



Tax Newsletter

Timely news and information on Transfer Pricing issues

Transfer Pricing Adjustments deriving from intra-group service transactions

According to the current Tax Code (TC), taxpayers, for purposes of complying with the obligation established in Article 62-A, shall determine the market prices of their transactions with related parties by using the technical procedures and methods contained in the TC and in the Transfer Pricing (TP) guidelines of the Organization for Economic Cooperation and Development (OECD).

The OECD Guidelines, corresponding to the last edition published in July 2017, recognize that most multinational enterprises groups (MNE groups) provide various services to their affiliates, among which administrative, technical, financial and commercial services could be included. The cost of providing these services may initially be assumed by the parent company, by a specific company of the group (service

center) or by any other company that forms part of the MNEs.

In the analysis for the determination of TP of the intra-group services, two issues arise. The first issue is knowing whether the service has actually been provided. The second issue is whether the remuneration for those services, for tax purposes, should be in accordance with the arm's length principle.

Following are our comments regarding both situations.

1. Identification of the intra-group services actually provided

In order to identify whether an activity may be considered as an intra-group service and consequently recognize a charge for such services, the taxpayer should analyze the following aspects:

- 1.1. *Benefits test or materialization:* In the application of the arm's length principle, the question of whether an intra-group service has been provided depends on whether the activity a) presumes an economic or commercial interest for a member of the group, and b) whether an independent party would have been willing to pay for such activity.
- 1.2. *Shareholder activities:* Some activities (usually performed by the parent company or regional holding company) performed by shareholders would not be considered as intra-group services and, thus, would not justify a charge to the companies of the MNE group.
- 1.3. *Duplicated activities:* In general, activities that are limited to duplicating a service that another group member is performing for itself should not be considered as intra-group services.
- 1.4. *Incidental Benefits:* If a member of the MNE group receives an indirect benefit, these are not considered as intra-group services since the activities producing the benefits would not be ones for which an independent company would be willing to acquire.
- 1.5. *Centralized Services:* Routine services provided by regional headquarters or service center. These would be considered as intra-group services since normally an independent company would be willing to pay for these types of activities.

2. Determination of the arm's length remuneration

Once it has been established that an intra-group service has been provided, it is necessary to determine whether the amount of the remuneration, if any, is in accordance with the arm's length principle. In these cases, the Tax Administration would evaluate what arrangements have actually been put in place between the related companies to facilitate the charges for the provision of services between them.

The charges for intra-group services can be done through the direct-charge or indirect-charge method. **In general, a MNE group may be able to adopt a direct-charge method when services to related parties are provided in a manner that is similar to how they are provided to independent parties and their information systems accurately provide**

the costs and expenses actually incurred in the rendering of services to their clients. Otherwise, an indirect method would be applied.

In these cases of indirect charges, the MNEs group use different cost allocation and apportionment keys. The form of remuneration can be based on the volume of sales, staff employed, number of activities performed and other criteria that will depend on the nature and use of the service.

Following is a simplified mechanism for the charging of intra-group services, under the indirect-charge method:

- 2.1. *Determination of costs pools:* in this step, the taxpayer should eliminate from their cost pools those costs attributable to services provided by one member of the group solely on behalf of another member of the group.
- 2.2. *Allocation of service costs:* the taxpayer shall select the allocation keys based on the nature of the service and the consistency in similar service categories.
- 2.3. *Profit mark-up:* For the case of low value-adding services, the OECD Guidelines recommend a mark-up of 5%, provided that they meet the definition indicated for its classification. In all other cases, the mark-up is obtained from a specific economic analysis for each category of service identified. The profit mark-up must be applied to the cost pools determined, separating any pass-through costs.
- 2.4. *Charge:* it is the sum of the cost incurred plus the profit mark-up and is based on the corresponding proportion according to the step described in paragraph 2.2.

The OECD Guidelines suggest that all MNE groups that opt to apply this mechanism for charging intra-group services, must prepare the following information: a) a description of the categories of services, b) written agreements or contracts that support the services, c) calculations of the determination of costs and expenses related to the service, d) calculations that justify the application of specified allocation keys.

Criteria of the Tax Administration in intra-group service transactions

The Tax Administration in the exercise of its faculty indicated in Art. 62-A of the TC, may evaluate the determination of market prices made by the taxpayer and make tax adjustments resulting from these types of transactions.

According to recent cases of tax audits, the Tax Administration makes specific requests for intra-group service transactions, evaluating in detail the economic analyses performed and verifying the market prices of the transactions. Additionally, it requests the following information (list presented for illustrative purposes):

- a) Photocopy of contracts in Spanish;
- b) Description of the activities and actions performed by the service provider for providing each service received by the taxpayer;
- c) Determination of the price of the service provider;
- d) Information that documents the materialization of the service, such as: periodic visits, names of people who provided the services, dates, information on entries into and departures out of the country, detailed description of the activity, receiving area;
- e) Name, Tax ID Number, position and department of the people who requested the services, detailing the information used that supports these requests;
- f) Description of the receivers of the service, based on the organizational structure, stating what was the result, benefit or value added within the taxpayer's operations;
- g) Detail of accounts in which the disbursements for such services were recorded.

Based on this analysis and the evaluation of the information provided by the taxpayer, the Tax Administration will conclude whether the services in question comply with the arm's length principle, and if applicable, it would make the corresponding adjustments to the price.

Transfer Pricing adjustments, per that indicated by the Tax Administration in the Transfer Pricing Guidelines DG-001/2018, would be made at the median of the interquartile range, or if applicable, concluding that the expenses for these items are not deductible for Income Tax purposes.

Final Comments

Intra-group service transactions are currently one of the types of transactions that are most frequently questioned by the tax authorities, and remains of the areas in which resident taxpayers present the most opportunities for improvement in the supporting documentation and detail of the form of determining the price.

In light of the above, it is recommended that taxpayers apply additional procedures for appropriately identifying and documenting their intra-group services, and thus decrease any possible present or future tax exposure.



Wilmer García

Transfer Pricing Manager
Deloitte Consulting, S.A. de C.V.
wsgarcia@deloitte.com

Regulatory Summary

Monthly declarations of Specific and Ad Valorem Taxes and the Special Contribution (F06) are now done online

The Tax Authority, through the Directorate General of Internal Taxes (known in Spanish as DGII) and the Directorate General of Treasury (known in Spanish as DGT), informed taxpayers of the following:

As of September 1, 2018, the declarations of Specific and Ad Valorem Taxes and the Special Contribution (F06), must be filed only by using the online application, which implies that the tax declarations will no longer be received in DET format.

If there is an amount payable in the declaration, the taxpayer shall have the option to pay through electronic banking or by printing the Payment Order with NPE, in order to pay at authorized financial institutions or collection offices of the DGT.

For more information, you can read the press release at the site of the Tax Authority, using the following link: <http://www7.mh.gob.sv/pmh/es/Novedades/9417-Declaraciones-tributarias-mensuales-en-Linea-Impuestos-Especificos-y-Advalorem-y-Contribucion-Especial-F06.html>

Tax Calendar September 2018

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2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30						

September 14

VAT

- Declaration and payment of VAT (F-07).

INCOME AND FINANCIAL TRANSACTIONS

- Monthly declaration of Payment on Account, Tax Withheld on Income from Financial Transactions, and the Special Contribution for Citizen Security and Coexistence (F-14)

SPECIFIC TAXES AND AD VALOREM:

- Declaration and payment of Specific Taxes, Ad Valorem Taxes and Special Contribution (F-06).

OTHER OBLIGATIONS

- Report on Donations (F-960)
- Report on Specific and Ad Valorem Taxes on Producers and Importers of Alcoholic Beverages, Potable Ethyl Alcohol and Beer, Carbonated Beverages, Isotonic Beverages, Fortified Beverages or Energy Drinks, Juices, Nectars, Soft Drinks and Concentrated or Powder Mixtures for the Preparation of Drinks (F-955)
- Report on Specific and Ad Valorem Taxes on Producers and Importers of Firearms, Ammunitions, Explosives and Similar Items, Producers of Tobacco and Producers, Importers and those that clear fuels through customs (F-988)
- Monthly Report of Sales to Producers, Distributors or Retailers of Tobacco and Tobacco Products (F-956)
- Statement of Origin and Application of Funds (F-950).

September 21

VAT

- Monthly Report on Withholdings, Collections, and Advances on Account of VAT (F-930)

PRINTING

- Monthly Report on Documents Printed for Taxpayers of the VAT (F-945)

Contacts:

Federico Paz
Lead Partner of the Tax and Legal Services Practice
fepaz@deloitte.com

Ghendrex García
Tax and BPS Partner
ggarciaq@deloitte.com

Cosette Fuentes
Legal Services Manager
cq.fuentes@deloitte.com

Daniela Vargas
Tax Consulting Manager
dvargas@deloitte.com

Magdalena Tobar
Tax and Municipal Compliance Manager
mtobar@deloitte.com

Alberto Raimundo
Tax Audit and Compliance Manager
sraimundo@deloitte.com

Wilmer García
Transfer Pricing Manager
wsgarcia@deloitte.com

Alvaro Miranda
Transfer Pricing Manager
ajmiranda@deloitte.com

Henry Aguirre
BPS Manager
haquirre@deloitte.com

Eduardo Mejía
Tax Controversy Manager
edmejia@deloitte.com



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