing transactions before the commencement of the relevant financial year, or for an APA covering proposed transactions before those transactions commence.

Unilateral, bilateral, and multilateral agreements are available. The application for a unilateral APA must be filed with the Director General of Income Tax (International Taxation), and with the Indian Competent Authority in the case of bilateral or multilateral agreements.

The APA team will consist of income tax authorities and also include experts in economics, statistics, law or any other field designated by the Director General of Income Tax (International Taxation).

Prefiling meetings or consultations with the authorities are mandatory, and could be either on a named or an anonymous basis. The rules call for the filing of exhaustive information at the time of the prefiling consultation with the authorities.

The filing fee for an APA application ranges from USD 20,000 when the value of international transactions does not exceed USD 20million, USD 30,000 when the transaction value is between USD 20 million and USD 40 million, and USD 40,0000 when the international transactions value is above USD 40 million.

The applicant can choose the term of the agreement, for a period not exceeding five years.

If an application does not contain full information or is not in accordance with the requirements of the tax authorities, the application will be treated as defective, and the tax authorities will serve notice on the applicant to that effect within a month from receipt of the application. The applicants must then submit the requisite information within a period of 15 days and not exceeding 30 days.

The APA team will hold meetings with the applicants on such time and date as it deems fit, and can request any additional information they deem necessary. They may also visit the applicant's premises, and can make any inquiries they deem necessary.

The rules allow taxpayers to withdraw an APA application at any point before conclusion of the negotiations. However, the rules are silent regarding the use of confidential information for audit purposes upon withdrawal. Further, an applicant can request an amendment before finalization of the APA.

A signed APA will include a description of the international transactions covered, the agreed transfer pricing methodology, a determination of an arm's length price, and critical assumptions.

The rules state that the agreement is not binding in case of a change in any of the critical assumptions or failure to meet the agreed upon conditions.

Taxpayers that have entered into an APA must file annual compliance reports within 30 days of the due date for filing the tax return, or within 90 days of entering into the APA, whichever is later.

The transfer pricing officer with jurisdiction will carry out a compliance audit to ensure satisfaction with the critical assumptions and the correctness of the supporting data and information, apart from confirming the consistency in application of transfer pricing method. The officer must send an audit report within six months from the filing of the annual compliance report to the Director General of Income Tax in the case of unilateral agreements, and to the Competent Authority in case of bilateral or multilateral agreements.

The illustrative list of information taxpayers must provide as part of an APA application includes the following:

- Details of the applicant and associated enterprise;
- Global structure of the applicant;
- Business model of the applicant and its operations in the prior three years;
- Details of the international transactions along with the audit history for the last three years;
- Critical assumptions;
- Industry analysis;
- Functional and risk profile of the applicant vis-à-vis the associated enterprise;
- Business strategy;
- Proposed transfer pricing methodology and its impact vis-à-vis the prior years ;
- Details of third-party comparables;
- Financial data of the applicant for the last five years, and income tax returns for the last three years;
- Copies of all the relevant intercompany agreements; and
- Details of the any other APA entered into by the applicant or associated enterprise with Indian or foreign tax authorities.

Detailed forms for prefiling, APA filing, withdrawal and annual compliance have been prescribed.

Until the conclusion of an APA, applicants are expected to comply with all regular compliance mandates, including filings and audits.

The revision of APAs is possible, either by the tax authorities or the taxpayer. The rules provide the scenarios under which revisions may occur, such as a change in the critical assumptions, a change in the law, or a request from the competent authority of another country. Any revision of an APA by the authorities, they will provide an opportunity to the applicant.

The rules provide for the cancellation of the APA by either of the parties in the specified circumstances. Cancellation of an APA can arise because an applicant is not compliant with the annual compliance report requirement, or because of failure to comply with the terms of the agreement, including the critical assumptions.

The rules provide for renewal of an APA. The procedure for renewal is the same as for the initial application, except that the prefiling consultation is not required.

The rules are silent about the timeline for conclusion of an APA. They also fail to mention the possibility of any roll back of the APA to open tax audit years.

Although the rules are effective 1 July 2012, in case of ongoing transactions, the applicants cannot use the APA mechanism for the current year, and APAs are available only from the next year – that is, 1 April 2013 for existing transactions. In the case of proposed transactions, it is possible to enter into an APA in the current year, before undertaking such transactions.

Now that the long-awaited rules are available and the necessary teams are in place, it is possible for multinational enterprises to utilize the APA mechanism to obtain certainty on their transfer pricing. The success of the APA mechanism will depend on how the authorities entrusted with implementation of this mechanism deal with applicants during the prefiling meetings and negotiations during the course of the APA process.

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Finland Revises Proposed Intragroup Interest Deduction Limitation Rules

Finland's Ministry of Finance on 17 September 2012 issued a new draft proposal that would limit the deduction of interest on related-party loans. Although the draft generally is unchanged from the version issued in April 2012, it contains modifications to the effective date, giving companies more time to prepare, and to the scope of the provisions based on comments received.

According to the draft rules, interest expense paid on related-party loans would be fully deductible provided the borrower had interest income, but the deduction would be limited to a maximum of 30 percent of profit before interest, tax, depreciation, and amortization (taxable EBITDA). Group contributions granted and/or received would be part of the taxable EBITDA.

Parties would be deemed to be related for purposes of the EBITDA limitation rules if one party had direct or indirect control over the borrower, or if a third party had control over both parties in the debt relationship. Control would be established if one party held at least 50 percent of the capital or voting power or the right to nominate a certain number of board members of the other party, or other factors were present that constitute control.

Any interest that could not be deducted because of the EBITDA limitation would be available for carryforward to future tax years and deducted according to the 30 percent limit. Specific rules would apply in the case of reorganizations (mergers, demergers, and transfers of assets). A full deduction would be allowed for interest expense up to the amount of interest income of the borrower. Furthermore, if the net interest expense of the borrower is EUR 500,000 or less, the total amount of interest expenses would be tax deductible and not subject to the limitations. However, if the amount of net interest expense exceeds EUR 500,000, the interest deduction limitations would be applied to the total net interest expense.

The interest deduction limitation rules would not be considered anti-avoidance rules and, for purposes of their application, the business rationale for the capital structure would not be examined. However, the capital structure and interest rates would have to conform to the arm's length principle or face challenge under other tax provisions (i.e., anti-avoidance and hidden dividend distribution provisions).

Revisions

The revised version of the proposed rules contains the following changes:

- The interest deduction limits would not be applicable if the equity ratio (the ratio between total equity and total assets) of the company was equal to or greater than the equity ratio of the whole group based on the group's audited financial statements.
- The definition of a related-party loan would be narrowed slightly, specifically with respect to collateral arrangements and cash pooling between related parties.
- Financial, insurance, and pension institutions would fall outside the scope of the new rules, as would entities that are subject to tax laws other than the Business Income Tax Act (the latter exclusion would be particularly relevant to real estate investment businesses).
- If approved, the changes would enter into force on 1 January 2013 and be applied for the first time when assessing taxes for 2014 (under the earlier proposal the new rules would apply for assessing taxes for 2013). Therefore, the limitations would be applicable to financial years ending on or after 1 January 2014.

The final draft of the rules will likely be presented during October 2012.

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Australian Parliament Passes New Retroactive Transfer Pricing Legislation

The Australian government has accomplished a significant part of its agenda for reforming Australia's transfer pricing rules, by amending the Income Tax Assessment Act 1997 to include new Subdivision 815-A ("treaty-equivalent cross-border transfer pricing rules"). The legislation, passed by Parliament on 20 August 2012 and now awaiting Royal Assent, is substantially the same as the Exposure Draft legislation released for public comment in March 2012.

Purpose of Retroactive Transfer Pricing Rules

Subdivision 815-A's primary purpose is to ensure that the transfer pricing articles in Australia's tax treaties (the Associated Enterprises and Business Profits Articles) can be applied as an assessment power independent of Division 13 of the Income Tax Assessment Act 1936. In a nutshell, Subdivision 815-A authorizes the Australian Taxation Office (ATO) to tax a "transfer pricing benefit," which is essentially the amount of profit that would, but for non-arm's-length conditions, be allocated to an Australian entity or permanent establishment under a transfer pricing article in an applicable tax treaty.

Subdivision 815-A has effect for years of income commencing on or after 1 July 2004, with the retroactive application of the new legislation being its most controversial feature. The government views the legislation as a revenue protection measure, pointing to the need to address uncertainties as to the operation of the existing transfer pricing laws, particularly following last year's Federal Court decision in the *SNF Australia* case.

Practical Implications of Retroactive Transfer Pricing Rules

Key points to note regarding Subdivision 815-A's practical implications for taxpayers include the following:

- Australia's transfer pricing rules now comprise three sets of provisions: new Subdivision 815-A, as well as the existing laws in Division 13 and the treaty transfer pricing articles. All apply fundamentally the same arm's length principle, although differences in wording between Division 13 and the other provisions create the potential for differing outcomes. The ATO is expected, when possible, to rely on all three of the provisions in the alternative to support transfer pricing adjustments.
- Subdivision 815-A does not give the ATO any more power to make transfer pricing adjustments than it believes it already had under existing law. This is consistent with the government's repeated statements that it is only "clarifying" the existing law regarding the treaty transfer pricing articles being an assessment power independent of Division 13.
- The major impact of the retroactive law is on taxpayers with ongoing ATO transfer pricing audits. The ATO has indicated that it has 40 such cases involving transfer pricing adjustments worth A$1.9 billion in tax. For those taxpayers, the ATO now has legislative backing for what were previously only arguable views.
- Other taxpayers potentially affected by the law's retroactive application are those at risk of an ATO audit of the 2004 to 2012 years. Factors that may place taxpayers at risk of an ATO audit include persistent losses, global restructures, or significant related-party debt expenses.
- Subdivision 815-A significantly strengthens the ATO's position for its views on issues, such as its power to use profit methods to make transfer pricing adjustments, its power to require commercially realistic outcomes in the taxpayer's circumstances, and its power to reconstruct transactions (such as pricing related-party debt by reference to arm's length debt amounts).
- Subdivision 815-A explicitly requires that it be interpreted consistently with relevant OECD guidance. This should help ensure that the ATO cannot depart from internationally accepted principles and approaches in applying the new provisions.
- From 1 July 2012, Australian taxpayers engaging in cross-border transactions with related parties in countries that have a treaty with Australia will need to be aware of the implications of Subdivision 815-A. In particular, these taxpayers will need to keep in mind OECD transfer pricing guidance regarding policies, processes, and records. For many taxpayers, this is likely to be business as usual.

- Subdivision 815-A includes a provision dealing with its interaction with Australia's thin capitalization regime in Division 820 ITAA 1997, by essentially adopting the ATO's position in Taxation Ruling TR 2010/7.
- The ATO has publicly announced that it will not apply Subdivision 815-A retroactively to reopen settled cases, including concluded audits, agreed advance pricing arrangements, and settled treaty mutual agreement procedures (MAP).
- Because Subdivision 815-A applies only in treaty cases, MAP should be available for taxpayers to obtain relief for any resulting double taxation, although MAP does not guarantee relief and some other countries may have a statute of limitations that precludes relief for adjustments to early years.
- There is no additional penalty exposure on a retroactive application of Subdivision 815-A. The amount of any penalty is the same as if Subdivision 815-A had not been enacted, and is therefore limited to the amount imposable on the application of Division 13 or the treaty transfer pricing article.

Next Phase of Australian Transfer Pricing Reform

The Subdivision 815-A amendments are the first stage of the government's transfer pricing reforms. Further amendments are proposed to prospectively replace the current Division 13, for which Exposure Draft legislation is expected shortly. Key changes likely to be introduced are a mandatory transfer pricing documentation requirement, a limitation of the years available to the commissioner to make transfer pricing adjustments, and the adoption of a self-assessment regime for transfer pricing. Also under consideration is a proposal to bring Australia's permanent establishment profit attribution rules fully into line with the current OECD-endorsed approach.

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Latvia Introduces New Transfer Pricing Documentation Requirements

Latvia recently published amendments to the law "On taxes and duties" that introduce transfer pricing documentation requirements. The new requirements will enter into force on 1 January 2013. Pursuant to the amendments, Latvian corporate taxpayers – residents and permanent establishments – will be required to prepare transfer pricing documentation if their annual turnover exceeds LVL 1 million and their related-party transaction value exceeds LVL 10,000.

The transfer pricing documentation requirements will apply to transactions with:

- Foreign related companies;
- Latvian companies that qualify for group relief;
- Companies that take advantage of tax reliefs;
- Related persons; and
- Companies that operate, are founded in, or set up in low-tax or tax-free jurisdictions or territories.

The transfer pricing documentation should contain the following information:

- An industry analysis that includes a general description of the industry in which the taxpayer operates;
- A company analysis that contains relevant information about the company, such as. strategy, forecasts, and legal and operational structures;
- A functional analysis that includes the description of functions, risks, and assets employed by the parties engaged in the transaction;
- The method selected to establish the market price; and
- An economic analysis based on the transfer pricing method selected for the establishment of the market price and that contains an analysis of financial data or values of transactions between comparable unrelated companies.

Taxpayers will be obligated to keep their transfer pricing documentation for five years and provide the tax authorities with the documentation within a month of receiving a request for the same. If the information is not provided fully or on a timely basis the tax authorities have the right to establish the market price for the transaction under review, based on the information at their disposal.

The amendments provide taxpayers with the option to enter into advance pricing agreements with the tax authorities to negotiate the market price for the defined transaction or transaction type, if the value of the transaction or planned value exceeds LVL 1 million during the year.

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Panama Expands Scope of Transfer Pricing Regime

Panama's National Congress on August 28 approved Law 52, which introduces changes to the Internal Revenue Code of Panama, including significant modifications to the transfer pricing regime.

The most important element of this reform is, without a doubt, the broadening of the scope of application of the transfer pricing rules, which will now apply to "any transaction that a taxpayer conducts with related parties that are tax residents of other jurisdictions… " Previously, the transfer pricing regime applied only to taxpayers that engaged in transactions with related parties in the countries with which Panama had entered into income tax treaties – Barbados, Mexico, and Spain. Therefore, every taxpayer that has transactions with related parties in any country is now subject to the transfer pricing regime in Panama.

Taxpayers are also required to file a transfer pricing report, known as Form 930, for fiscal year 2011. A time extension was granted until September 30, 2012, to submit the report. The law reform establishes a penalty of 1 percent of the total value of all transactions with related parties if a taxpayer fails to submit the transfer pricing report.

The reform also changes the conceptual name of the information and documentation referred to in Article 762-I, to "Transfer Pricing Study," adding that the study should be developed taking into account the complexity and volume of transactions.

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The Impact of Retroactive Transfer Pricing Adjustments on the Customs Value of Imported Goods: Are you compliant in South Africa?

The South African Revenue Service (SARS) recently issued a notice regarding retroactive transfer pricing adjustments in an effort to determine taxpayers' compliance with customs rules.

The customs value of goods imported into South Africa is determined primarily using the price paid or payable for the goods when sold for export, that is, the price as determined using a transfer pricing policy for related-party transactions.

In some instances, this transfer price is often subject to yearly adjustments (upwards or downwards) especially for limited-risk distributors to bring their profit margins within a range determined by the transfer pricing policy (the arm's length range). It is important for importers to note that these transfer pricing adjustments have an impact on the customs value of imported goods, especially in instances in which the price paid or payable was declared as the customs value to the South African Revenue Service (SARS) on importation, necessitating a similar adjustment for customs purposes.

The Customs Valuation and Transfer Pricing Divisions within SARS are collaborating with a view to eliminate duplication and foster information sharing, as well as to conduct joint audits. As a result of this collaboration, it has become apparent to

SARS that in some cases these year-end retroactive transfer pricing adjustments between related parties were not appropriately declared by taxpayers. In light of this, and to encourage importers to come forward and declare these adjustments, SARS issued a communication on 21 August 2012 alerting importers of their legal duty to declare the transfer pricing adjustments to Customs.

SARS is also requesting that all taxpayers who engage in related-party transactions respond to the following questions to verify whether transfer pricing adjustments have been taken into account for Customs Valuation purposes:

- Has the company made retroactive transfer pricing adjustments in the last five years of assessment?
- Is a value determination number (VDN) in place? If yes, please supply the VDN.
- Were the retroactive transfer pricing adjustments taken into account for customs valuation purposes?

All responses to the questions above were to be forwarded by 7 September 2012.

Interestingly, SARS is requesting for information on all transfer pricing adjustments going back five years, but the Customs Act (91 of 1964) allows them to go back only two years (unless SARS can prove that there was an intent to defraud the fisc). It should also be noted that if customs valuation adjustments have been made after a specific year end, it is the taxpayer's obligation to inform SARS of any adjustments, if any, in the following year.

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Chilean Tax Reform Includes Transfer Pricing Changes

The Chilean Congress recently enacted tax reform legislation that introduces new transfer pricing regulations. The new law specifies the accepted transfer pricing methods, and includes a new definition of related parties and rules regarding the newly required annual transfer pricing return. The law also introduces the concept of advance pricing agreements between taxpayers and the Chilean Internal Revenue Service (IRS).

Transfer Pricing Methods

A taxpayer may be summoned by the Chilean IRS in accordance with Article 63 of the Tax Code to certify that his or her transactions with related parties have been carried out at market value according to the following methods:

- Comparable uncontrolled price method;
- Resale price method;
- Cost-plus pricing method;
- Profit split method;
- Net margin method; and
- Residual methods.

These methods are consistent with the transfer pricing methods provided in the OECD Transfer Pricing Guidelines.

Taxpayers should use the most appropriate method considering the characteristics and circumstances of every case, the advantages and disadvantages of every method, its applicability in accordance with the type of transactions and circumstances of every case, the availability of information, and the existence of comparable transactions.

Residual methods are any other methods to calculate prices or values agreed with related parties when it is not possible to apply the five listed methods.

Related Parties

A related-party relationship exists when an entity or company "is directly or indirectly involved in the management, control, capital, profits, or income of the other party." The new definition of related parties has been expanded to include more relationships within its scope.

Transfer Pricing Tax Return

Taxpayers must now file an annual return with the Chilean IRS and provide information regarding the characteristics of transactions with related parties and unrelated parties, the methods used to calculate the prices or values of such transactions, and information regarding their related parties abroad. The failure to file this return, or erroneous, incomplete, or late filing will be penalized.

Transfer Pricing Studies or Reports

Taxpayers may accompany a transfer pricing study that explains the calculation of prices, values, or yields of transactions with related parties.

Transfer Pricing Adjustments

If a taxpayer cannot prove that transactions with related parties are carried out at arm's length prices, the Chilean IRS will redetermine the prices to calculate the tax due. The difference between the two prices will be subject to additional tax, and a 5 percent fine of the omitted amount will also be applied.

APAs

Taxpayers may propose to the Chilean IRS an APA for a maximum period of four years – the year in which the APA is entered into and an additional three years.

Corresponding Adjustments

Subject to approval by the Chilean IRS, taxpayers may correct the price of transactions with related parties based on the adjustments of transfer pricing made by other countries with which Chile has an applicable income tax treaty that allows such adjustments

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Have a question?
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