

**Inter -American Center of Tax Administrations – CIAT**

**CIAT General Assembly**



**47° ASAMBLEA GENERAL**

**Buenos Aires**

**República Argentina**

**“INTERNATIONAL TAXATION ASPECTS THAT AFFECT MANAGEMENT  
OF THE TAX ADMINISTRATIONS”**

**Subtopic 2.1:**

**“SPECIFIC METHODS FOR THE CONTROL OF TRANSFER PRICING”**

**Federal Administration of Public Revenue**

**Argentina**

**Buenos Aires, Argentina  
April 22 – 25, 2013**

## A- SUMMARY

In the last century, the concentrated economic groups have progressed in a decentralization process in order to expand their territorial presence. In this sense, our country has a strong economic presence of *commodities*, leading to the possibility for exporting groups to manipulate the prices of their operations looking for planning, in many cases harmfully, their tax structure.

In this context, large concentrated exporter groups, mainly related to the grains, oils and oil seeds, mining and fishing sector are developing a “triangle” maneuver which involves invoicing goods to a destination but sending them to another by using intermediaries (*traders*) based in jurisdictions of low or zero taxation or with a preferential tax regime (fiscal opacity).

This is to arbitrarily assign part of the income to an intermediary through the artificial conclusion of future operations between the local exporter and an international *trader* for reducing the tax burden in our country

Based on the study of this situation, AFIP detected that these sectors related to the international commercialization of goods in a transparent market, had a common denominator: most of the exports were invoiced to intermediaries or *traders*, and the merchandise was never intended to be addressed to this international purchaser but to another located in another country and the operation is invoiced from a different country.

During the explosion in *commodities* prices and harvest record years, it is logic to imagine that the accounting and taxation profits from the large concentrated exporter groups mainly related to grains, oils and oilseeds sectors, should have reached their peak; on the contrary, the tax profit and the determined taxation levels were below the average, some companies even declared tax losses.

Given this situation the control strategy designed by the AFIP was to verify all their operations with related companies, by verifying the corresponding application of the “sixth method”<sup>i</sup>. To do this, the business knowledge of the company’s operations and the market in which they operate was requested, the support documentation of operations from Argentines companies, subsidiaries and/or related abroad and the comparison of *commodities* prices of the respective contracts with the market price. → **The application of the "sixth method" or the shipment date method is the tool for valuing transfer pricing of commodities operations.**

**In summary, the purpose of the regulation is to prevent the taxpayer from using, for the determination of the profit tax base, the price agreed with the international *trader* since it is presumed that they do not deserve any payment because they are just simple intermediaries and therefore do not add any value or make any effort to market the product, unless proven otherwise.**

Because of the ongoing controls done by the administration in 2009, the adjusted amounts, the total amounts and the amounts to be determined by judicial processes were significantly increased.

Furthermore, in 2012 AFIP launched a comprehensive control plan for the cereal and mining sector, in order to verify the application of the sixth method.

As previously mentioned, the increasing globalization of trade operations is the perfect excuse for large concentrated groups to apply "harmful tax planning" in order to evade tax payment.

Due to this harmful behavior, the AFIP has developed the "Global Taxpayer" concept which allows knowing the whole taxation of taxpayers and concentrated economic groups at local and international level as well as the different taxes of the taxpayer's activity.

AFIP's coordinated actions allow understanding the taxpayers' taxation from a global point of view. In other words, by considering the taxation at tax levels, customs rights and social security resources.

This has been achieved due to the fact that the Administration's central areas have promoted a coordinated work by the different operational areas. The expansion of the exchange of information treaties network was also one of the key elements to move forward in the taxation of taxpayers since it allows obtaining relevant data regarding their behavior abroad.

## **B- PRESENTATION OF TOPICS**

### **I. INTRODUCTION**

### **II. DESCRIPTION OF THE VERIFIED SITUATION**

1. The triangle maneuver
2. The "No profitability" of enterprises in the agro-export sector in years of prices and harvests records

### **III. CONTROL STRATEGY. APPLICATION OF THE SIXTH METHOD**

### **IV. DEVELOPMENT OF THE "GLOBAL TAXPAYER" CONCEPT**

1. Global Taxpayer: The taxpayer's whole taxation
2. Tax administration development from the single agency perspective.
3. Expansion of the information exchange treaties network

## C- DEVELOPMENT OF TOPICS

### I. INTRODUCTION

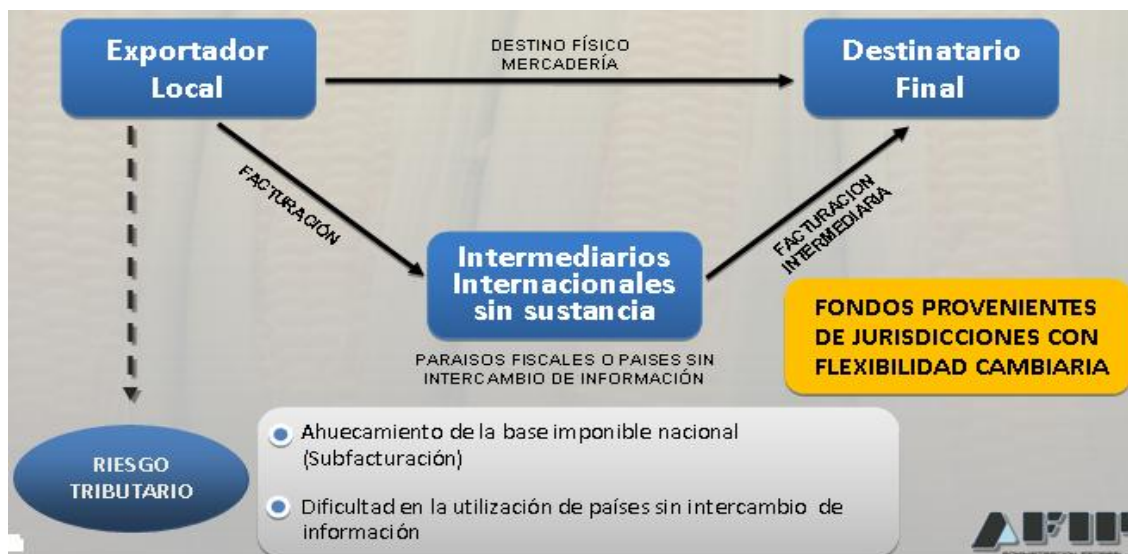
In the last century, the concentrated economic groups have progressed in a decentralization process in order to expand their territorial presence. In this sense, our country has a strong economic presence of *commodities*, leading to the possibility for exporting groups to manipulate the prices of their operations looking for planning, in many cases harmfully, their tax structure.

On the basis of the commitment made by the Government-within the G20 framework-on issues related to fiscal transparency, the Federal Administration of Public Revenue (AFIP) has started a new stage characterized by a pro-active attitude in favor of transparency in international trade transactions and in the taxpayers integral taxation developing the GLOBAL TAXPAYER concept when analyzing commercial transactions of concentrated groups.

### II. DESCRIPTION OF THE VERIFIED SITUATION

#### 1. The triangle maneuver

The “triangle” maneuver developed by large concentrated exporter groups mainly related to the grains, oils and oil seeds, mining and fishing sectors, involves invoicing goods to a destination but sending them to another by using intermediaries (*traders*) based in jurisdictions of low or zero taxation or with a preferential tax regime (fiscal opacity)



In practice, the Argentinean exporter completes a sale of *commodities* with a client abroad, for example sale of soybeans to a Chinese buyer, and sends the merchandise to that destination, but the invoice is issued to an international *trader* based in a

jurisdiction with tax opacity.

To this we must add the rights on exports that did not enter due to the gap in their calculation basis (the FOB value of the transaction).

The purpose of this maneuver is to arbitrarily assign part of the income to an intermediary through the artificial conclusion of future operations between the local exporter and international *trader* for reducing the tax burden in our country.

The following table shows various detected situations during the development of the analysis:

ARGENTINA		INTERMEDIARIO		CLIENTE FINAL	DIF. PRECIO
CAPITALES HOLANDESES	→	VINCULADA ASIA	→	CHINA-EUROPA-BRASIL	5%
CAPITALES EE.UU.	→	SUCURSAL AMERICA	→	CHINA-ESPAÑA-MALASIA-INDIA	5%
CAPITALES ALEMANES	→	CASA MATRIZ EUROPA	→	CHINA-ESPAÑA-BRASIL-CHILE	5% - 10%
ARGENTINO	→	SUCURSAL AMERICA	→	CHINA-ESPAÑA	5% - 10%
CAPITALES EE.UU.	→	CASA MATRIZ NORTE AMERICA	→	CHINA-ARABIA-SIRIA	5%

Based on the study of this situation AFIP detected that these sectors related to the international commercialization of goods known in a transparent market, had a common denominator: most of the exports were invoiced to intermediaries or *traders* and the merchandise was never intended to be addressed to this international purchaser but to another located in another country.

In addition to the above mentioned, these intermediaries and operations were characterized for:

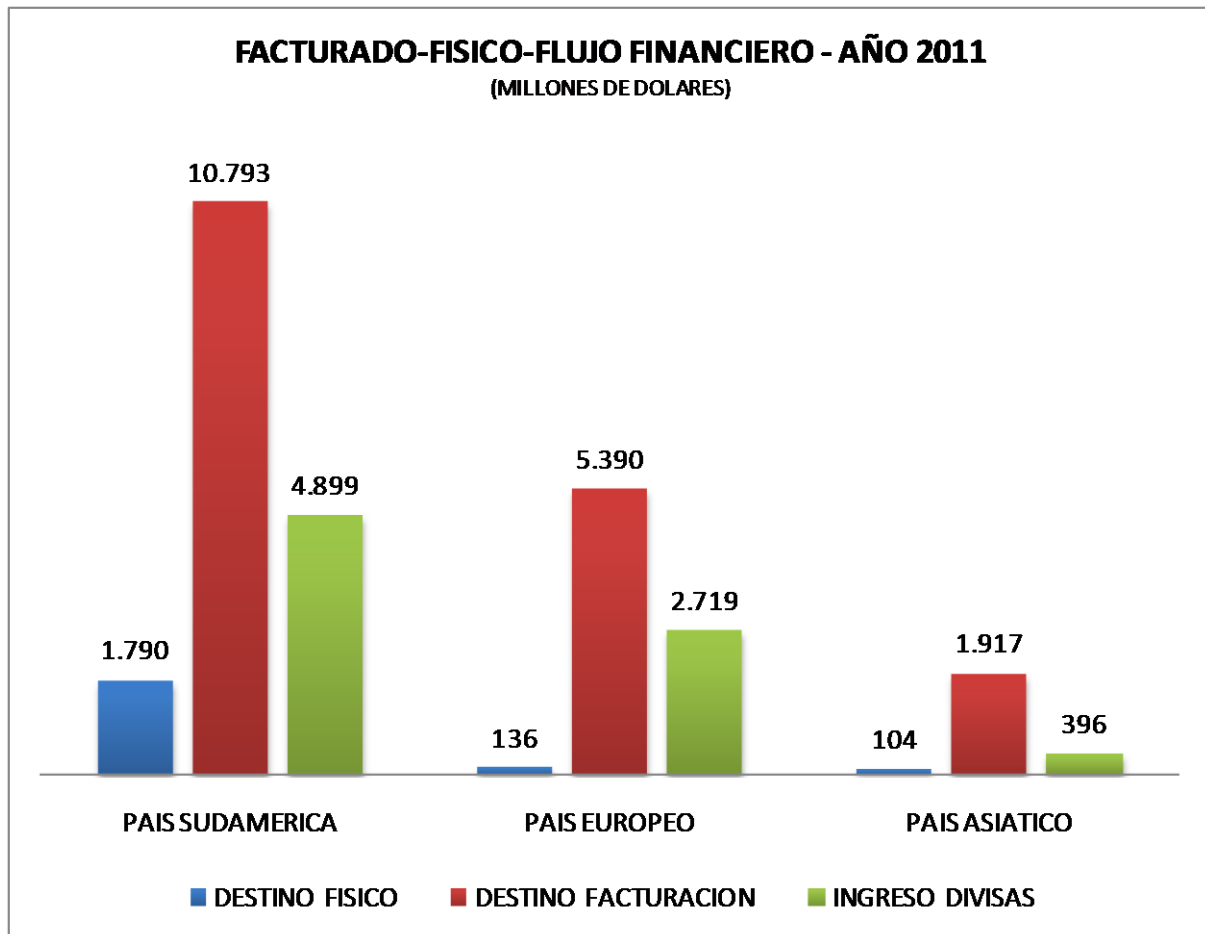
- Lacking of “economic substance”: the intermediaries were always simple resellers, they did not added any value to the product nor developed any task or made any effort for its marketing;
- Lacking of “Transparency”: The *traders* were always located in jurisdiction with low or no taxation or in territories with fiscal opacity where the national treasury could not obtain any information;
- Extension of the terms: many broader periods were found between the operation’s conclusion date and the shipment deadlines if compared to the market. In some cases, coordinated operations controlled from 180 to 500 days before the shipment date and in certain cases, this control was performed when the products did not exist; when sellers sold directly to independent third parties

the period were considerably lower.

- Lower Prices: in all audited cases, when the control was performed, the prices fixed were the lowest in the market, both in relation to prices used by other operators as well as to the official FOB price of the Agriculture, livestock and fishing Secretariat;
- Source of payments: It was found that the payments of operations were not coming from the client's country or from where the *Trader* was located but were from a third country (for example from the parent company of the group or from another jurisdiction with "flexible Exchange rate")

This study was carried out by using a "Risk Matrix" which shows that in most of this type of operations there was a big difference between the destination of the invoicing of goods, their physical destination and the origin of the financial collection flow .

This situation is shown in the following chart:

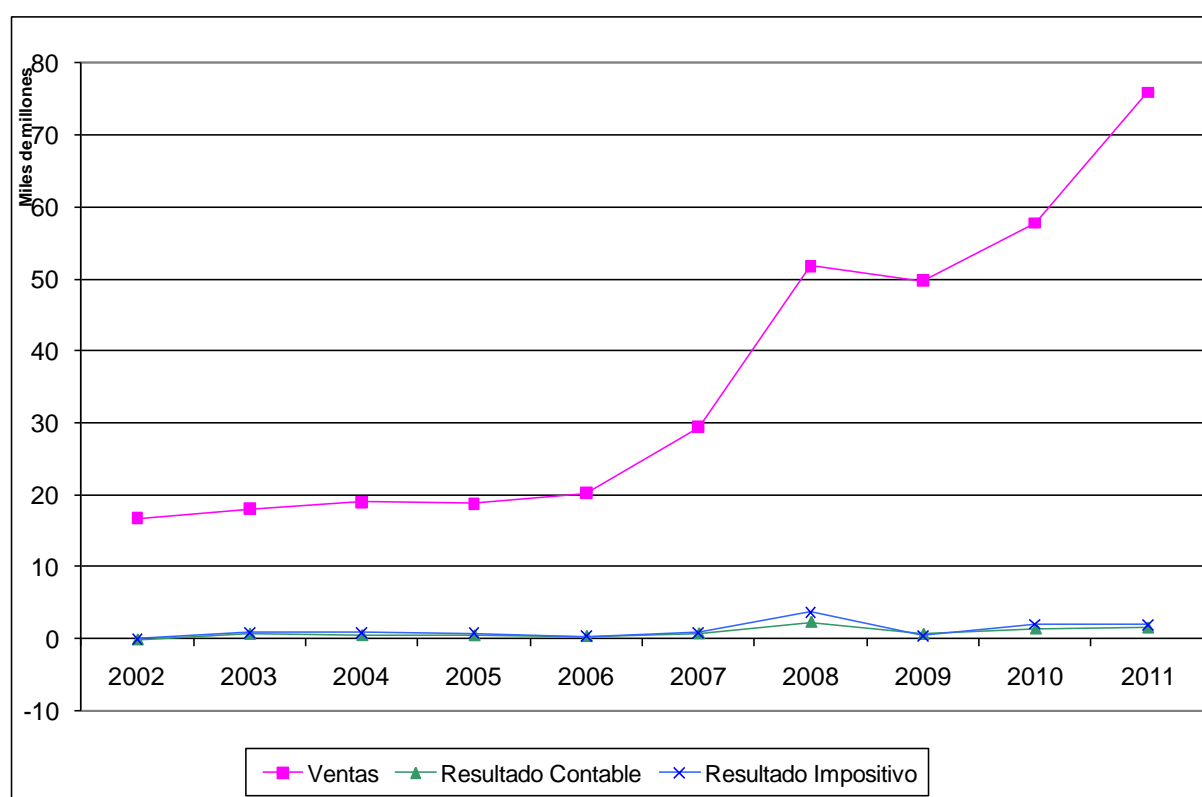


## 2. The "No profitability" of enterprises in the agro-export sector in years of prices and harvests records

During the explosion in *commodities* prices and harvest record years, it is logic to imagine that the accounting and taxation profits from the large concentrated exporter groups mainly related to grains, oils and oilseeds sectors, should have reached their peak; on the contrary, the tax profit and the determined taxation levels were below the average, some companies even declared tax losses. .

The following chart develops the above mentioned sequence according to the sales.

Accounting and tax profits from the agro exporter sector.



If we analyze the determined balances, profits and taxes from the agro export companies in recent years, we find that the amounts are beyond the logic of the international context since, as we have mentioned before, it was characterized by a harvest and historical records in the international contributions.

We will also develop the behavior of the main 10 companies in the sector which even though they make up only 18% of the total number of companies, concentrate 91% of the total sales of the sector.

If we analyze the behavior of these companies in 2010, which was deeply impacted by the effective implementation of the tax transparency policies, a significant increase is



noted in the tax voluntarily declared by taxpayers representing the sector. We note that only two companies did not determine capital gains tax. In spite of the fact that sales increase 16 %, the determined tax increases around 145 %.

The following table shows the figures for the year 2010:

**MAJOR COMPANIES IN THE AGRO-EXPORTER SECTOR: DETAIL OF SALES, PROFITS AND DETERMINED TAX YEAR 2010**

COMPANY	Sales	Accounting profits		Tax Profit		Determined Tax	
	Amount	amount	% sales	Amount	% sales	Amount	% sales
Company 1	13.700	142	1,04%	325	2,37%	112	0,82%
Company 2	11.304	426	3,77%	586	5,19%	165	1,46%
Company 3	8.257	246	2,99%	317	3,84%	63	0,77%
Company 4	5.239	114	2,18%	153	2,92%	0	0,00%
Company 5	4.569	12	0,26%	1	0,02%	0,27	0,01%
Company 6	3.301	40	1,22%	99	3,01%	35	1,05%
Company 7	3.081	67	2,17%	113	3,66%	49	1,58%
Company 8	1.834	126	6,87%	150	8,20%	26	1,40%
Company 9	684	10	1,40%	-15	-2,16%	0	0,00%
Company 10	666	18	2,64%	31	4,58%	10	1,53%
<b>TOTAL</b>	<b>52.633</b>	<b>1.201</b>	<b>2,28%</b>	<b>1.760</b>	<b>3,34%</b>	<b>460</b>	<b>0,87%</b>

Regarding the evolution of these companies in 2011 it shows that sales increased 44% while the self-declared tax increases 26%.

**MAJOR COMPANIES IN THE AGRO-EXPORTER SECTOR: DETAIL OF SALES, PROFITS AND DETERMINED TAX YEAR 2011**

COMPANY	Sales	Accounting profits		Tax Profit		Determined Tax	
	Amount	Amount	% sales	Amount	% sales	Amount	% sales
Company 1	15.067	298	1,98%	392	2,60%	137	0,91%
Company 2	15.595	522	3,35%	864	5,54%	302	1,94%
Company 3	14.914	232	1,55%	242	1,62%	85	0,57%
Company 4	6.680	193	2,89%	82	1,23%	0,34	0,01%
Company 5	6.922	36	0,51%	121	1,74%	42	0,61%
Company 6	5.089	68	1,33%	44	0,87%	15	0,30%
Company 7	4.432	51	1,16%	93	2,10%	23	0,52%
Company 8	5.761	13	0,23%	-9	-0,16%	0	0,00%
Company 9	377	-1	-0,29%	16	4,16%	0	0,00%
Company 10	1.083	65	6,03%	90	8,35%	31	2,90%
<b>TOTAL</b>	<b>75.921</b>	<b>1.477</b>	<b>1,95%</b>	<b>1.935</b>	<b>2,55%</b>	<b>637</b>	<b>0,84%</b>

### III. CONTROL STRATEGY. APPLICATION OF THE SIXTH METHOD

The control strategy designed by the AFIP was to verify all their operations with related companies, by verifying the corresponding application of the “sixth method”. To do this, it required the business knowledge of the company’s operations and the market in which they operate, the support documentation of operations from Argentine companies, subsidiaries and/or related abroad and the comparison of *commodities* prices of the respective contracts with the market price. → **The application of the "sixth method" or the shipment date method: article 15 of the Profit tax Law is the tool for valuing transfer pricing of commodities operations.**

To apply the “sixth method” the following conditions are required:

- a. It must be a triangle export: an international intermediary (*trader*) which is not the final recipient of the merchandise must participate, i.e. it is not a direct operation between a local and the final client;
- b. The intermediary –not the final recipient of the merchandise- does not fulfill the condition established by the rules to consider that there is economic substance (real activity that justifies the amount of the operation)  
In order to apply this method, the existence of formal or functional relationship with the intermediary is not required.
- c. The exported good must be *commodities*<sup>1</sup>, goods traded in well-known transparent markets.

Regarding its application, it is noted that:

- d. The value of the good in the transparent market is calculated the day the loading of the good is completed regardless of the transport used.
- e. If the price agreed with the intermediary is higher, this last one will be taken to determine the Argentine’s source income.
- f. The method is exclusive in regard to its application: if the legal requirements are enforced, only the "sixth method" and no other must be applied.

Regarding the business knowledge of the companies’ and the market operation it is important to interpret their actions not only as separate entities, but also to understand and know the economic group to which the Company belongs- both at vertical as well as at horizontal level -, establishing both the corporate and the functional relation.

It also means to exactly identify clients and suppliers, both for the economic group of the taxpayer under examination as for the countries in which they are located. The analysis must be based on the commercial and/or financial operations or services of the taxpayer.

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<sup>1</sup> They are assets, which due to their low level of development, are poorly differentiated. Thus, for example, the wheat from Argentina and China (the world’s leading producer) are very similar. The "commodities" have a well-known market price.

The application of Double Taxation Agreements and the limits to access to information (as incentives for the localization of Companies) should be analyzed.

In regard to the market in which they operate, it is necessary to know their customs, the way in which the contracts are concluded and the prices are fixed, the characteristics of each product and the geographical location of customers and suppliers.

To implement this, it is essential to obtain information from own or external databases. In case of AFIP the following can be mentioned:

- Databases from the organization: the information from the “E-Fisco Base”, fed with data that taxpayers report through different applications, customs information or information from other public organizations (such as BCRA). We will have soon the transfer pricing studies in pdf.
- External Database: They are contracted by this Administration to be used in audits, such as the OSIRIS Base (one of the bases used by taxpayers for making transfer pricing reports, which include the company's balance sheets at the global level quoted on the stock market). They allow having information from the sector's companies and at the same time they copy the company's sample submitted by the taxpayer in the Price Report. Other *web pages*: web sites from official organizations, commercial chambers, producers associations and even the web page of the company under examination.

Since the ongoing controls done by the administration in 2009, the adjusted amounts, the total amounts and the amounts to be determined by judicial processes were significantly increased.

However, these adjustments were partly done by taxpayers and others are to be determined by an administrative procedure.

Furthermore, in 2012 AFIP launched a comprehensive control plan for the cereal and mining sector in order to verify the application of the sixth method.

## **IV. THE DEVELOPMENT OF THE “GLOBAL TAXPAYER” CONCEPT**

### **1. Global Taxpayer: The taxpayer’s whole taxation**

As previously mentioned, the increasing globalization of trade operations is the perfect excuse for large concentrated groups to apply “harmful tax planning” in order to evade tax payment.

Due to this harmful behavior, the AFIP has developed the “Global Taxpayer” concept which allows knowing the whole taxation of taxpayers and concentrated economic groups at local and international level as well as the different taxes of the taxpayer’s activity.

This is based on two pillars: (i) AFIPs work as a "Single Agency", coordinating the actions of the three operational areas (the Internal Revenue Service, the Directorate General of Customs and the Directorate General of Social Security Resources) and (ii) the decision and implementation of the Information exchange Agreements network to obtain data regarding the behavior of their taxpayers abroad, especially the large ones and concentrated economic groups.

### **2. Tax administration development from the single agency perspective.**

AFIP coordinated actions allow to understand the taxpayers’ taxation from a global point of view. In other words, by considering the taxation at tax levels, customs rights and resources from social security.

This has been achieved due to the fact that the Administration’s central areas have promoted a coordinated work through the different operational areas.

In 2010, in order to modernize, transform and support the existing process, a reorganization of the organizational structure was carried out.

### **3. Expansion of the information exchange treaties network**

Argentina has given a qualitative jump in the matter from the 2008 global economic crisis and the active presence of the Government within the G20 framework on issues related to international trade and tax transparency.

AFIP played a key role in this strategic decision of the Government and from then started a new phase characterized by a pro-active attitude. In this sense, from the year 2009 their actions were aimed at increasing the agreement network for obtaining data regarding Argentinian residents and/or taxpayers abroad, mainly from large taxpayers and concentrated economic groups allowing detecting undeclared income, to have information on their economic situation, fight triangle operations and detect fictitious transactions.

## D- CONCLUSION

We can conclude that the main benefits from the application of the “sixth method” are the following:

- Allows fighting evasion in strategic export sectors of Argentina's economy.
- Avoid the relocation of Argentina’s source income through harmful tax planning.
- Allows the detection of intermediaries without economic substance.
- Discourage the use of the triangle mechanism.

Currently, one of the main challenges of the Administration is the control of Companies that could in the scope of this method, in which the wide Exchange of information network is a useful tool in order to obtain data from the operations abroad and from the participating intermediaries.

It has been noted that many agro exporter economic groups have restructured their operations by migrating intermediaries to countries with fiscal opacity or by making a triangle directly with their parent companies in order avoid the test of “economic substance” of the intermediary.

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It is noteworthy that, at the time of its incorporation in the regulatory framework of Argentina, this new method did not register any precedent in the legislation of other countries, making our country the pioneer in its creation and implementation.