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# What to Learn From Transfer Pricing Controversies in Argentina

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# FEATURED PERSPECTIVES

## What to Learn From Transfer Pricing Controversies in Argentina

by Cristian E. Rosso Alba

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The Argentine Revenue Service (ARS) is one of the most active in Latin America in auditing, assessing, and litigating transfer pricing cases. Because tax rates are relatively high in Argentina compared with those in other Latin American countries, and because Argentina has run fiscal deficits, the ARS understands that the only way to increase revenue is by refining the collection of existing taxes rather than increasing rates. Also, the Argentine transfer pricing framework allows for discretionary interpretations of existing laws. There are unique methods that would not match with the arm's-length standard, such as the sixth transfer pricing method for taxing exporters of commodities regarding set triangular transactions.[1]

This article reviews the latest trends in transfer pricing controversies as well as the lessons learned from some cases decided in the last 12 months. Even though they deal with the automobile and pharmaceutical industries, the holdings also apply to other transfer pricing cases.

### The *Toyota* Case

The *Toyota* case[2] was made public in March and involves a tax controversy framed under the Argentine transfer pricing law as amended and updated in 1998, which is the current legislation for this sector. However, the implementing resolution from the ARS was different for fiscal 1999 compared with that of 2000 and onwards. While the ARS general resolution in force until December 31, 1999, was GR 702/99, the one for years 2000 to the present is GR 1122/01. Among the relevant differences between the two general resolutions is that only the second one includes the interquartile range as the mandatory measure to improve comparability with the set of comparables.

The ARS made a notice of deficiency against the taxpayer, for fiscal 1999, based on the following facts: (i) that the taxpayer should have fallen within the interquartile range of comparables to prove that its levels of taxable income were reliable; and (ii) that the taxpayer may not make comparability adjustments on the tested party unilaterally, unless it proves that any extraordinary losses — segregated from taxpayer's profit and loss statement — were also not present in the comparables. The second discussion was focused on two specific sources of extraordinary losses: the factory's idle capacity and a governmental plan that burdened the company with abnormal expenses.

The decision before the tax court was entered for the taxpayer, so the ARS appealed before the Federal Court of Appeals, which confirmed the decision. The Federal Court of Appeals ruled that:

- The requirement of the interquartile range used by the ARS for fiscal 1999 violated the legality principle because it resulted in an invalid, retroactive application of GR 1122. GR 1122 may only apply to fiscal 2000 and onwards.
- The taxpayer timely provided a transfer pricing study and its sworn statements. For the ARS to succeed in a challenge of such documentation, it

[1]For an extensive analysis of the sixth method, see Cristian E. Rosso Alba, ''An Inside Look at Argentina's Tax Reform on Transfer Pricing,'' *Latin Am. Tax Strategies*, Dec. 2003, p. 1.

[2]*Toyota Argentina SA v. AFIP*, Federal Court of Appeals Chamber III (Aug. 11, 2012), La Ley, Mar. 13, 2013.



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must bring up an alternative assessment, rather that limiting its work to sustain that the burden of proof as to the comparability adjustments only relies on the taxpayer. Having all taxpayer's data, the ARS is the one that should have proved that the comparables were not facing similar extraordinary losses compared with the taxpayer.

- The use of the OECD guidelines is valid to integrate local norms in case of an absence of a specific statute and to the extent there is no incompatibility with the Argentine income tax norms in general.

While the outcome regarding the interquartile range was expected, the issue of the burden of proof was more debated. The court of appeals set a reasonable standard, in line with a long-standing principle of Roman Law: *ubi emolumentum ibi onus* — ''where the advantage is, there should be the burden'' — meaning that the ARS, since it has full information as to the taxpayers and their transfer pricing studies, should have the burden of proof.

## The *Volkswagen* Case

The *Volkswagen* case[3] involved a tax assessment made under the old transfer pricing framework — the one in force before the 1998 major tax reform. The ARS believed that exports of automobiles from Volkswagen's Argentine subsidiary to its affiliated counterparts in Brazil, channeled through a Brazilian unrelated intermediary, were underpriced. The ARS made a novel interpretation of the law (which is no longer in force). Then-section 8 of the Income Tax Law (ITL) established that income obtained by exporters was Argentine-source income and thus taxable in Argentina. However, if the export price was lower than the wholesale price in the destination market, parties were deemed to be affiliated (although evidence to the contrary was allowed), and the ARS could issue a notice of deficiency for the difference.

The use of wholesale prices as a benchmark was consistent with the legislative history: The old transfer pricing framework was enacted in 1943, when the Argentine National Congress was only concerned about the adequate valuation of the international trade of agricultural commodities (''agri-commodities''). Then-section 8 further stated that if such wholesale prices were not publicly known, or other reasons were to compromise comparability, the ARS could then test transfer pricing margins by using ones obtained by comparable companies engaged in the same industry. If this information was not available, margins of similar or analogous activities were allowed to scrutinize the prices of the Argentine exporter. The ITL Implementing Decree, however, provided for a fallback testing method. Once affiliation was proved, the ARS could issue a notice of deficiency after comparing the export price with the domestic wholesale market price for the same product (ITL Implementing Decree, section 11). Since this lower-ranked norm had exceeded the law being implemented, many tax scholars believed that the implementing decree had violated the law. Certainly these benchmarks were not legislated for industrial manufacturers (such as vehicle producers), but this did not impair the ARS from using the ITL norms to such an extent.

The fallback benchmark was used by the ARS in *Volkswagen*. The taxpayer prevailed before the tax court, and the ARS appealed. The taxpayer won the appeal because of two core arguments:

- First, the ARS did not prove why the first two benchmarks should be overlooked. The court of appeals clearly stated that there was an order of priority, which should have been observed by the ARS by bringing material evidence about why it was unreasonable to use the wholesale prices in the destination market or the profit margins of comparable companies. The lack of substantiation impairs the tax authorities using the residual fallback benchmark.

- Second, even though the transfer pricing adjustment was made according to the old legislation, reasonable comparability work is a condition precedent to any transfer pricing adjustment. Accordingly, it is not valid to use the domestic wholesale prices as a benchmark, because it includes domestic taxes, insurance, warranty costs, and so forth that are not present in the export of vehicles.

The holding shows a clear trend in domestic case law: Grounded comparability analyses are necessary not only to sustain taxpayers' transfer pricing policies but also to succeed in defending their cases before Argentine courts. The ARS could only succeed in a controversy if it were to submit to the courts its own alternative study.

## The *Boehringer Ingelheim* Case

*Boehringer Ingelheim*[4] concerns a pharmaceutical company that manufactured and exported medicines as well as imported and distributed finished branded products. The main issues in the case are recounted below.

### Use of the Benchmark of Wholesale Prices

The holding highlights that this standard was introduced for the first time in 1998 in Law 25.063. Cases such as *Volkswagen* noted above are good precedents to stress how unconstitutional the pre-1998 framework

[3] *Volkswagen Argentina SA v. AFIP*, Federal Court of Appeals, Chamber IV, Aug. 30, 2012.

[4] *Boehringer Ingelheim SA v. AFIP*, Federal Tax Court, Chamber B, Apr. 13, 2012.



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was — since it had such benchmarks only in the lower ranked implementing decree.

### The Burden of Proof

Once the taxpayer files its annual transfer pricing study, the burden is on the ARS to provide an alternative transfer pricing analysis to challenge the taxpayer's work. The tax court understands that the burden of proof is shared by the taxpayer and the tax authorities, so the ARS should have well-supported evidence in order to succeed in the controversy. The tax court demands that the ARS produce an alternate reasoning to that of the taxpayer that ''would reproduce business decisions that are compatible with the ones unrelated parties would undertake.''[5] This standard is further helpful, generally, for a reasonable construction of the Argentine transfer pricing framework; in no case can the tax authorities validly challenge business-oriented, arm's-length conduct.

### The Level of Personnel

The level of personnel in the comparable set versus the tested party and its degree of compromise on the comparability work proved controversial regarding exporters of commodities that sell to related trading companies located abroad. In those cases, many times the ARS compared just the level of employees of the trading companies against the Argentine exporter's (which not only produces but also processes goods in its own premises) to sustain that the trader may be unsubstantiated. The tax court made clear that, for comparability purposes, a difference in the level of employees is relevant only if this means that the functional analysis of the tested party differs from the one of the comparables. Conversely, if a company located in Argentina has more employees than a related party abroad, and the functional paradigm differs between the two, the exclusive difference in the level of employees could be perfectly explained by the largest functions that need to be attended by the Argentine party.

### The Use of the OECD Guidelines

The tax court indicated again that OECD standards could be validly used to construe Argentine transfer pricing norms, if:

- they do not expressly contradict domestic statute;
- they do not lead to an outcome incompatible with the domestic standards; and
- they help to improve the comparability analysis.

Based on such guidelines, the tax court allowed the taxpayer to average the comparable sets during a three-year period.

[5]*Boehringer Ingelheim*, Point III, second paragraph.

### Functional Segmentation

The tax court upheld the ARS criterion that the taxpayer should have used a functionally segmented transfer pricing analysis, so that the results reached and the comparables used for the manufacturing function do not get blended with those of the distributing function. It further upheld the use of a markup on total cost for the manufacturing function and the use of a return on sales for the distribution function. The case is the first one to have a full discussion on the profit-level indicators. Note, however, that the taxpayer's transfer pricing study was the source for the discussion, as it prepared segmented comparables for the different functions (that is, later blending the margins by using one single return on sales as profit-level indicator). The tax court understood that the taxpayer was not able to prove its statement that using a single return on sales on the blended margins would be numerically identical to separately keeping the margins for the different functions. This peculiar factual background allowed the tax court to sustain that, regarding this specific taxpayer, functional segmentation was reasonable for a taxpayer like Boehringer, which further filed segmented data in its transfer pricing study. The outcome could be different for other taxpayers that are engaged in a different industrial segmentation.

### Use of the Interquartile Range

Similar to *Toyota*, the tax court ruled that since it was not mandatory for taxpayers to use interquartile ranges, the ARS may not validly issue a notice of deficiency that results in a tax adjustment to the median of the range. However, the taxpayer may use such statistical measures to improve comparability. The impairment applies only on the tax authorities, who are banned from applying tax norms retroactively. Note that the interquartile range and the ability to assess to the median (adjusted 5 percent) were introduced in the Argentine transfer pricing regulations in 2000.

### Use of a Country Risk Adjustment

The tax assessment was revoked concerning the country risk adjustment. Although transfer prices for the same goods or services may vary within the different geographic markets in which the tested party or the comparable companies may operate, the country risk adjustment was ruled to be not a convincing pattern because there is no reliable method to test it. This outcome has been consistent with other cases.[6]

### Analysis

All the issues discussed in this case are material for transfer pricing litigation in general, and the burden of proof is particularly important. Since the tested party is

[6]Rosso Alba and Matias Lozano, ''Transfer Pricing Analysis for Developing Countries: Reviewing Market Data,'' *Tax Notes Int'l*, Sept. 21, 2009, p. 1039.

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always the Argentine one, and the comparables are mainly located in developed countries, there is an intrinsic comparability problem. Many times this issue is sorted out by adjusting the tested party itself. The ARS has stated that in such cases the taxpayer should also prove that the comparables do not experience similar adjustments — evidence that is usually cumbersome to obtain. The tax court has now paved the way to shift this burden of proof onto the ARS. This trend is consistent both in this decision and in *Toyota* above.

## The Agri-Exporting Sector

The single most important transfer pricing case during the last year was *Oleaginosa Moreno*,[7] in which the taxpayer prevailed. The case showed the importance of the comparability analysis to succeed in a challenge of a transfer pricing notice of deficiency. The company successfully proved that the benchmark used by the ARS — internal comparables to the Chilean market — may not be validly used to value commodity exports throughout the region.

Coming next is the constitutional validity of the sixth method implementing regulations, which is what the federal Supreme Court now has under review. ◆

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[7] *Oleaginosa Moreno SACIFIA v. Apelación impuesto a las ganancias*, Tax Court, Chamber A, Mar. 6, 2012, published in *Doctrina Tributaria Errepar* No. 389, Aug. 2012.

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