

CONCEPTS AND PRACTICES OF THE “SIXTH METHOD” IN TRANSFER PRICING

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The problem of the valuation of commodities' exports

- While transactions of commodities between related parties have been found on many occasions to be settled without an agreement and often involving trading and transport related companies located in low or zero tax jurisdictions; exports of commodities to nonrelated parties have been found to also involve intermediates with no economic substance located in low or zero tax jurisdictions (Argibay Molina, 2013).
 - Definition of related parties
 - Exports to non- related parties
 - Underlying financialization/ capital flight/ illicit financial flows problem for developing countries

The problem of the valuation of commodities' exports

1. Lack of validity of the price settled by such an agreement:

- Independent parties trading commodities settle their agreements in **open markets** and generally based on future prices (e.g. producers of agricultural products with multinational companies)
- **Conditions are necessarily different between related parties**

2. Risk management

- Producer faces risks resulting either from natural causes (i.e. the weather) or from the volatility of the markets which often produce wide price fluctuations, or indeed both.
- **An integrated firm can internalise this risk management. Often, it assigns the trading activity to an affiliate to which it attributes substantial risks and capital, in order to justify the fact that it receives a disproportionate profit margin.**

3. Other related activities

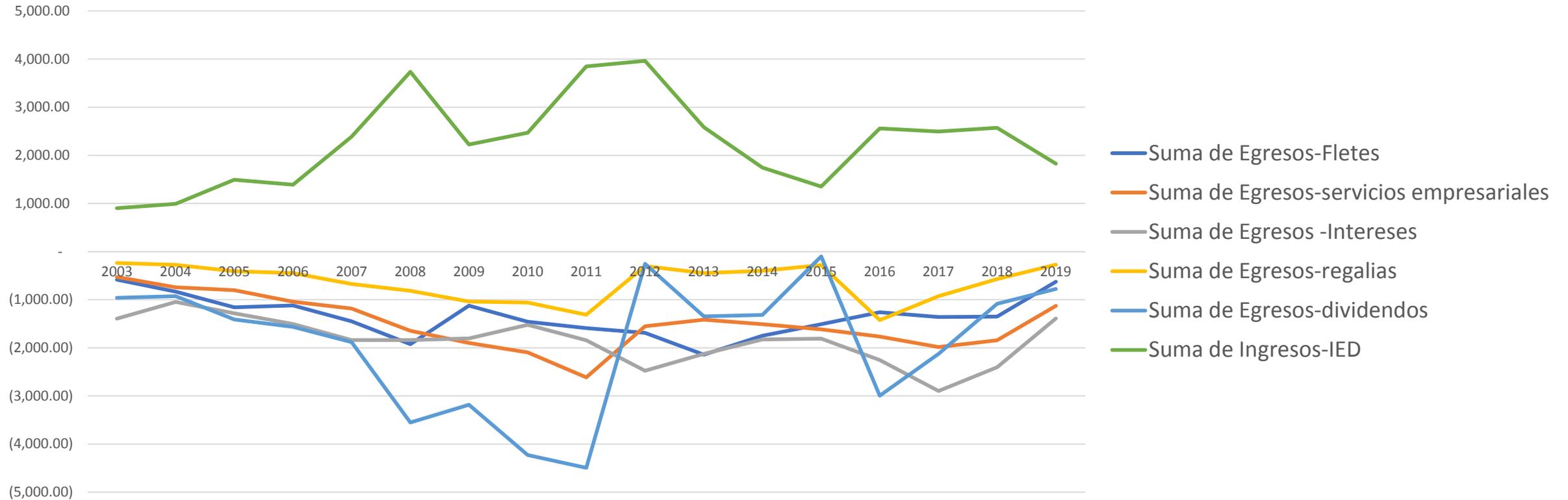
- The commodity supply chain often includes a number of other activities which are generally internalised within integrated corporate groups, such as logistics, insurance, transportation and commercialisation; which may also be assigned to separate affiliates in jurisdictions where they will be subject to low levels of taxation.

The problem of the valuation of commodities' exports

- Commodity producing countries face the situation where the profits attributable within an integrated firm to physical production are often far lower than those to related service activities. Since such service activities are easily organised in such a way as to bear low taxes, this is a major source of base erosion and profit shifting
- The BEPS effect in respect of transactions with commodities and the extractive industry is possibly even more critical for developing countries than similar practices in other sectors of the economy.

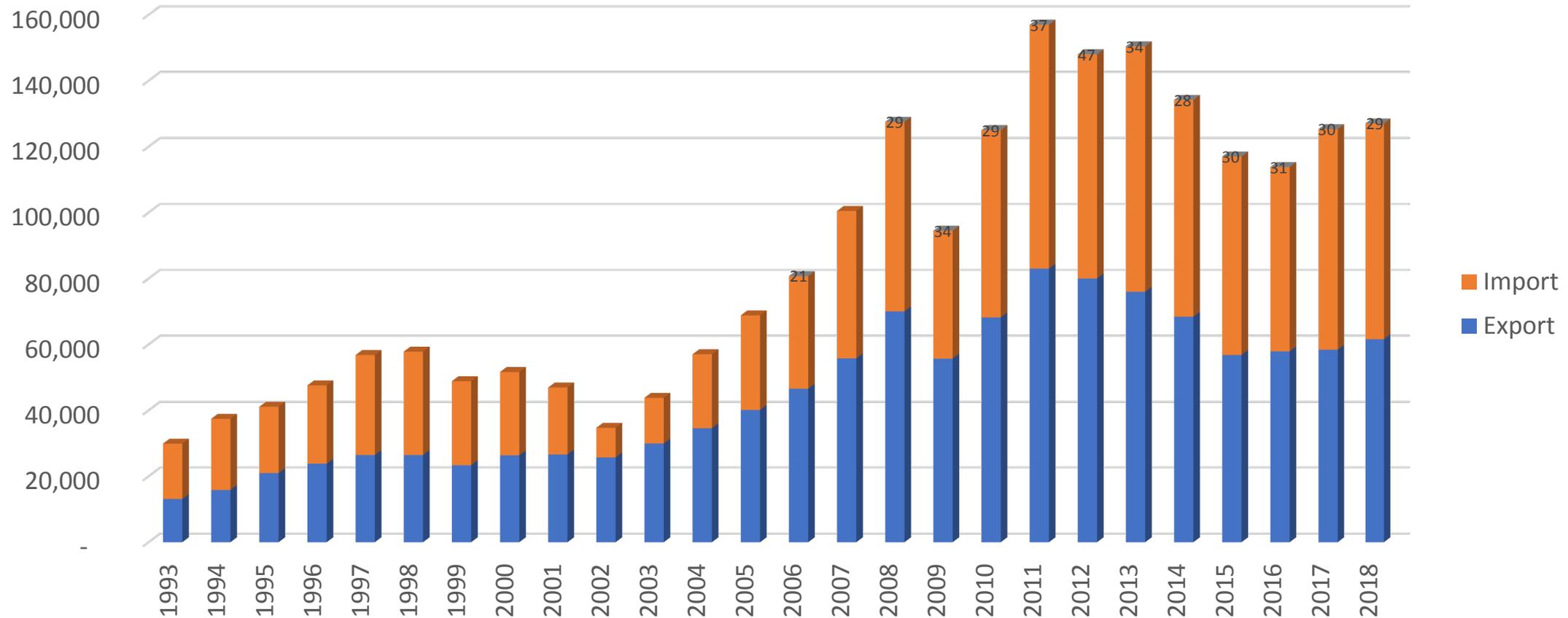
Some financial flows of interest. Argentina.

Millions of dollars



Source: Author's based on BCRA

Foreign trade-Millions of dollars



Source: Author's based on COMTRADE

OECD approach

- 1995/2010 OECD approach:
 - a transaction between related parts of an integrated corporate group has none of the characteristics of a contract freely negotiated between truly independent parties
 - Lack of comparables
 - attribution of profits based on the functions performed, assets owned and risks borne by the various affiliates.
 - Multinational enterprises (MNEs) design corporate structures involving functional fragmentation frequently with BEPS objectives
- BEPS Action Plan approach:
 - The Sixth Method as a quoted price under the “comparable uncontrolled price”.
 - allows for the use of quoted prices on other days and other valuations by MNEs and not only the international quoted prices at the shipping date.

Actual policy experience: the 6th method

- Advantages of the 6th method:
 - a quoted price can provide a clear and relatively objective point of reference to challenge the prices attributed in transactions with related parties or with tax havens
 - it may be possible to identify such a price which can be used as an appropriate benchmark, usually with some modification
 - a basis for rules which are easy to administer and do not involve either subjective judgment or detailed examination of facts and circumstances
- Difficulties with the 6th method:
 - Ex-post, for transfer pricing documentation purposes, the taxpayer can use the most advantageous quoted price;
 - impossibility of considering an agreement between two related parties as sufficient proof of the date of settlement of the price of the commodity transaction
 - For some commodities' exports it may be difficult to find quoted prices, e.g. different qualities of gold, oil, etc.

Actual policy experience: 6th method

- By 2017, the method was in place in:
 - Argentina, Bolivia, Brazil, Costa Rica, Dominican Republic, Guatemala, Honduras, Peru, Uruguay and some Caribbean countries; as well as in Zambia, Malawi and India.
- By 2017, practical experience in: Argentina, Brazil, Ecuador and Uruguay.
- Differences in its design and application

Actual policy experience: Argentina

Experience from 1946....

Law 20.628 from 1973 •Article 8: **When the export price is lower than the wholesale price at destination, it will be understood that there is an economic relation between the exporter in Argentina and the importer abroad;** and the valid price will be the wholesale price; the inverse will be valid for imports. The difference in prices will constitute net **profit of Argentine source.**

Law 25.063 from 1998 •Article 8: When the export price is lower than the wholesale price at destination, the valid price will be the wholesale price; the inverse will be valid for imports. The difference in prices will constitute net profit of Argentine source. •**It defines the assumptions under which two parties are considered to be related.**

Article 8 was amended again in 2003, to provide that in cases of transactions with related parties, as well as with parties located in low or zero tax jurisdictions, **article 15 of the LIG (OECD's TP Methods) should be applied.**

Law 25.784 of October 2003 •**The Sixth method is introduced**, replacing article 8, for the estimation of the transfer prices in the cases of commodities exports **performed through international intermediaries**, when such intermediaries **do not demonstrate to have economic substance.** According to the sixth method, the price in such transactions should be that of the market at the **shipping day.**

In this sixth paragraph, **economic substance** is defined as a) having real presence in the territory of residence, and assets, functions and risks of a similar weight to the volumes of transactions negotiated; b) its main activity must not constitute the obtaining of passive income, nor the intermediation of sales of goods from and to Argentina or with other members of the economic group; and c) its foreign trade operations with other members of the same economic group do not exceed 30 per cent of the total annual turnover of the entity. These conditions are cumulative, not alternative.

Actual policy experience: Argentina

- The Sixth Method could be applied to third party transactions
- Not addressed: the role of the transport and trading, which are a very important part of the BEPS problem in commodity trading.
 - In some sectors, such as oil, international quotes can also be found for the logistics, insurance and transport between, for example, Buenos Aires and the international market used for the quote (e.g. Chicago).

Actual policy experience: Argentina

- On December 2017, **the Sixth Method was modified** in the context of a series of modifications that were made to the LIG.
- It is **now applicable only to cases in which**:
 - the taxpayers are involved in import and export transactions via an **intermediary that is a related party**, or
 - via an **intermediary that is located in a non-cooperative jurisdiction or a low or null tax jurisdiction**, or
 - **the exporter at origin and the importer at destination are related parties.**
- In such cases, the **contracts will need to be registered** in the Tax Administration detailing the comparability differences that justify the difference in price to a relevant market quote at the delivery date of the goods; as well as other elements explaining for primes or discounts applied.
- **If no contract is registered**, or if the contract is registered but does not comply with the requirements listed above:
 - **the valuation of the export of commodities will be made considering the value of a quote at the shipping date, after considering the necessary comparability adjustments.**
- Finally, the legislation was changed in order to introduce a **revenue threshold** above which transfer pricing requirements (including the Sixth Method) would be applicable.

Actual policy experience: Argentina

Data resources

For customs information, the **INDIRA** system gives AFIP access to micro data (volumes, prices, invoicing details, etc.) from Argentina and other MERCOSUR countries, as well as some others, such as India.

Customs micro data in this system –which works like an online database – can be accessed immediately and automatically by tax officials from the Sub General Directorate of Tax Auditing of the central administration. Where, for example, mismatches have been found, they send the relevant individual transaction data that have been screened by the central administration to the regional agency conducting the audit. Regional agencies cannot directly access the information.

Actual policy experience: Argentina

Court cases using **article 8**:

- Successful application:
 - SIA S.A. (CSJN ruling from **1967**) declared losses on the export of horses to Peru, Venezuela and the United States of America. The Dirección General Impositiva (DGI) challenged this under the export and import clause and calculated the 'wholesale price' based on data from foreign magazines on the horse business, which explicitly referred to the horses of the taxpayer and the transactions involved in this case.
- Applicability problem: **definition of related party**
 - Eduardo Loussinian S.A.C.I.F.I.A. (CSJN ruling from 1983): The Tax Administration Department had challenged what seemed to be schemes to over-invoice imports, based on Article 8 of the LIG. But the CSJN found that there was no ownership relationship between the entities, and the profit could not be said to be of Argentine source.

Actual policy experience: Argentina

Court cases using article 8:

- Applicability problem: **wholesale price at destination was not always higher than export price**
 - Cargill (CNAPT –National Appeal Court for Tax Crimes, ruling from 2011): The case related to exports from Argentina through a branch located in Uruguay. The company argued that the prices from Montevideo were settled with different importers throughout the world and that these prices were agreed verbally by telephone or through different types of mail, in relation to the demand and supply at the date of these communications, and that this is the reason why the prices were different from those at the shipping date taken by the tax authority. Cargill’s directors were charged for the crime of tax evasion, and the Court on Economic Crimes ruled against them on the grounds that there was no definitive date of agreement; but on appeal to the CNAPT that court ruled in their favour, considering that the pricing methodology involved had not always resulted in a lower export price.
- Applicability problem: **Wholesale price used by Tax Administrator was that of the export country**
 - Volkswagen (TFN ruling from 2009): A company resident in Brazil acquired products from Volkswagen Argentina S.A., and sold them to Volkswagen do Brasil. The AFIP considered that the three were related parties, and that Article 8 of the LIG should be applied and the prices compared with the wholesale price in the jurisdiction of destination, and if such prices were not found, the wholesale price in the seller’s jurisdiction, which in this case would be the price of the local car dealers. The court rejected this possibility.
 - In Daimler Chrysler Argentina S.A. (CSJN ruling 2014), exports between Mercedes Benz Argentina and Mercedes Benz Brazil were at a lower price than the wholesale price in Argentina. The TFN applied to all the exported units the difference in value between the price of the car in the domestic market and the export price of the same car. The parties appealed to the CCAF (part of the ruling had been against the tax authority’s demands), which overruled the TFN, quashing the AFIP’s decision which had initially been appealed by the company. Both parties appealed to the CSJN, and the latter confirmed the CCAF’s decision.

Actual policy experience: Argentina

Court cases: **Application of the sixth method**

- Applicability problem: **the sixth method was used retroactively**
 - In *Nidera S.A.* (ruling by TFN ratified by the Cámara Contencioso Administrativo Federal (CCAF) in 2013 and revoked partially by the CSJN in 2016; relating to fiscal year 1999): the company exported commodities (cereals and oils) through intermediaries resident in tax havens, and argued that its export prices should be based on the export prices at the date of the agreement. The tax authority finally suggested the application of the CUP Method using the prices published by the Secretary of Agriculture in Argentina at the shipping date, based on the analysis of the behaviour of other comparable companies (*Alfred C. Toepfer* and *La Plata Cereal S.A.*). The TFN ruled in favour of the tax authority and the CCAF upheld the decision of the TFN. However, in 2016, the CSJN asked the CCAF to review its first ruling.
 - *Oleaginosa Moreno* (ruling by TFN of 2014; relating to fiscal year 1999): *Oleaginosa Moreno* exported commodities to Atlantic Oils & Meals (a related party resident in Switzerland), priced free on board (FOB), at international prices on the contract date. The invoice date was relatively close to the shipping date, but the price reflected in the invoice was based on a prior contract, which did not have a specific date. The tax authority made the tax adjustments based on the highest price published by the Secretary of Agriculture between the invoice and the shipping date for the commodities exported to Atlantic Oils & Meals, in a transaction by transaction analysis. The adjustments made by the tax authority reduced the tax loss carry forward of the taxpayer. The TFN found that there had not been a retroactive application of the Sixth Method. However, it ruled in favour of the taxpayer since the legislation in place in the fiscal year under analysis did not indicate that the price to be used should be that of the international exchange quoted price at the shipping date, so a valid quoted price at the date for the contract could be used. Nevertheless, the TFN ruled in favour of the tax authority in relation to the use of a transaction by transaction analysis, instead of the average global analysis employed by the taxpayer.
 - In the case of *Oleaginosa Moreno SACIFIA* (relating to the fiscal year 2000), and *Toepfer* case (CSJN ruling from 2015) the CSJN ruled in favour of the taxpayer, based on the grounds that the Sixth Method could only be applied prospectively. |

Actual policy experience: Argentina

Court cases: Application of the sixth method:

- Success case: application to difference in custom prices
 - Malteria Pampa (ruling of the TFN of 2019, fiscal year 2007): Export of barley malt via a related party trader in Uruguay (Maltería Uruguay, S.A., 100% controlled by Malteria Pampa), goods shipped to another related party in Brazil (Companhia de Bebidas das Americas -AMBEV-, controlling in a 60% Malteria Pampa). Customs noticed, using Indira, that the Price of the export from Uruguay to Brazil was substantially higher than that from Argentina to Uruguay. Also, that the pricing date used was that of the contract, and the shipping and invoice was done 1 year later. The problem for customs was the triangularization of the export, as all parties are related, and the functions assumed to be performed by the said intermediary are thus fictional. The prices were adjusted applying the 6th method using the official Price published by the Ministry of Agriculture at the shipping date. The court supported the position of the Customs Direction.

Different approaches in implementing the Sixth Method In Latin America

Aspect	Adopted approach
Transactions covered	<ul style="list-style-type: none"> • Only export transactions • Only import transactions • Import and export transactions
Nature of the Measure	<ul style="list-style-type: none"> • A way of applying the CUP Method • A way to arrive to an arm's length price • A separate method
Products or goods subject to the measure	<ul style="list-style-type: none"> • Commodities • Renewable natural resources and / or non-renewable natural resources • Goods with known quotes in transparent market • other goods provided that those meet certain requirements • The international intermediary does not have economic substance • And/ or the tax agency considers it appropriate • whenever the foreign company is resident in a listed jurisdiction regardless of whether the companies involved are related enterprises.
Hierarchy of the method	<ul style="list-style-type: none"> • Mandatory if the conditions established in the regulation are met; • Optional, either this measure or the CUP method, or other OECD methods may be applied; • Not expressly established by the regulation

Source: Author's based on UN (2017), CIAT (2013).

Different approaches in implementing the Sixth Method in Latin America

Aspect	Adopted approach
Prices to be considered	<p>Exports and imports are afforded different treatment:</p> <ul style="list-style-type: none"> ● For exports: research on international prices in accordance with the terms agreed upon by the parties as of the last shipment date unless there is evidence that it was agreed on another date; ● For imports: the price may not exceed the price based on international parameters as of the date on which they were originally purchased ● Multiple criteria in a single regulation: <ol style="list-style-type: none"> (i) Price on the transparent market on the loading or unloading date; (ii) average price over a 4-month period or 120 days prior to unloading or after loading; (iii) price as of the date on which the agreement was executed; (iv) Average price over a 30-day term after the agreement was executed; (v) quoted price on the transparent market on the loading date, that of the prior date in which a quoted price was available or that of the first day the goods are loaded
Comparability adjustments	<p>Some countries allow for comparability adjustments to the publicly available price so as to take into account market circumstances, contract terms and conditions, and product quality and specifications whereas other countries do not accept comparability adjustments.</p>
Exemptions to applying the rule	<ul style="list-style-type: none"> • Some measures provide the local taxpayer with the possibility to evidence that the intermediary has economic substance and thus be exempted from applying the rule. • Some countries exempt the application of the Sixth Method if an agreement is filed with the tax agency or with any other government agency a few days after it has been signed.

Source: Author's based on UN (2017), CIAT (2013).

Actual policy experience: Latin America– similarities and differences to the Argentine case

- Uruguay applies the method in a similar way to Argentina until December 2017
- Peru:
 - The adjustment is based on the value of the commodity in an international market, stock exchange and similar markets, at the shipping date. But it can also be made on the basis of the following alternatives:
 - Average quotes of the 4 previous months and 4 following months to the shipping finalization date.
 - The contract date
 - Average of the contract date and 30 following dates
 - The method is not applied:
 - In transactions that have been hedged by the taxpayer
 - If the international intermediary has economic substance
- The Dominican Republic applies the Sixth Method in export transactions to related party effective recipients of products which have a known quote, that have been performed by intermediaries that are not related parties.
- Ecuador:
 - A CUP is applied in which the value of the quote in a transparent market at the shipping date is considered, except when the price at the contract date is higher, in which case the latter should be applied.

Paraguay:

- The triangulation of the transaction through an intermediary that is not the effective recipient of the merchandise is not a requirement for the application of this rule.

Brazil:

- The PECEX is the median daily value of products with a quotation in stock exchanges and future markets of internationally recognized raw materials.
- To export made to i) related parties, ii) resident in a jurisdiction with a favourable taxation, or iii) entities that benefit from differential fiscal regimes.
- The shipping date is only used if the settlement date has not been identified.

Actual policy experience: increase in tax collection in Latin American countries

- Argentina: Between 2001 and 2007, tax collection from cereal and oil export companies increased in more than 12 times.
- In Ecuador, between 2009-2010, increased 18% the value of declared exports, a bit more than 6 billion dollars
- In Paraguay: audits in 2011 in agro-export companies resulted in an 8% increase in corporate taxation tax collection
- A similar method applied by Dominican Republic to all inclusive tourist packages increased tax collection in the hotel sector by 818% in relation to the corporate income tax, and 70% in the case of VAT.

• Source: CIAT, 2019

Implementation in African Countries

- Zambia:
 - Practice Note 1/2008,25 paragraph 3.17 introduced a version of the Sixth Method for the purposes of the Corporate Income tax. In Zambia's case, the introduction of the Sixth Method was made through the introduction of a reference price for any transactions relating to the
...sale of base metals, precious metals or any substance containing base metals or precious metals, directly or indirectly, between related or associated parties.
 - The “reference price” means:
 - a) the monthly average London Metal Exchange cash price;
 - b) the monthly average Metal Bulletin cash price to the extent that the base metals or precious metal prices are not quoted on the London Metal Exchange;
 - c) the monthly average cash price of any other metal exchange market as approved by the Commissioner-General to the extent that the base metal price or precious metal price is not quoted on the London Metal Exchange or Metal Bulletin; or
 - d) the average monthly London Metal Exchange cash price, average monthly metal market exchange cash price approved by the Commissioner-General, less any discounts on account of proof or low quality or grade.
- Malawi:
 - in June 2017 it adopted some of the wording from the African Tax Administration Forum (ATAF) Suggested Approach to Drafting Transfer Pricing Legislation:

for the export or import,[...] in general, goods where prices can be obtained at the date of the transaction from an international or domestic commodity exchange market, or from recognized and transparent prices reporting or statistical agencies, or from any other index but excluding all auctions in Malawi trading coffee, macadamia nuts, tea or tobacco, that is used as a reference by unrelated parties to determine prices in transactions between them [...] the monthly average of that publicly quoted price of the month in which the goods are shipped, regardless of the means of transport, shall be, [...], the sale price used for the purpose of computing the taxable income of that person unless the person provides all of the evidence needed to show that adjustments are appropriate to that quoted price to be consistent with the arm's length principle....

Analysis of the policy's impact and lessons learned: Argentina

Measuring the effectiveness of transfer pricing audits in Argentina

Various triangulation situations found by the AFIP since 2009

Argentina	Intermediary	End client	Price difference
Dutch Capital	Related company Asia	China – Europe – Brazil	5%
US Capital	America branch	China, Spain, Malaysia, India	5%
German Capital	Parent company Europe	China, Spain, Brazil, Chile	5% - 10%
Argentine	America branch	China – Spain	5% - 10%
US Capital	US parent company	China, Saudi Arabia, Syria	5%

Source: Elaborated based on Echegaray, Michel and Barzola 2013

Data

Export under-pricing by Price of soybean, soybean meal and soybean oil, of the set of exporters.

Year	Soybean meal	Soybean Oil	Soybean	TOTAL
2010	-672.689.866	-327.886.389	-242.665.029	-1.243.241.284
2011	-553.279.766	-257.674.139	-117.655.984	-928.609.890
2012	-1.134.870.549	-163.414.113	-212.319.241	-1.510.603.903
2013	-717.142.518	-251.908.091	-168.319.051	-1.137.369.659
2010	-11%	-10%	-8%	-10%
2011	-8%	-7%	-4%	-7%
2012	-16%	-5%	-15%	-13%
2013	-10%	-10%	-9%	-9%

Source: Grondona and Burgos, 2015

Thank you!

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