Transfer Pricing
Developments in Latin America

June 27, 2014

Peter Meenan
Ivan Gutierrez
Agenda

- Current State of Transfer Pricing in Latin America
- Highlights of Comparative Analysis of TP legislations in Latin America
- Transfer Pricing in Brazil
- Base Erosion and Profit Shifting Action Plan
- Strategic Transfer Pricing in Latin America
- Building solid positions for intercompany charges
Current State of Transfer Pricing in Latin America
Escalation of Transfer Pricing Regimes and Enforcement

1995
- Australia
- South Africa
- USA
- Japan
- Italy
- New Zealand
- Mexico
- Korea
- France
- Australia
- South Africa
- USA

1996–1998
- China
- Slovakia
- Brazil
- Peru
- India
- Netherlands
- Germany
- Russia
- Belgium
- Venezuela
- Argentina
- Canada
- UK
- China
- Slovakia
- Brazil
- Japan
- Italy
- New Zealand
- Mexico
- Korea
- France
- Australia
- South Africa
- USA

1999–2000
- Thailand
- Portugal
- Peru
- India
- Netherlands
- Germany
- Russia
- Belgium
- Venezuela
- Argentina
- Canada
- UK
- China
- Slovakia
- Brazil
- Japan
- Italy
- New Zealand
- Mexico
- Korea
- France
- Australia
- South Africa
- USA

2001–2002
- Lithuania
- Taiwan
- Hungary
- Colombia
- Malaysia
- Thailand
- Peru
- India
- Netherlands
- Germany
- Russia
- Belgium
- Venezuela
- Argentina
- Canada
- UK
- China
- Slovakia
- Brazil
- Japan
- Italy
- New Zealand
- Mexico
- Korea
- France
- Australia
- South Africa
- USA

2003–2004
- Estonia
- Latvia
- Peru
- China
- Slovakia
- Brazil
- Japan
- Italy
- New Zealand
- Mexico
- Korea
- France
- Australia
- South Africa
- USA

2005–2007
- Panama
- Greece
- Egypt
- Ireland
- Hong Kong
- Romania
- Estonia
- Latvia
- Uruguay
- Turkey
- Vietnam
- Singapore
- Poland
- Norway
- Kazakhstan
- Indonesia
- Ecuador
- Denmark
- Taiwan
- Lithuania
- Taiwan
- Hungary
- Colombia
- Malaysia
- Thailand
- Portugal
- Peru
- India
- Netherlands
- Germany
- Russia
- Belgium
- Venezuela
- Argentina
- Canada
- UK
- China
- Slovakia
- Brazil
- Japan
- Italy
- New Zealand
- Mexico
- Korea
- France
- Australia
- South Africa
- USA

2008–2010
- Dominican Republic
- Chile
- Angola
- Kenya
- Nigeria
- Guatemala
- Costa Rica
- El Salvador
- Malawi
- Puerto Rico
- Namibia
- Uganda
- Zambia
- Panama
- Greece
- Egypt
- Ireland
- Hong Kong
- Romania
- Estonia
- Latvia
- Ukraine
- Slovakia
- Russia
- Germany
- Netherlands
- Austria
- Hungary
- Colombia
- Malaysia
- Thailand
- Portugal
- Peru
- India
- Indonesia
- Mexico
- Argentina
- Canada
- UK
- China
- France
- Brazil
- Japan
- Italy
- New Zealand
- Mexico
- Korea
- Australia
- South Africa
- USA

2011–2013
- Luxembourg
- Chile
- Angola
- Egypt
- Ireland
- Hong Kong
- Romania
- Estonia
- Latvia
- Ukraine
- Slovakia
- Russia
- Germany
- Netherlands
- Austria
- Hungary
- Colombia
- Malaysia
- Thailand
- Portugal
- Peru
- India
- Indonesia
- Mexico
- Argentina
- Canada
- UK
- China
- France
- Brazil
- Japan
- Italy
- New Zealand
- Mexico
- Korea
- Australia
- South Africa
- USA

2008–2010
- Panama
- Greece
- Egypt
- Ireland
- Hong Kong
- Romania
- Estonia
- Latvia
- Uruguay
- Turkey
- Vietnam
- Singapore
- Poland
- Norway
- Kazakhstan
- Indonesia
- Ecuador
- Denmark
- Taiwan
- Lithuania
- Taiwan
- Hungary
- Colombia
- Malaysia
- Thailand
- Portugal
- Peru
- India
- Netherlands
- Germany
- Russia
- Belgium
- Venezuela
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- China
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- Mexico
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- France
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2011–2013
- Luxembourg
- Chile
- Angola
- Egypt
- Ireland
- Hong Kong
- Romania
- Estonia
- Latvia
- Ukraine
- Slovakia
- Russia
- Germany
- Netherlands
- Austria
- Hungary
- Colombia
- Malaysia
- Thailand
- Portugal
- Peru
- India
- Indonesia
- Mexico
- Argentina
- Canada
- UK
- China
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- Japan
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Generalizing...

Leading the way:
- APAs
- Royalties
- Services

Established legislations:
- Routinely request documentation
- Audits moving past formal requirements
- Challenges on economic analysis
  - Comparable companies
  - Economic Adjustments
- Routine transactions vs Intangibles

New comers:
- Lack of experience in enforcement
- Largely focused on form
- Documentation requirements
- Routinely reject treatment of certain transactions
- Accelerated learning curve

- 2005–2007
  - Panama
  - Ecuador
- 2003–2004
  - Uruguay
- 2001–2002
  - Colombia
- 1999–2000
  - Peru
  - Venezuela
  - Argentina
  - Mexico
- 1995
  - Brazil
  - Mexico

2008–2010
- Dominican Republic
- Chile
- Panama
- 2011–2013
- Guatemala
- Costa Rica
- El Salvador
- Puerto Rico
Transfer Pricing Trends in Latin America

Transfer pricing has become a enforcement priority for tax authorities throughout the region as tax revenues have fallen.

Compliance

- TP documentation and informative returns
- TP documentation requirements are broadly similar across the region, with the exception of Brazil.
- Penalties for non-compliance

Transactions Commonly Challenged

- Intercompany transactions usually scrutinized:
  - Services
  - Royalties
  - Transfer of commodities
  - Financial operations
- Focus on the substance and purpose of intercompany transactions, as well as on supporting documentation.

What to take into account when taking about TP in Latin America

- Tax authorities in Argentina, Colombia, México, Peru, and Venezuela have broader experience in TP and audit processes. In other jurisdictions, tax authorities have limited TP experience; however, TP rules and formal TP requirements have been implemented and are enforced.

Audits
Highlights of Comparative Analysis of TP legislations in Latin America
# Comparative Analysis: Covered Transactions

<table>
<thead>
<tr>
<th>Countries</th>
<th>Purchase/Sale</th>
<th>Interests</th>
<th>Services</th>
<th>Intangibles</th>
<th>Local or foreign?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Foreign</td>
</tr>
<tr>
<td>Chile</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Foreign</td>
</tr>
<tr>
<td>Colombia</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Foreign and free trade zone</td>
</tr>
<tr>
<td>Ecuador</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Domestic and foreign</td>
</tr>
<tr>
<td>Mexico</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Domestic and foreign</td>
</tr>
<tr>
<td>Newcomers</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Domestic and foreign</td>
</tr>
<tr>
<td>Peru</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Domestic and foreign</td>
</tr>
<tr>
<td>Uruguay</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Foreign</td>
</tr>
<tr>
<td>Venezuela</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Foreign</td>
</tr>
</tbody>
</table>
## Comparative Analysis: Methods

<table>
<thead>
<tr>
<th>Countries</th>
<th>CUP</th>
<th>Cost Plus</th>
<th>Resale Price</th>
<th>Profit Split</th>
<th>TNMM</th>
<th>Sixth Method</th>
<th>Hierarchy*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Yes</td>
</tr>
<tr>
<td>Chile</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>n/a</td>
<td>No</td>
</tr>
<tr>
<td>Colombia</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>n/a</td>
<td>No</td>
</tr>
<tr>
<td>Ecuador**</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Yes</td>
</tr>
<tr>
<td>Mexico</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>n/a</td>
<td>Yes</td>
</tr>
<tr>
<td>Newcomers</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>n/a</td>
<td>Yes</td>
</tr>
<tr>
<td>Peru</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>n/a</td>
<td>No</td>
</tr>
<tr>
<td>Uruguay**</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>No</td>
</tr>
<tr>
<td>Venezuela</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>n/a</td>
<td>Yes</td>
</tr>
</tbody>
</table>

* The hierarchy is based on the methods starting from left to right, in this case starting from the CUP Method.
** In Ecuador, Chile, Uruguay and Argentina have a “sixth” method acceptable when applied in any reasonable economical analysis. (i.e., commodities)
## Comparative Analysis: Services (Requirements)

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Chile</th>
<th>Colombia</th>
<th>Ecuador</th>
<th>Peru</th>
<th>Uruguay</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>Verify service cannot be provided locally (is it necessary?)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Proof of effective service provision (economic substance)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Requirement for qualification as intragroup services (Functional analysis, service agreement, etc.)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Review of analysis and comparability</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>
## Transfer Pricing Formal Requirements

<table>
<thead>
<tr>
<th>Country</th>
<th>Transfer Pricing Documentation</th>
<th>Transfer Pricing Informative Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Threshold</td>
<td>Deadline</td>
</tr>
<tr>
<td>Argentina</td>
<td>No</td>
<td>Eight month after the year-end.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td>No</td>
<td>If requested</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Colombia</td>
<td>Yes</td>
<td>September 8&lt;sup&gt;th&lt;/sup&gt; – 19&lt;sup&gt;th&lt;/sup&gt; The specific day will depend on the taxpayer’s ID number (“NIT”)</td>
</tr>
<tr>
<td></td>
<td>N/A</td>
<td>Pending: To be determined by the tax authorities. 2014 is the first year in which the tax authority will require the preparation and submission of TP documentation</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Yes</td>
<td>Transfer Pricing Report must be prepared by March and submitted two months after filing the income tax return (June 2014). The specific day will depend on the taxpayer’s ID number (“RUC”).</td>
</tr>
</tbody>
</table>
## Transfer Pricing Formal Requirements (continued)

<table>
<thead>
<tr>
<th>Country</th>
<th>Transfer Pricing Documentation</th>
<th>Transfer Pricing Informative Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Threshold</td>
<td>Deadline</td>
</tr>
</tbody>
</table>
| Mexico    | Yes       | Transfer Pricing Documentation customarily requested after March 31th. | No        | - The Appendix 9 must be submitted in March 31th along with the income tax return.  
  - Appendix 33/34 and Appendix 33.1/34.1 of the Statutory Tax Audit Report (“Dictamen Fiscal”) and the Transfer Pricing Questionnaire must be submitted in June. The specific day will depend on the first letter of taxpayer’s ID number (“RFC”). |
| Panama    | No        | If requested                                   | No        | - Should be available by the time the tax return is filed.  
  - The taxpayer must file a transfer pricing return six months after the close of the fiscal year. |
| Peru      | Yes       | October  
The specific day will depend on the taxpayer’s ID number (“RUC”) | Yes       | The Transfer Pricing Informative Return must be submitted in October. The specific day will depend on the taxpayer’s ID number (“RUC”). |
| Uruguay   | Yes       | It is recommended to prepare a transfer pricing report by the filling date of the annual income tax return (within the fourth month after year-end). However, it must be submitted in September. | No        | The Transfer Pricing Informative Return must be submitted in September. |
| Venezuela | No        | If requested.  
The requirement in practice is to have the entire documentation prepared contemporaneously with the filing of the transfer pricing return (six months after year-end). | No        | The Transfer Pricing Informative Return must be submitted six months after year-end. |
Transfer Pricing in Brazil
Brazil
Overview of Regulations

• Rules introduced back in 1997, Brazil is not member of OECD and rules are not consistent with OECD guidelines

• Transfer pricing rules apply to the following intercompany transactions
  • Export of goods, services or rights
  • Import of goods, services or rights
  • Loan transactions

• Brazilian regulations do not provide a “best method rule”

• Just traditional methods, equivalent to: Cost Plus, Resale Minus, CUP, and commodities methods

• Statutory fixed margins for different methods: Minimum/maximum

• Product-by-product approach

• Use of different transfer pricing methods for each item is allowed

• Unable to offset transfer pricing adjustments between different transactions/items
Cost Plus Method - CPL

- Calculated as the weighted average production cost of identical or similar goods, services or rights in the country where they were originally produced plus 20%
- The production costs should be itemized by component, values, and respective suppliers, and the data may be used from the supplier’s plant or from producers from other companies located in the country of origin of the good, service or right
- Costs include:
  - Cost of acquisition of raw materials, and any other good, service or right used or consumed during production;
  - cost of personnel involved in production; and
  - costs of rental, maintenance and repairs, and the charges for depreciation, amortization, or depletion of the goods, services or rights used in production
Resale Price Method - PRL

- The PRL method is defined as the weighted arithmetic mean of the resale prices for the goods, rights, or services, less unconditional discounts granted, the taxes and contributions levied on sales, the commissions and brokerage fees paid, and a **profit margin** calculated as follows:

  - net sale price - the weighted arithmetic mean of the sale prices of the produced good, right, or service, less the granted unconditional discounts, taxes, and contributions on the sale, and the commissions and brokerage fees paid;

  - percentage of participation of the imported assets, rights, or services in the total cost of the good, right, or service sold - the percentage ratio between the weighted average cost of the imported good, right, or service and the total weighted average cost of the sold asset, right, or service;

  - participation of the imported assets, rights, or services in the sale price of the sold good, right, or service - application of the percentage of participation of the imported good, right, or service in the total cost on the calculated net sale price.
Brazil
Inbound Methods

Resale Price Method – PRL (cont.)

• Gross profit margins (2012 and before)
• 60%: Items used in the production process
• 20%: Pure resale
• Gross profit margins (2013 and after – optional for 2012):

<table>
<thead>
<tr>
<th>Statutory Profit Margin</th>
<th>Sector or Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>40%</td>
<td>• Pharma-chemicals and pharmaceuticals</td>
</tr>
<tr>
<td></td>
<td>• Tobacco-related products</td>
</tr>
<tr>
<td></td>
<td>• Optics, photography and cinematographic equipment</td>
</tr>
<tr>
<td></td>
<td>• Medical and dentistry-related machinery and equipment</td>
</tr>
<tr>
<td></td>
<td>• Extraction of oil and natural gas</td>
</tr>
<tr>
<td></td>
<td>• Petroleum products</td>
</tr>
<tr>
<td>30%</td>
<td>• Chemical products</td>
</tr>
<tr>
<td></td>
<td>• Glass and glass-related products</td>
</tr>
<tr>
<td></td>
<td>• Cellulose, paper and paper products</td>
</tr>
<tr>
<td></td>
<td>• Metallurgy</td>
</tr>
<tr>
<td>20%</td>
<td>All other sectors</td>
</tr>
</tbody>
</table>
## Brazil

### Inbound Methods

**Impacts on the new TP Regulations on the Resale Price Method – PRL**

<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable adjustment decrease for those companies that used to apply the PRL 60% based on NR 243/02</td>
<td>Substantial taxable adjustment increase for those companies that used to apply the PRL 60% based on Law 9430/96</td>
</tr>
<tr>
<td>Freight and insurance expenses, and import taxes incurred by the local importer, should not be taken into account when determining the year average actual price</td>
<td></td>
</tr>
<tr>
<td>Tax authorities have historically argued that the CIF + Import Tax should be the basis for the average actual price calculation, instead of the FOB price</td>
<td></td>
</tr>
<tr>
<td>Discussion about PRL application based on NR 243/02 or Law 9.430/96 has historically been an area of intense litigation between the Brazilian tax authorities and taxpayers</td>
<td></td>
</tr>
</tbody>
</table>
Comparable Uncontrolled Price Method – PIC

• Weighted average of the prices of goods, services or rights which are considered similar to one another, as calculated in the Brazilian market or in other countries, in buying and selling operations, under similar payment conditions

• The prices of the goods, services or rights acquired abroad, by a related company, are compared to the prices of goods, services or rights, which are identical or similar in purchase and sale transactions carried out between unrelated legal entities, either resident or nonresident

• The value of the goods, services or rights will be adjusted so as to minimize the effects caused by differences in business conditions, of a physical and content nature

• The documentation needed to prove the prices include copies of invoices where the related-party suppliers sold the same goods, services or rights to unrelated parties. For this purpose, the invoice must have the product’s full description and/or part number

• Simple pricing lists, quotations, or statements from these suppliers will not be accepted by the tax authorities.
## Brazil

### Inbound Methods

#### Comparable Uncontrolled Price Method – PIC (cont.)

<table>
<thead>
<tr>
<th>Changes</th>
<th>Before Law 12.715</th>
<th>After Law 12.715</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comparable uncontrolled price method (PIC) – scope</td>
<td>No specific guidance</td>
<td>Application of the PIC method should take into account similar uncontrolled transactions with a volume representing at least 5% of the total import amount from related parties.</td>
</tr>
<tr>
<td>Comparable uncontrolled price method (PIC) - application</td>
<td>PIC method should be applied based on transactions entered during the same fiscal year as that under analysis. Where transactions entered during the same period are not available, the taxpayer can rely on transactions entered in the prior or following year, as long as it makes adjustments to the price of such transactions to account for foreign exchange rate fluctuations.</td>
<td>PIC method should be applied based on transactions entered during the same fiscal year as that under analysis. Where transactions entered during the same period are not available, the taxpayer can rely on transactions entered in the prior year, as long as it makes adjustments to the price of such transactions to account for foreign exchange rate fluctuations.</td>
</tr>
</tbody>
</table>
Brazil
Outbound Methods

• Export Sale Price (PVEx) - Weighted average of the sales price of the goods, services or rights exported by the taxpayer to unrelated customers, during the same calculation period.

• Acquisition or Production Cost, Plus Taxes and Profits (CAP) - Weighted average of the acquisition or production costs of the exported goods, services or rights, plus the taxes and contributions charged in Brazil and a 15% profit margin.

• Wholesale Prices in the Country of Destination, Less Profits (PVA); and Retail Price in the Country of Destination, Less Profits (PVV) - Weighted Average of the selling prices of identical or similar goods, services or rights, as charged in the wholesale / retail market in the country of destination under similar payment conditions, reduced by 15% / 30% profit margin of the wholesale / retail price, respectively.
## Brazil
### Outbound Methods

### New TP Legislation (Law 12.715/12) – Safe Harbor changes

<table>
<thead>
<tr>
<th>Thresholds</th>
<th>Revenue Safe Harbor</th>
<th>Profitability Safe Harbor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Intercompany net revenue &lt; 5% of the total net revenue</td>
<td>Pretax earning in intercompany outbound transactions &gt; 5%</td>
</tr>
<tr>
<td></td>
<td>Same as before</td>
<td>Based on the financial data for the three most recent years, i.e. current year, plus two preceding years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Exceptions were available for some years allowing the calculation in a single year basis</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Applicability</th>
<th>Fiscal years starting on or after January 1, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>N/A</td>
<td>Net revenue from related parties &lt; 20% of the total outbound transaction net revenue</td>
</tr>
<tr>
<td>Pretax earning in intercompany outbound transactions &gt; 10%</td>
<td>Pretax earning in intercompany outbound transactions &gt; 10%</td>
</tr>
<tr>
<td>Based on the financial data for the three most recent years, i.e. current year, plus two preceding years</td>
<td>Based on the financial data for the three most recent years, i.e. current year, plus two preceding years</td>
</tr>
</tbody>
</table>
## Brazil

### Inbound Methods

#### New TP methods for commodities

<table>
<thead>
<tr>
<th>Changes</th>
<th>Before Law 12.715</th>
<th>After Law 12.715</th>
</tr>
</thead>
<tbody>
<tr>
<td>New transfer pricing methods for commodities</td>
<td>Not available</td>
<td>Introduction of two additional and mandatory transfer pricing methods to the existing Brazilian methodologies: (i) the stock exchange import price (PCI), and (ii) stock exchange export price (PECEX) for inbound and outbound transactions in commodities, respectively. Under the additional methods, the basis for comparison is the daily average stock exchange price for the items, adjusted for any applicable increase or decrease spreads.</td>
</tr>
</tbody>
</table>
Brazil
Intercompany loans

Agreements not registered before Bacen – Interest expenses are not deductible if above the six-month (LIBOR US) plus 3% spread

Combination of a “rate” plus a spread
Different rates are provided, depending on the type of transaction, the currency used, and other factors
The margin will be determined by the minister of finance. (It is not clear when and how often.)
Spread: Please see the next slide

<table>
<thead>
<tr>
<th>Currency</th>
<th>Market</th>
<th>Type</th>
<th>Rate Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD</td>
<td>Foreign</td>
<td>Fixed rate predetermined</td>
<td>Market rate of sovereign bonds of Brazil, issued in USD, in foreign markets</td>
</tr>
<tr>
<td>Real</td>
<td>Foreign</td>
<td>Fixed rate predetermined</td>
<td>Market rate of sovereign bonds of Brazil, issued in Reais, in foreign markets</td>
</tr>
<tr>
<td>Any (a)</td>
<td>Any (a)</td>
<td>Any (a)</td>
<td>Libor for six months for the respective currency adopted (b)</td>
</tr>
<tr>
<td>Real</td>
<td>Foreign</td>
<td>Variable</td>
<td>May be determined by the Minister of Finance</td>
</tr>
</tbody>
</table>

- For inbound financial transactions, where the Brazilian taxpayer is paying interest to a foreign related party, the annual spread is limited to maximum rate of 3.5%.

- For outbound financial transactions, where the Brazilian taxpayer is receiving interest from a foreign related party, the annual spread is limited to a minimum rate of 2.5%.
BEPS History and Timeline

G20 leaders met
November 2012

OECD released “Addressing Base Erosion and Profit Shifting”
February 2013

Forum of Tax Administration meeting
May 2013

OECD’s action plan delivered to G20 Finance Ministers
June 2013

OECD’s Committee on Fiscal Affairs to agree action plan
July 2013

September 2014

Delivery of:
- Report on digital environment
- Changes to model tax convention
- Recommendations for domestic rules
- Review of member country tax regimes
- Changes to Transfer Pricing Guidelines
- Report on international law and multilateral instrument

September 2015

Delivery of:
- Further recommendations for domestic rules
- Strategy to expand participation to non-OECD members
- Further changes to the model tax convention
- Changes to the transfer pricing guidelines
- Recommendations regarding data to be collected

December 2015

Delivery of:
- Further changes to the transfer pricing guidelines (re interest deductions)
- Revision of existing criteria regarding harmful tax regimes
- A multilateral instrument
Broad Impact of Priorities and Developments

- **Flexibility:** There are conflicting forces at work in tax policy requiring tax officials to evaluate the impact of multiple scenarios.

- **Substance / Business Model:** Premium on substance in offshore deferral structures; tie planning to business objectives.

- **Capital Allocation or Reallocation:** Identify potential dispositions and how to efficiently redeploy proceeds.

- **Repatriation:** Establish annual base line of cash repatriation; identify strategic transactions.

- **Transfer Pricing:** Be prepared for local country challenges.
TP Specific BEPS Actions

• Suggest that TP outcomes are in line with value creation

• Profit shifting by moving intangibles (12-24 months)
  - Adopting a broad and clearly delineated definition of intangibles;
  - Affirming profits are appropriately allocated in accordance with value creation;
  - Creating special guidelines for transfers of hard-to-value intangibles; and
  - Revisiting guidance on cost contribution arrangements.

• Profit shifting by transferring risks/allocating capital (24 months)
  - Adopting TP rules so that returns do not accrue to an entity solely because it bears contractual risk or provides capital; and
  - Aligning returns with value creation
TP Specific BEPS Actions

- Profit shifting by entering into transactions that would not/only rarely occur between unrelated parties (24 months)
  - Clarifying circumstances in which transactions can be re-characterized;
  - Clarifying the application of TP methods (in particular profit splits with respect to global value chains); and
  - Providing protection against common types of base eroding payments, such as management fees and head office expenses.

- Re-examining transfer pricing documentation (12-18 months)
  - This may include rules requiring disclosure to governments of:
    - Global allocation of income; and
    - Economic activity and taxes paid among countries.
Key Areas of Transfer Pricing Focus

• There are three key areas of transfer pricing focus in BEP

• Substance versus contractual terms
  • Which guides transfer pricing - intercompany legal agreements or actual behavior (i.e., functions, risks, assets)

• Ecommerce business
  • Perhaps creating a virtual PE based on customer location

• Transfer pricing documentation and disclosure
  • Disclosure of tax planning, transfer pricing positions, full country reports are among the options being discussed
Substance versus Contractual Terms

• Contractual arrangements without substance are under scrutiny
  • For example, having a principle with contract manufacturing, stripped distributor, and contract R&D arrangements but little substance in the principle will be under focus

• How to address? Two possibilities:
  • Respect legal contracts when there is substance but ignore or recharacterize when actual circumstances deviate from agreements
  • Use the significant people function criteria of the OECD Authorized PE approach along with the functional and risk profile of the legal entity to determine profit outcome.
Issues with Substance Approach

There is not a widely accepted standard definition of significant people functions and substance. Even the OECD Authorized Approach definition is somewhat subjective and subject to interpretation.

Also, even though there really are four factors that lead to economic ownership of IP (functions, risks, funding, decision-making), the BEPs focus on decision-making and control will give this element large weight relative to the other three.

Initial business feedback is that Approach 1 – retention of legal contracts is preferred over the substance criteria of Approach 2.
Documentation and Disclosure

Most prognosticators agree that increased transparency and disclosure is definitely a short-run outcome of BEPS.

Various disclosure requirements have been discussed, including:

- Non-mandatory statement of principles
- Disclosure of uncertain tax positions
- Disclosure of aggressive tax planning
- Full country-by-country reporting
- Sharing of transfer pricing documentation

In June the G8 committed to the automatic sharing of information for tax purposes, including greater transparency on company ownership and wider tax reporting by multinationals.

This information sharing will likely be limited to sharing among tax authorities, not public disclosure.
Country-By-Country Reporting

- Originally, the draft document suggested a comprehensive amount of information to be included. Expectation that this will be reduced in the final version (likely to remove items in grey, based on comments from WP6 deliberations).

- Information to be provided on an ‘entity by entity’ basis annually, including:

  - Place of effective management
  - Revenues in functional currency
  - Earnings before income tax
  - Income tax paid on a cash basis (a) to the country of organization and (b) to all other countries
  - Current tax accrual
  - Total amount of withholding taxes paid
  - Stated capital and accumulated earnings

  - Total number of employees of each entity, regardless of actual location. 'Seconded-in' employees included, 'seconded-out' employees excluded

  - Total employee expense

  - Interest/Royalties/Service fees paid to (and received from) constituent entities

  - Book value of tangible assets other than cash and cash equivalents

  - Important business activity code(s)
Country-By-Country Reporting – Recent Developments

• The OECD recently released more than 1,000 pages of public comments on action 13 of the base erosion and profit-shifting action plan, which calls for a review of the OECD's transfer pricing documentation rules and the development of a template for country-by-country reporting (CbC) reporting. As a result of these comments, the OECD will change its proposed CbC template to significantly reduce the information that is required to be reported.

• These changes will include a requirement to aggregate countrywide reporting instead of entity-by-entity reporting, which should please taxpayers concerned with the compliance burden that entity-by-entity reporting would entail.

• The OECD will remove transactional reporting from the CbC template and increase the flexibility in how taxpayers report financial data. Further, the master file will be a separate document from the CbC template, and it will no longer require data on the 25 highest paid employees.

• As part of the template, the master file is designed to gather information on organizational structure, descriptions of businesses along business lines, information regarding the group's intangibles, intercompany financial activities, and financial and tax positions. There will be a mix of quantitative and qualitative information to be included in the master file.
Transfer pricing documentation

• On July 30, 2013, OECD released a White Paper on Transfer Pricing documentation inviting public comments

• Transfer Pricing documentation is a top priority of both taxpayers and tax authorities
  – Diverse local transfer pricing documentation requirements
  – Significant increase in the volume and complexity of international intra-group trade
  – Increased scrutiny of transfer pricing issues by tax authorities

• The key objective of transfer pricing documentation is identified as simplification, streamlining, and yet comprehensive that would help address the “global” perspective of the MNC’s transfer pricing policies
Purpose of transfer pricing documentation

Three reasons for tax authorities to require the creation and submission of transfer pricing documentation

Transfer Pricing risk assessment
- Provides tax authorities information necessary to conduct an informed Transfer Pricing risk assessment at the commencement of a tax audit

Taxpayer’s assessment of its compliance with the arm’s length principle
- To determine that taxpayers have given appropriate consideration to Transfer Pricing documentation requirements in establishing prices and other conditions for related party transactions and in reporting the income derived from such transactions in their tax returns

Provision of information necessary to start, conduct, and complete an audit
- To provide tax authorities with the information that they require in order to conduct a broad audit of the Transfer Pricing practices of entities subject to tax in their jurisdiction
# OECD - Two tier documentation structure

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Master file</th>
<th>Local file</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Give “big picture” information for risk assessment purposes</td>
<td></td>
<td>• Supplement the “master file” and help meet the objective of suggesting compliance by the taxpayer with the arm’s length principle in its material Transfer Pricing positions</td>
</tr>
<tr>
<td>• Give reasonably full picture of global business, financial reporting, debt structure, tax situation of the MNE</td>
<td></td>
<td>• The “local file” would give a detailed information on the related party transactions to meet the local documentation requirements at the time of audit</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Elements</th>
<th>Master file</th>
<th>Local file</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Overview of MNE group</td>
<td></td>
<td>• Details of local entity</td>
</tr>
<tr>
<td>• Description of the MNE’s business(es)</td>
<td></td>
<td>• Details of controlled transaction, i.e.,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Description of transaction</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Amount charged</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Detailed FAR, etc.</td>
</tr>
<tr>
<td>• MNE’s intangibles</td>
<td></td>
<td>• Details of financial information, i.e.,</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Annual accounts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Data used at the time of economic analysis</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Duly tied up with financials, etc.</td>
</tr>
</tbody>
</table>

• MNE’s inter company financial activities

• MNE’s financial and tax positions
Coordinated approach to documentation

• Approach to documentation will require high degree of coordination
  – Essential for reducing compliance burden
  – Centralized data collection
  – Centralized or decentralized analysis?
  – Centralized preparation of masterfile
• Experience with EU approach — limited success
• Other documentation in addition to reports
  – Informational returns
  – Questionnaires
Strategic Transfer Pricing in Latin America
Company objectives

ETR Management
- Deductibility and double taxation
- Withholding taxes
- Indirect taxes

Cash Mobilization
- Foreign exchange controls
- Substance of intercompany charges

Risk Management
- Transfer pricing documentation
- Intercompany agreements
- Monitoring and controls
Tool box and Key Considerations

Intangible Property
- Document benefit
- Legal document registrations
- Substance of charges

Services
- WHT and indirect taxes
- Automatic Disallowances
- Document benefit

Tangible Goods
- Customs
- Close monitoring and year end adjustments

Financing
- Thin capitalization
- Safe harbors
Business Model Alternatives

**Low**

- **Shared Services Company**
  - Shared Services Company costs shared amongst affiliates
  - Shared cost pool is lowered by combining activities in a low cost jurisdiction
  **Tax Implications**
  - Return earned by Shared Services Company is a cost-plus return
  - Minimal tax benefit
  - Operational cost savings likely outweigh any tax benefits assuming a low cost jurisdiction is identified

- **Intellectual Property Hub**
  - IP development costs funded by IP Co established in tax efficient jurisdiction
  - IP Co “owns” IP and grants access to Operating Entities in exchange for royalty
  - Royalty income minus intangible development costs subject to lower IP Co tax rate
  **Tax Implications**
  - Significant potential tax benefit
  - Challenge to “defer” royalty income from US tax
  - Withholding tax issues

- **Service Principal Company (SPC)**
  - IP development costs funded by SPC established in tax efficient jurisdiction
  - SPC “owns” IP and employs personnel responsible for managing delivery of services to Operating Entities in exchange for “service fee”
  - Services income minus employee and intangible development costs subject to lower SPC tax rate
  **Tax Implications**
  - Significant potential tax benefit
  - Services income “deferred” from US tax if performed in country of SPC incorporation
  - Reduced withholding tax implications

- **Principal Operating Company (POC)**
  - IP development costs funded by POC established in tax efficient jurisdiction
  - POC contracts directly with customers taking on contractual risk of loss on local service delivery. Local affiliates earn cost plus from POC on functions and risk they manage.
  - Residual income minus employee and intangible development costs subject to lower POC tax rate
  **Tax Implications**
  - Significant potential tax benefit
  - POC income should be deferred from US tax as earned directly from third-parties. Necessary for POC employees to work in POC jurisdiction.
Shared Services Company – Operating Model

- **Intl. HoldCo**
  - Responsible for maintaining client relationship and generating sales.
  - Provides IT and other shared services support to Operating Entities (and other related entities).

- **Operating Entities**
  - Each Operating Entity owns Intellectual Property.

- **Shared Services Company**
  - Service Agreement
  - Service Fee
  - Contractual arrangements
  - Service/Product Flow
  - Cash Flow
Intellectual Property Company – Operating Model

**Operating Entities**
- Responsible for maintaining client relationship and generating sales

**International HoldCo**
- Owns IP and grants right to access IP through license agreements
- Provides innovation guidance and funds new IP development
- Employs:
  - Roles that can take decision on innovation stage gates
  - Finance or legal roles

**IP Co (Tax Efficient Location)**
- License Agreement
- Service Agreement
- Royalty
- Service Fee

**Shared Services Company**
- Provides IT and other shared services support to IP Co, Operating Entities (and other related entities)

**Contractual arrangements**
- Service/Product Flow
- Cash Flow
SPC – Central Contracting with Local Services (Transfer Pricing Methodology)

Contractual Authority and Risk, IP Rights, Strategic Direction, and P&L Accountability Must Migrate to the SPC

- Total Operating Margin
  - Fully Taxed Locally

- Residual Profit
  - Fully Taxed Locally

- Return on IP (% of Net Sales)
  - IP Owner
  - Fully Taxed Locally

- Return on Service Function (% of operating costs)
  - Local Service Co
  - Fully Taxed Locally

- SPC (Tax Efficient Location)
  - Contractual Authority
  - Contractual Risk
  - IP Licensee
  - Overall P&L Accountability
  - Strategic Direction

- IP/Routine Returns
- Stay Local

- Stay Local

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Operating Entities

POC (Tax-Efficient Location)

International HoldCo

Subcontractor Service Agreement

Service Fee

Provision of Services

Service Fee

Shared Services Company

Third-Party Customers

Subcontractor Service Agreement

• Negotiates and concludes contracts with customers
• Owns IP and provides local affiliates with access to data analytics capabilities (can be combined with IP Co planning)
• Employs:
  - Management responsible for Global P&L/IT Platform/Analytics
  - Commercial team responsible for negotiating and concluding customer contracts
  - Quality Control on data received by customers
  - Data Analytics team responsible for analytics capabilities provided by IT web based platform
  - Bespoke client solutions
  - Training to local affiliates

Provides IT and other shared services support to SPC, Operating Entities (and other related entities)

Contractual arrangements
Service/Product Flow
Cash Flow
Building solid positions for intercompany charges
Building solid positions through documentation

Define Arm’s Length Pricing

Outline in Legal Agreements

Prepare Transfer Pricing Support Documentation

Monitor and Control Implementation
Intercompany Agreements

Ensure services charged out are consistent with character of the transaction

Tax Authorities in Latin America typically challenge and disallow “cost allocations”

Review classification of Stewardship costs
Contemporaneous Documentation Regional Approach

- Develop framework for delivering transfer pricing documentation reports in multiple countries in a consistent, efficient, and cost-effective manner.
## Content of Regional Contemporaneous Documentation

<table>
<thead>
<tr>
<th>Approach to TP Documentation</th>
<th>Separate country TP documentation</th>
<th>Centrally prepared Local country rules</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Functional Analysis</strong></td>
<td><strong>Local functional analysis</strong></td>
<td><strong>Generic regional functional analysis</strong></td>
</tr>
<tr>
<td><strong>Economic Analysis</strong></td>
<td><strong>Multiple local benchmark analysis</strong></td>
<td><strong>Single regional benchmark analysis</strong></td>
</tr>
<tr>
<td><strong>Deliverable</strong></td>
<td><strong>Locally-prepared documentation report (incorporating centrally prepared core elements)</strong></td>
<td><strong>Centrally-prepared masterfile &amp; separate country file</strong></td>
</tr>
<tr>
<td><strong>Relative cost</strong></td>
<td><strong>High</strong></td>
<td><strong>Medium</strong></td>
</tr>
<tr>
<td><strong>Level of assurance</strong></td>
<td><strong>Penalty-resistant</strong></td>
<td><strong>Penalty-resistant</strong></td>
</tr>
</tbody>
</table>
Information Systems to aid monitoring and control

- Provide with a clear overview of transfer pricing positions
- Mitigate transfer pricing risks and identify potential opportunities for cash tax savings
- Enable proactive transfer pricing analysis and planning, which helps to manage the challenge of year-end adjustments
- May allow integration of indirect tax analysis, such as Value Added Tax (VAT), Withholding Tax, and customs, to provide visibility into the impact of transfer price adjustments
- Support efficient management of audits by tax authorities and independent auditors
- Help mitigate the risk of penalties and audits by tax authorities through proactive compliance management
- Provide a broad-based audit trail, supporting the arm’s length nature of related-party transactions
- Reduce manual effort, freeing internal resources
Questions & Answers
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Appendix A
Resumes
Peter Meenan is a Principal and Leader of Deloitte Tax LLP’s U.S. Southeast Transfer Pricing with 19 years of transfer pricing experience. In addition to practicing transfer pricing in Deloitte Tax’s Northeast and Southeast US regions, Peter has significant international transfer pricing experience. For example, Peter was seconded for seven year to Deloitte’s UK and German Transfer Pricing Practices where he helped establish the Deloitte European Transfer Pricing practices. Peter was also seconded for a four year period to Deloitte’s Japanese transfer pricing practice in Tokyo, where he served as Deloitte’s senior Asian transfer pricing economist.

Peter is a frequent speaker and lecturer on valuation and transfer pricing at internal and external conferences. He developed Deloitte’s pan-European and pan-Asian internal transfer pricing training courses (partner and manager levels). Peter has also been a consultant and a trainer for the tax authorities in the Czech Republic, Denmark, Malaysia, and Vietnam on transfer pricing matters.

Peter has been named as both a World’s Leading Tax Adviser and World’s Leading Transfer Pricing Adviser by Euromoney.

Ivan is a Senior Manager of Deloitte Tax LLP with 14 years of transfer pricing experience.

Ivan worked with Latin American leadership establishing transfer pricing practices throughout the region working on numerous local and global transfer pricing projects including documentation and planning projects and coordinating regional documentation and planning projects.

In 2006, Ivan joined our office in Hong Kong for two years assisting companies with tax transfer pricing planning, documentation, and other conflict resolution matters with respect to HK, China, and various Asian countries.

Ivan has been with Deloitte Tax U.S. Transfer Pricing team since 2008 and has been involved in projects including analysis of intangibles and cost sharing, Advanced Pricing Agreements, and analysis of complex financial transactions.

Ivan has authored and coauthored articles on transfer pricing including the final chapter in the 2006 Latin America supplement of the International Tax Review and various other publications.

Ivan holds a bachelors degree in Management and a masters degree in Finance.