ARGENTINA

ARGENTINA AND THE SO-CALLED "SIXTH METHOD"

General concepts

Over the last ten years, international trade has shown a material growth globally, while states have gained greater control to safeguard the revenues they are entitled to collect. In this context, and under income tax laws, transfer pricing provisions have become a key element in examining the appropriate allocation of profits between jurisdictions, both by tax authorities and multinational enterprises.

All this emphasises the need to take great care determining and documenting market values considered reasonable in accordance with transfer pricing standards. However, multinational enterprises with a high volume of transactions with related parties have seen increased levels of confrontation and disputes with tax authorities regarding these issues.

In spite of the fact that the Organisation for Economic Cooperation and Development (OECD) and some countries are working to standardise transfer pricing rules globally, these regulations are still subject to interpretations that are not fully consistent between different jurisdictions, and this involves a material risk for multinational enterprises so far as transfer pricing, potential double taxation, interest and penalties are concerned.

Transfer pricing regulations in Argentina

In Argentina, tax regulations applying to transfer pricing are included under the income tax law (sections 8, 14, 15, 15.1, 129 and 130), its regulatory decrees, and general resolutions (AFIP) 1122/2001, and their amending and supplementary provisions. Furthermore, the OECD transfer pricing guidelines for multinational enterprises and tax administrations have to be taken into account.

All the above-noted regulations are based on the arm's length principle, under which transactions with related parties must be agreed based on the prices or considerations that unrelated parties would have used in comparable transactions. However, it must be noted that certain local regulations on transfer pricing include some rules that may not be consistent with the OECD guidelines. For instance, under the Argentine law, and in specific situations, a special method for transactions involving commodities, commonly known as the "sixth method" should be applied.

The so-called "sixth method" in Argentina

In order to analyse this issue, we should first measure the importance of commodities for our country. According to data from the National Statistics Board (INDEC), around 65% of the country's exports consist of sales of commodities.

It should further be mentioned that a significant proportion of these activities is carried out by multinational enterprises, and therefore the proper allocation of taxable bases in the different jurisdictions is a relevant factor for the tax authorities involved. This explains why transactions involving commodities have recently featured amongst the main issues discussed.

Transactions involving commodities are usually assessed by applying the CUP (comparable uncontrolled price) method, with internal or external comparables, depending on the available data.

However, amendment No. 25,784 to the income tax law, in force as from 22 October 2003, provides that in import or export transactions for which a public international price can be quoted in transparent markets, stock exchanges or similar entities, those prices should be applied to determine the Argentine-source net income. In addition, pursuant to that amendment, the so-called "sixth method" was introduced, which applies where:

- Exports are made to related parties;
- The exports involve cereals, oil seeds, and other products of the region, hydrocarbons and their derivatives, and in general, goods with publicly quoted prices in transparent markets; and
- Participators include an international intermediary, other than the actual recipient of the goods.

The best method of determining the export income will be **the quoted value of the goods in the transparent market on the day on which they are loaded**, irrespective of the means of transport used, and **not taking into account the price which would have been agreed with the international intermediary**. However, if the price agreed with the international intermediary was higher than the quoted price in force at the stated date, the former price would apply in relation to the transaction.

The law further provides that this method will not apply if the taxpayer duly proves that the foreign intermediary meets all the following requirements:

- It has an actual presence in the territory of residence, i.e. business premises there, from where its business is conducted, and meets the legal requirements regarding incorporation and registration as well as the filing of financial statements. Likewise, the assets, risks and functions undertaken by the international intermediary must be in conformity with the volumes of traded transactions;
- Its main activity must not involve passive income or any involvement in trading goods from or to the Republic of Argentina or with other members of the economically related group; and
- Its international trade transactions with other members of the same economic group cannot exceed 30% of the annual aggregate transactions agreed by the foreign intermediary.

Case law related to commodities in Argentina

Taking into account the specific Argentine legislation, it should be mentioned that there are several administrative and legal cases relating to commodities, which up to the present, can be divided into: (i) case law relating to agricultural commodities prior to the enforcement of the so-called "sixth method"; (ii) case law relating to energy commodities; and (iii) case law relating tax evasion under the criminal tax law.

(i) Agricultural commodities prior to the so-called "sixth method"

Court decisions relating to the trading of agricultural commodities, prior to the enforcement of the so-called "sixth method", include 1) Alfred C. Toepfer Int. S.A.; 2) Nidera S.A.; and 3) Oleaginosa Moreno S.A. In almost all the cases, the main activity in which the companies are engaged is related to the export of commodities (i.e. grains, cereals and oilseeds) of Argentine origin. These companies maintain that the commodity's trading price is the market value at the time of the transaction or of agreeing the transactions. On the other hand, the AFIP DGI controls and independently determines the income subject to income tax for the fiscal period 1999 and/or 2000, depending on the case. In general, companies develop their activities through foreign intermediaries, and explain the reasons for their need and method of operation.

In some cases, it is held that the operations are performed in compliance with the terms of the GAFTA (Grain and Feed Trade Association), which is a previously agreed sample contract, which the tax authority does not acknowledge. In this regard, taxpayers state that the tax authority arbitrarily creates a fiction, which entails determining that the price fluctuation risk will only pass to the foreign purchaser when the goods are shipped and not when the agreement is made. In any event, if the agreed price is higher than the market price at the time of shipment, the collecting entity withholds the greater amount, without any legal basis applying to the years mentioned above.

It is further pointed out that the lack of an actual date does not hinder the use of agreements, since these were made in accordance with customs and usage. In addition, at that time the agreements did not have to comply with specific requirements or with any other registration procedures. Taxpayers can also request that symmetrical adjustments be acknowledged; in other words, that positive and negative adjustments be considered if the prices taken into account are those of the Secretariat of Agriculture, Livestock, Fisheries and Food (SAGPyA) at the date of shipment.

On the other hand, the tax authority denies the retrospective application of law No. 25,784 (use of the "sixth method") and mentions that the timing aspect is validated in the value reported by the SAGPyA at the time of shipment, since it understands that the export of assets was legally established at that time. The tax authority further states that agreements have no actual date and therefore this renders them unenforceable for third parties - and even if they were, they would not reflect the market value at the time of completing the shipment.

It is important to highlight that the cases had different outcomes, and there is still no judgment from the Supreme Court of Justice regarding these disputes. Some cases were settled in favour of the taxpayers and others in the favour of the tax authorities. In all cases, the key element was the evidence submitted by taxpayers to defend their positions.

(ii) Energy commodities

There are no records in relation to disputes regarding energy commodities. The only case that could be analysed in this field is YPF S.A. in the Argentine Tax Court. The main activity of the company was the extraction, exploration and distillation of hydrocarbons. In that scenario, the AFIP DGI controls and independently determines income tax for the fiscal period 2000, including transfer pricing concepts. The transactions under analysis included exports of commodities (diesel gas, butane and propane) to related companies and traders.

The arguments put forward by the taxpayer include the following:

- To apply the CUP, a maximum level of accuracy is required for comparable purposes (identical transactions or making adjustments).
- An explanation of the price setting policy, which the tax authority does not acknowledge. These products have prices in transparent international markets or stock exchanges.
- Pursuant to the agreements, in all the cases the price is determined using market data (i.e. Platt`s Oilgram US Marketscan) and taking into account an adjustment to this positive or negative value called "premium". It was stated that this price-setting policy is used both in transactions with related and independent parties.
- Reference was further made to the issue of the transaction date, and differences were established between the date of agreement, the shipment date and date of the bill of lading.
- It was mentioned that the tax authority used in its first resolution an annual interquartile range and then used an interquartile range made up of selected samples.
- It was claimed that the application of the interquartile range, pursuant to the provisions of general resolution (AFIP) 1122/2001, for the year 2000 implies re-opening a closed year, while the income tax law and the regulatory decree in force at that time should be applied.
- It was pointed out that the transactional net margin method (TNMM) additionally ratifies the arm's length situation in intercompany transactions. The income of YPF S.A. was not below the interquartile range.

However, the Argentine Tax Court judges did not analyse the elements of the case to arrive at their decision. They simply mentioned that they would firstly consider whether the provisions in force for 2000 should apply retrospectively or not. In this regard, they noted that general resolution (AFIP) 1122/2001 was issued in 10/2001, after the fiscal period under consideration. Therefore, applying it retrospectively would imply ignoring the principle of legality and infringing legal certainty. The tax authority could never validly retrospectively apply the interquartile range specified by that general resolution. The median and interquartile ranges are only legally incorporated with the enactment of decree order 916/2004. The fact that the taxpayer elected to apply the interquartile range for that period was the company's choice in carrying out a thorough analysis, but under no circumstances does it imply that this mechanism is mandatory. The case was settled based on the above.

Several considerations follow from the analysis of this case:

- Firstly, once again the substance of the case was not analysed. This means that the issue was settled, but with no clarification regarding the mechanism and proper application of the CUP (i.e. no thorough analysis was made of the trading of commodities with and without premium, the offsetting of prices above and below the range, the characteristics of the publicly quoted prices, etc.)
- Secondly, the resolution enforces the principle of legality and the non-retrospective nature of tax laws.
- Finally, it is established that the interquartile range and the adjustment to the median are deemed valid from the enactment of decree order 916/2004 published by the middle of 2004.

(iii) Commodities and tax evasion pursuant to the criminal law

The Federal Court of Appeals in criminal economic matters delivered its verdict in the Cargill S.A.C.E.I. case. The company's main activity was the processing, marketing and export of grains, oils, flours and other commodities. The destination of its sales was overseas, and exports accounted for 90% of its total revenues. The transactions challenged by the tax authority were certain exports made through its Uruguayan branch. The dispute arose from the use of the agreement date or the shipment date.

The defendants had been charged with the offence of tax evasion for over ARS 1 million, but the judges hearing the appeal dismissed the charges, as no malicious intent was proven.

The taxpayer maintained that the prices were agreed verbally (by telephone) or alternatively by mail. In addition, it stated that the prices were determined based on supply and demand factors on the day of performing the transaction (as opposed to the shipment date). In most cases, the prices agreed were higher than the ones quoted at the time of shipment, and in weighting total exports, the tax to be paid at the shipment date would have been lower. All this was stated and proved by expert evidence.

The court noted that the agreements were not recorded in certified copies including an actual date. At the same time, it indicated that no offsetting was allowed for losses and profits, and that the transfer pricing verification must be done individually and not globally. Finally, the Federal Court of Appeals with jurisdiction over Criminal Economic Matters ruled that "irrespective of right or wrong considerations having been made by the judge, the calculation of the tax liability is affected, but the charge of having committed a wilful offence is rendered void. It was therefore clearly proven that the use of the plaintiff's criteria would have resulted in the tax liability being lower than that declared. It is obviously unlikely, therefore, to render those representations misleading. The consistent application of the criteria stated by the defendants, whether or not correct or in accordance with tax law or regulations, proves that there was no malicious intent in the case".

Final considerations

In case law relating to commodities, the existence or non-existence of an actual date in the agreements therefore becomes a significant issue. Considering the importance of commodities transactions for Argentina, it would be very useful if the provisions applicable to these transactions did not give rise to concerns or vacuums, to enable companies to understand how they must pay taxes and to provide the tax authorities with an easier way to review them. Therefore, more certainty would be offered to taxpayers, the risk of potential tax contingencies would be eliminated, and the level of disputes over these issues would be reduced.

Moreover, from reading all the case law rulings, it is noticeable that proof becomes a substantial element in all the cases. The onus is on the tax authority to reverse the burden of proof given by taxpayers and, for most judges, mere rhetoric is not enough. It can also be noticed that there are many cases in which the issue under discussion is similar, but the judges ruled differently, all based on the proofs submitted during the process.

Finally, it should be highlighted that Argentina was the first jurisdiction to develop the so-called "sixth method" by the year 2003. Following this, many Latin American countries, as well as some emerging countries that do not belong geographically to the region, have begun to consider this type of ruling, with some amendments or adjustments. At the same time, some OECD and United Nations publications show that these organisations have begun to take these issues into account. In fact, in December 2014 the OECD issued a discussion draft on the transfer pricing aspects of cross-border commodity transactions, proposing changes to the Transfer Pricing Guidelines. As usual, this discussion draft is published for comment by interested parties.

Therefore, we need to follow all these issues closely and take care with the treatment of transactions involving commodities.

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