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Transfer Pricing: Concepts and Practices of the 'Sixth Method' in Transfer Pricing*

By Veronica Grondona

Advisor to European United Left/Nordic Green Left (GUE/NGL) on the European Union Parliament Inquiry Committee on Panama Papers

A. Introduction

The Sixth Method was first introduced by Argentina as the sixth paragraph following the fifth paragraph of Article 15 of the Profit Tax Law[1]. It is called the Sixth Method because it was incorporated after the other five methods for transfer pricing valuation which consist of the traditional transactional methods (the Comparable Uncontrolled Price Method, the Resale Method and the Cost Plus Method); and the transactional profit methods (Transactional Net Margin Method and the Profit Split Method), recommended by the 1995 Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines. The Sixth Method is applicable to commodities and is distinct because it draws a comparison with a market quote, instead of allowing the comparison to be made with transactions and prices agreed between unrelated parties (Grondona, 2015) (Grondona & Knobel, 2017).

The Sixth Method has been legislated by Argentina, Bolivia, Brazil, Costa Rica, the Dominican Republic, Guatemala, Honduras, Peru, Uruguay and some Caribbean countries; but also by Zambia, Malawi and India; because it has a number of advantages.

To date, practical experience with the rule exists in mainly Argentina, Brazil, Ecuador and Uruguay, which have different experiences in applying it.

The advantages of the Sixth Method are that a quoted price can provide a clear and relatively objective point of reference to challenge the prices attributed in transactions between related entities. In some circumstances it may be possible to identify such a price which can be used as an appropriate benchmark, usually with some modifications, if applying it seems to result in an appropriate level of profit. This can establish a basis for rules which are easy to administer and do not involve either subjective judgment or detailed examination of facts and circumstances.

However, the experience of its application in different countries shows that some loopholes have been left open that have reduced the benefits to be expected from its application.

This policy brief analyses the problem of the valuation of commodities in section B, actual policy experience in section C and the policy's impact and the lessons learned in section D.

B. The problem of the valuation of commodities[2]

The central problem underlying the commodity transactions between two related parties is the lack of validity of the price settled by such an agreement. Independent parties trading commodities settle their agreements in open markets and if the transaction is done between the producer and the trader, it is normally based on future prices.

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[3], exports of commodities to non-related parties have been found to also involve intermediates with no economic substance located in low or zero tax jurisdictions.[4]

Moreover, regarding transactions within economic groups, these are generally vertically-integrated, so that the commodity is transferred to the related party for processing and perhaps eventual use in manufacturing; or they are large diversified commodity traders and brokerages. This gives rise to a range of problems for tax authorities seeking to establish an appropriate level of profit for the commodity producing subsidiary of such a group.

First is the question of risk. Due to the characteristics of the extractive industries producing such commodities, the 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 independent producer can try to manage such risks by using forward contracts, and may also benefit from knowledge of published prices where there is organised trading of derivative contracts based on relevant commodities. However, an integrated firm can internalise this risk management, by combining the relative security of supply due to involvement in production, with the management of stocks and ultimate delivery. 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.

* The views contained in the policy brief are personal to the author and do not represent the institutional views of the South Centre or its Member States.

Secondly, 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. Like commodity trading, these functions may also be assigned to separate affiliates which, because of the nature of the functions concerned, can easily be organised so that their profits are attributable to jurisdictions where they will be subject to low levels of taxation. Thus, 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 (BEPS). 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. This is due to the primary importance and key nature of this industry for the economies of many developing countries and thus inherent reliance and dependency of the state budgets of these countries on the tax revenues from these commodity producing or extracting activities; as well as from the foreign currency obtained in such trading.

In this context, the standard OECD approach to transfer pricing is clearly unsuitable. The OECD Guidelines (1995) (2010) specify that the starting point in evaluating the profits of associated enterprises should be the transactions between them, which are supposed to be evaluated by reference to comparable transactions between unrelated entities. However, it should be clear that a transaction between related parts of an integrated corporate group has none of the characteristics of a contract freely negotiated between truly independent parties, since all of its terms and conditions will have been decided administratively and aimed at maximising the benefits to the firm as a whole. Indeed, in the case of primary commodity production, the producing affiliate will generally be very much subordinate to the concerns of the firm's head office, which is likely to focus on the upstream and marketing aspects of the business. Therefore, such contracts cannot be considered the starting point. Recognising the lack of suitable comparables in many cases, the OECD has increasingly moved towards the attribution of profits based on the functions performed, assets owned and risks borne by the various affiliates. This also is unsuitable, since multinational enterprises (MNEs) design corporate structures involving functional fragmentation frequently with BEPS objectives, as described above.

C. Actual policy experience

For the reasons described in Section B above, several countries have adopted an alternative method for the valuation of commodities: the Sixth Method, which basically consists of comparing the price of the exported commodities with an international quotation of such good at the shipping date.

The Sixth Method has been adopted by a number of developing countries because it has a number of advantages, but they have also in practice experienced difficulties applying it. Its advantages are that a quoted price can provide a clear and relatively objective point of reference to challenge the prices attributed in transactions between related entities. In some circumstances it may be possible to identify such a price which can be used as an appropriate benchmark, usually with some modifications, if applying it seems to result in an appropriate level of profit. This can establish a basis for rules which are easy to administer and do not involve either subjective judgment or detailed examination of facts and circumstances.

The difficulties which have been experienced are both in identifying a suitable benchmark and because, once such a benchmark has been established, it is possible for the firm concerned to organise the transactions between its affiliates to take advantage of it. An important element in this is that transfer pricing documentation is generally presented to the tax authorities after the transaction has been made, enabling the adoption by the taxpayer of the most advantageous quoted price; and the impossibility of considering an agreement between two related parties as sufficient proof of the date of settlement of the price of the commodity transaction.

The method in issue is in place in countries such as Argentina, Bolivia, Brazil, Costa Rica, Dominican Republic, Guatemala, Honduras, Peru, Uruguay and some Caribbean countries; as well as in Zambia, Malawi and India. To date, practical experience with the rule exists in mainly Argentina, Brazil, Ecuador and Uruguay. However, the method is not applied unequivocally the same in all these countries.

1. Legal framework and court decisions in Argentina[5]

The Vestey case was one of the first export cases exposed for its tax evasion consequences in Argentina. A Senate commission created in 1934 to analyse the consequences of the Roca-Runciman pact[6] between Argentina and the United Kingdom (UK) revealed that the Anglo-Argentinean meat-packing company (Vestey) was paying no taxes in Argentina or in the UK. Senator De la Torre then suggested, in a public speech in the Congress, that for the purposes of calculating the income attributable to Argentina, the transaction prices should be based on the meat prices in Great Britain (CIF),[7] less the cost of transportation and insurance calculated by the Argentine government. This was considered as a possible solution to the problem because it had been observed that the import price in the UK was significantly higher than the export price in Argentina; and as from 1943 an article known as the "import-export clause" was introduced on the Income Tax Law (LIG) with such consideration.[8]

The rule in place treated the difference between a wholesale price at origin and the importers' price as implying an economic linkage between the parties.

When a wholesale price was not available, the arm's length criteria would be applied[9]; i.e. a comparison with the profits of independent entities could be used for the calculation of the profits of the Argentine source, although it was not very clear what was meant by a 'comparison with the profits of independent entities'.

The economic reality principle was first introduced into Argentine law in 1946, and is still quoted in the Federal Act on Tax Procedures, which provides that it should be the true substance of a taxable event and not the legal forms or structures used that needs to be considered for the determination of the taxable base.[10] The National Supreme Court of Justice (CSJN, Spanish acronym) applied this economic reality principle in several other cases relating to interest loans and royalty payments, and even merchandise transactions within the domestic market, in 1973 and 1974.

Between 1973 and 1974, Law 20.628 on income tax (hereinafter 'LIG', for its Spanish acronym), Law 20.557 on foreign capital investment, and Law 20.794 on technology transfer were enacted, establishing the legal doctrine which arose out of these rulings of the CSJN[11], which had determined that it was the substance (the 'economic reality') and not the legal form which was relevant, and that in view of this it was valid to disregard contractual arrangements between entities belonging to the same economic group. This doctrine stressed that such contracts had not been made between legally independent parties, either for operations within a country or with entities located abroad.

The civilian-military coup of 24 March 1976 was supported and encouraged by local and foreign multinational entities. Changes to the legislation affecting MNEs' investment interests in Argentina were among the first to be made, thus, since the economic reality principle was argued by MNEs to be too hostile to foreign investment, it was modified at a very early stage in the dictatorship. So, in August 1976, a new foreign investment law was passed validating contracts between related entities provided that they conformed to normal market practices between independent parties. The same modifications were soon after introduced to the LIG, and to the law on technology transfers. Thus, the arm's length principle was re-introduced de facto in the legislation.

In 1983, the CSJN[12] ruled in favour of the taxpayer, in *Eduardo Loussinian*. The Tax Administration Department had challenged what it considered to be schemes to over-invoice imports, noting that a difference between the price paid and the current wholesale price in the place of origin supposed the existence of an economic linkage between the foreign company and the local importer; and that therefore this difference in prices constituted a net Argentine-source profit for the exporter, according to Article 8 of the LIG. Nevertheless the CSJN took the view that it was not possible to verify whether there was an economic linkage (ownership relationship) between the foreign entities and Eduardo Loussinian SACIFIA; and therefore the profit could not be said to be of Argentine source.

In 1992, the worldwide income principle was incorporated into the LIG. This applied to all residents in Argentina, including companies and their foreign subsidiaries[13]. It provided that residents should calculate their taxable base on the total profits gained in the country and abroad, while they could deduct from their local income tax liability the actual payments made for similar taxes abroad.

Many changes were introduced into local legislation from 1998 onwards in relation to the treatment to be given to transactions between related parties, most of them aimed at making local rules consistent with the OECD approach (Baistrocchi, 2012). In this way, the five transfer pricing methods specified in the 1995 OECD Guidelines (OECD, 1995) (comparable uncontrolled price (CUP), resale price minus, cost plus, profit split, and the transactional net margin method (TNMM)) were introduced in the LIG at this point.

Probably as a consequence of *Eduardo Loussinian SACIFIA*, the export-import clause was modified in 1998 in order to make it applicable even when the economic linkage between the parties cannot be verified.[14]

The export-import clause was amended again in 2003,[15] to provide that in cases of transactions with related parties, as well as with parties located in low or zero tax jurisdictions, the OECD methods should be applied. Also, in cases of imports or exports for which an international price could be established in a transparent market, such a price should be applied to determine the profit of the Argentine source.

Finally, the same law amending the export-import clause incorporated a sixth paragraph after the five OECD methods, applying to'*…exports made to related parties, that relate to cereals, oil products, and other products of the earth, hydrocarbons and its by-products, and, in general, goods that have a known quote in international markets, in which an international intermediary is involved that is not the effective recipient of the merchandise"*, under which prices should be based on '*the trading value of the goods in a transparent market on the date on which the goods are shipped'*. The application of this Sixth Method is specifically required only when the foreign intermediary cannot demonstrate economic substance.

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.

It should be noted that the Sixth Method can be applied to third party transactions in Argentina. However, something not addressed in the rule is 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).

For customs information, the INDIRA system gives the Argentine Federal Administration of Public Revenue (AFIP, Spanish Acronym) access to micro data (volumes, prices, invoicing details, etc.) from Argentina and other MERCOSUR countries, as well as some others, such as India. An agreement has been signed with the United States, and with India, for sharing customs information, although not through the INDIRA database, since it is restricted to a bilateral exchange. However, customs data does not distinguish between related and unrelated parties. Customs micro data in this system –which works like an online database – can be accessed immediately and automatically by national tax officials, who send the information on mismatches found to the regional agency conducting the audit.

On December 2017, the Sixth Method was modified in the context of a series of modifications that were made to the LIG. Such modifications affected the Sixth Method by making it 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 in which 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, then 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 -to be defined by the Tax Authority- above which transfer pricing requirements (including the Sixth Method) would be applicable.

The Organization for Economic Co-operation and Development (OECD)'s BEPS Action Plan discussed the Sixth Method in its Action 10. The proposals under Action 10 suggest that what had been known as the Sixth Method should be understood as a quoted price under the 'comparable uncontrolled price' (CUP).

Even when both the Sixth Method and OECD's CUP Method seem to be similar, the CUP Method is based on the arm's length principle, and thus aims at looking for prices set between independent parties that have performed transactions "comparable" to those between related parties. Searching for comparable transactions between independent parties is often very complex, on one side because of the lack of available information; but also, and not less important, because transactions between related parties, performed between one party and another party subject to it, are in essence not comparable to transactions performed between two parties that are in equal conditions to negotiate a contract. The Sixth Method simplifies the problem by defining how the comparability should be done, providing greater certainty both for the taxpayer and the Tax Authorities, and reducing compliance costs.

In addition, the OECD version of the Sixth Method[16] 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. However, given that transactions of commodities between related parties are set between one party and another party subject to it, there is no other date that reflects a real transaction except from the shipping date. This is clear when observing the experience from court cases in Argentina described in Appendix 1 to this chapter, where in one case (Oleaginosa Moreno) it was found that the company set its prices with independent parties at the shipping date; and in other cases (Cargill, and Oleaginosa Moreno) it was found that there was no written arrangement between the related parties that could allow for the identification of an alternative date.[17]

However, as can be seen in Appendix 1, the Argentine Tax Authority has exploited the similarities between the Sixth Method and the CUP in order to defend the use of international quotes at the shipping date in cases that related to fiscal years that were prior to the year in which the Sixth Method was introduced in Argentine legislation (2003).

2. Other similar systems in Latin America

Several countries have lately incorporated new legislation or modified existing legislation in order to adapt it to the outcome of OECD's BEPS Action 10.

According to the United Nations Transfer Pricing Manual (UN, 2017), and CIAT (2013), Latin American countries have implemented the Sixth Method for the valuation of commodities in international transactions (see Table 1).

In this sense, Uruguay applies the method in a similar way to Argentina (until December 2017): to transactions with related parties, in which an international intermediary is involved that is not the effective recipient of the merchandise, and that does not have economic substance (as understood by Argentine legislation) involving commodities; and the comparison is made with a quote in a transparent market at the shipping date.[18]

Peru recently introduced several modifications to its transfer pricing rules[19] in order to adapt them to the OECD BEPS Action Plan, changing the Sixth Method in order to be applicable as a benchmark for export and im-

Table 1 Different approaches to the implementation of the Sixth Method

Aspect	Adopted approach
Transactions covered	• Only export transactions • Only import transactions • Import and export transactions
Nature of the measure	• 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	• Commodities • Renewable natural resources and / or non-renewable natural resources • Goods with known quotes in transparent market • Some regulations allow tax administrations to extend the measure to other goods provided that meet certain requirements. • The international intermediary does not have economic substance • And/ or the tax agency considers it appropriate
Relation condition	• Some countries define the condition by which the international exporter and / or intermediary trader and / or the exporter at origin and the importer at destination are related parties. • Some apply the method whenever the foreign company is resident in a listed jurisdiction (non-cooperative, low tax jurisdiction, or under a privileged tax regime), regardless of whether the companies involved are related enterprises.
Hierarchy of the method	• 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
Prices to be considered	• Exports and imports are afforded different treatment: ◊ 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: (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 (the criterion adopted varies by country)
Comparability adjustments	• 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.
Exemptions to applying the rule	• 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, even though the criteria are not the same in every case. • 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).

port transactions with known quotations in international markets, the local market or the destination market (including those of the derivative financial market).

Ecuador[20] also had some recent modifications in its transfer pricing regulations[21], and particularly in relation to the Sixth Method in order to adapt it to a CUP Method with specific benchmarks for export transactions of banana, crude oil, gold, silver, copper and any other mineral metal in any State. This methodology is to be applied in transactions with parties located in tax havens or jurisdictions with preferential tax regimes; or in transactions with international intermediaries that do not have a tax residence in the jurisdiction of the final destination of the goods. The benchmarks are the monthly average for crude oil, the price used for the calculation of royalties for the mining sector, and the minimum export price set for the banana sector.

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. The adjustment is based on an international quote of the good in a transparent market on the first day of the shipping, except when the intermediary has a real and effective presence in the jurisdiction of residence and is mainly dedicated to intermediation.

In Paraguay,[22] transfer pricing adjustments for exported merchandise with an international known price in transparent markets, stock exchanges or similar, should be established based on such prices at the day in which the shipping has finalized or in the day previous to a date in which there is a quote. 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. The Paraguayan legislation also observes that conditions would be set by the authorities on how to apply the adjustments in the case of operations agreed in future markets.

It should be noted that Paraguay, Uruguay and as from December 2017, Argentina, require the registration of contracts involving the export and/or import of commodities, detailing the conditions agreed in such transactions.

In Brazil[23], the application of the export quotation price (for which the Portuguese acronym is PECEX) is mandatory in the case of export of commodities made to i) related parties, ii) resident in a jurisdiction with a favourable taxation, or iii) entities that benefit from differential fiscal regimes. Commodities are defined as the products subject to public quotation in stock exchanges and future markets, or subject to public prices in internationally recognized sectorial research institutions (the commodities subject to PECEX are listed in the legislation), or traded in stock exchanges and future markets listed in the legislation. The PECEX is not a method, but a specific comparable transaction which is calculated as the median daily value of products with a quotation in stock exchanges and future markets of internationally recognized raw materials. The prices used are those at the date of the transaction. The shipping date is only used if the settlement date has not been identified.

3. Implementation in African countries

Zambia has introduced rules that apply to the sale of base metals or any substance containing base metals or precious metals between related parties. In such transactions the sale price for tax purposes will be broadly the monthly average quoted price on metal exchange markets (OECD, 2014).

Practice Note 1/2008[24], paragraph 3.17 introduced a version of the Sixth Method for the purposes of the Corporate Income tax[25]. 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.*

A recent study indicates that both the Zambian Revenue Authority (ZRA) and mining companies have had a positive experience of the sixth method. (Readhead, 2017)

Recently (in June 2017) Malawi has adopted some of the wording from the African Tax Administration Forum (ATAF) Suggested Approach to Drafting Transfer Pricing Legislation:

> *for the export or import, involving grains, oil, seeds, other agricultural products obtained from the land, hydrocarbons and derivatives thereof, and, 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 (hereinafter referred to as the "publicly quoted price"), 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, without considering the price that was agreed upon with the related person, 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:*
>
> *Provided that in the case of goods exported from Malawi where the price agreed upon between the person and the related person is higher than the publicly quoted price at the above-mentioned date, the agreed price in this case will be considered as the sales price for the purpose of computing the seller's taxable income in Malawi.*

Table 2 Spontaneous adjustment to the tax base and income tax, as a consequence of adjustments to the price of commodities

Fiscal Year	Number of taxpayers	Adjustment to the tax base (Argentine pesos)	Tax value (35%) in Argentine pesos
2003	13	369,624,402.04	129,368,540.71
2004	40	226,928,170.78	79,424,859.77
2005	11	121,367,737.80	42,478,708.23
2006	7	359,692,301.95	125,892,305.68
2007	4	974,886.17	341,210.16
2008	4	591,030.15	206,860.55
2009	6	6,479,686.64	2,267,890.32
2010	3	11,285,639.30	3,949,973.76
2011	4	4,248,810.86	1,487,083.80

Source: Elaborated based on Echegaray, Michel and Barzola (2013, p. 110)

D. Analysis of the policy's impact and lessons learnt from Argentina[26]

The AFIP monitors the spontaneous adjustments[27] made to the tax base by the taxpayers themselves in their transfer pricing declarations.

The AFIP interprets the reduction of the spontaneous adjustments to the tax base over time as a consequence of taxpayers giving traders an alleged 'economic substance' in order to avoid the application of the Sixth Method for the valuation of commodities (Echegaray, Michel, & Barzola, 2013, p. 110).

It is also possible to make some analysis of the data collected in tax declarations relating to transfer pricing and the transfer pricing documentation presented by MNEs. From such information, the AFIP can analyse the conduct of the MNEs by economic sector, analyse what is reported in relation to transfer pricing, and analyse the conduct of MNEs in relation to specific transactions. Such information is confidential, and is used by the AFIP for research purposes in order to plan a strategy for tax audit, but also to evaluate the effectiveness of the transfer pricing regulations.

An example of the use of such information for measuring the effectiveness of transfer pricing regulations is seen in the following table, in which an analysis was made of the price differences between origin and destination of Argentine commodity exports by large concentrated export groups (mainly linked to the oil and oilseeds sector) when using different intermediaries.

Case study: the Argentine soybean exports case[28]

The exports of soybean, soybean oil and soybean meal represented 24% of all Argentine exports in 2013, 22% in 2012, 24% in 2011, and 25% in 2010.

Table 4 Soybean exports in Argentine total exports

Year	2010	2011	2012	2013
Soybean meal	12%	12%	13%	14%
Soybean oil	6%	6%	5%	5%
Soybean	7%	6%	4%	5%
Subtotal	25%	24%	22%	24%

Source: Trademap

Table 3 Various triangulation situations found by the AFIP since 2009

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

Source: Echegaray, Michel and Barzola (2013, p. 86).

Table 5 Exporters, Group Membership and Headquarters Location

Exporter	Group to which it belongs	Headquarters	Jurisdiction of location of headquarters
Aceitera General Deheza	Urquía Group	Aceitera General Deheza S.A.	Argentina
Bunge	Bunge	Bunge Limited	Bermuda
Cargill	Cargill	Cargill, Inc	United States
Dreyfus	Louis Dreyfus	Louis Dreyfus Holding B.V.[29]	Netherlands
Nidera	Nidera	Nidera B.V.	Netherlands
Oleaginosa Moreno	Glencore	Glencore plc	Switzerland
Toepfer	ADM	Archer-Daniels-Midland Company	United States
Vicentin	Vicentin	Vicentin S.A.I.C.	Argentina

Source: Based on company websites, annual reports and Gaggero, Schorr, Wainer (2014, p. 107)

In a study by Grondona and Burgos (2015), eight companies dedicated to the export of soybean and related products have been selected for analysis. This selection is based on a list of companies fined by the Argentine tax authorities for paying export duties below the level required for soybean exports. These firms referenced an outdated export duty; lower than that in place at the moment of the purchase of the grains to be exported. (Gaggero, Rua, & Gaggero, 2013, p. 78)

Table 5 shows each of the exporters chosen for analysis, the group they belong to, and the jurisdiction where headquarters are located.

Table 6 Companies' share of Argentine soybean exports

Year	2010	2011	2012	2013
Soybean meal	73%	68%	67%	69%
Soybean oil	81%	71%	71%	67%
Soybean	61%	51%	46%	48%

Source: Trademap and Penta Transaction

The exports of these companies represented 69% of soybean meal exports in 2013; 67% of soybean oil exports; and 48% of the soybean exports.

Soybean exports are less significant because soybean oil and meal is processed by the multinational companies and subsequently exported. This processing implies higher entrepreneurial content in soybean meal and oil exports, and lower in soybean, where there is some participation of national exporters and cooperatives.

Grondona and Burgos (2015) (2016) compare the average price of daily customs registrations between 2010 and 2013 with the price of an international quote on the shipment date.

This methodology is the closest to what is known as the "Sixth Method" in transfer pricing. In Argentina, the Sixth Method is not applicable when the tax payer can demonstrate that the foreign intermediary has economic substance. In such case the best of the five remaining methods prescribed by law should be applied. These are based on the "arm's length" principle.

The comparison was drawn with price quotes on the Gulf of Mexico, which is one of the markets for soybean products; the other is Chicago.[30]

Table 7 Soybean Export under-pricing

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: Reuters and Penta Transaction

Table 8 Soybean Export over-pricing

Year	Soybean meal	Soybean oil	Soybean	TOTAL
2010	21.182.572	2.336.356	43.365	23.562.293
2011	32.390.020	12.470.257	44.528.967	89.389.244
2012	42.196.592	24.541.622	8.603.375	75.341.589
2013	66.439.464	2.041.905	5.372.137	73.853.506
2010	0%	0%	0%	0%
2011	0%	0%	2%	1%
2012	1%	1%	1%	1%
2013	1%	0%	0%	1%

Source: Reuters and Penta Transaction

Applying the methodology outlined above, the average mis-invoicing of exports in the soybean sector was close to 10%, amounting to as much as US$1,500 million per year.

Export over-invoicing did not exceed 2% over the same period.

It should be noted that this methodology does not allow for a complete analysis of the impact of the use of intermediaries for profit shifting in commodity exports[31]. Similarly, this analysis does not shed light on illicit financial flows channelled through other transfer pricing mechanisms, such as financial transactions, payments for intangibles or services, and the import of goods. Moreover, estimates of the manipulation of intragroup prices are likely to be higher where these distinct transfer pricing mechanisms can be identified and incorporated in analysis.

While this analysis does not differentiate between exports to related and non-related parties, based on the levels of concentration and integration in this sector, it should be assumed that there is either an economic linkage between parties or the possibility of applying trade mispricing mechanisms as if such a linkage existed.[32]

E. Conclusions and Recommendations

Many developing countries are particularly concerned with problems of transfer pricing in the extractive industries, which are often significant components of their economies. Similar to other sectors, profit attribution may be highly dependent on the valuation of commodity exports. For this reason, a number of developing countries have adopted the 'Sixth Method', following the Argentine experience. This method aims to establish a clear and easily administered benchmark and avoid the need for subjective judgment and discretion (BMG, 2015a).

However, even when the application of the Sixth Method is legislated for, and given Argentina's extended experience dealing with commodity mis-invoicing, the data shows that such practices are still being employed by multinational companies, resulting in under-invoicing by approximately 10% in the Argentine soybean and soybean related products export sector.

One of the difficulties evidenced for the application of the Sixth Method is the limitation imposed when its application is limited to cases in which the intermediary is understood to have no economic substance. The economic substance of the intermediary is in most cases almost impossible to prove, and as has been observed in the Argentine case, companies have found ways in which to provide the intermediary with substance and avoid the application of the Sixth Method.

Nevertheless, Argentine court cases show that it has been found to be a reliable tool to settle transfer pricing disputes, regardless of whether it is considered a benchmark of the CUP Method or a separate method for the valuation of commodities; and regardless whether an analysis of the economic substance of the intermediary is made.

However, there are some major variations in the way in which the Sixth Method has been applied in different legislations that need to be highlighted, and their impacts followed upon. Such differences relate to, among other things: a) the consideration of the Sixth Method as an independent method for valuation, or as a variation of the CUP method; b) the date of the quote to be used (e.g. shipping date, delivery date, unloading date, average prices, the price at the date of the agreement, etc.); c) the value given to the written arrangement between the parties and; d) the range of comparability adjustments accepted.

Some of these variations seem to correspond to the pressure exercised by the transnational conglomerates trading commodities as well as their tax and legal advisors that in many countries advise both the multinational enterprises and tax administrations. In this sense, the written arrangements between the parties have proved to have little value in some Argentine court cases, something that seems logical considering that related parties do not establish "contracts" in equal negotiating conditions; and the date of the quote to be used has also been found to be the object of manipulation in order to leave the maximum profit in the most convenient jurisdiction for tax purposes.

Therefore, even when the Sixth Method seems to be a useful tool for tax authorities in countries exporting commodities, it could prove useful in time to do an analysis of court cases at an international level, and to analyse as well the impact of its application on the tax authorities' revenue collection, in order to better understand the way in which the different variations of the Sixth Method have proved to be a solution or a problem for the determination of the taxable profit in commodity trading cases.

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Appendix 1. Court cases in Argentina relating to the application of the import-export clause or the Sixth Method[33]

All court cases relating to the application of the Sixth Method for the valuation of commodities or the import-export clause have been listed in this section. There is no public list of such cases, so the list is as exhaustive as it can be.

SIA S.A. (CSJN ruling from 1967) declared losses on the export of horses to Peru, Venezuela and the United States of America. The Tax Authority at that time (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.

From 2003 onwards, the Administración Federal de Ingresos Públicos (AFIP; in English, Federal Administration of Public Revenue) attempted to apply the Sixth Method in several cases that reached different court levels. However it did not always succeed in this application because all such cases related to fiscal years prior to the method's introduction into Article 15 (2003), and so the AFIP's attempts faced the problem that legislative changes can only be applied prospectively.

Volkswagen (fiscal year 1998, Tribunal Fiscal de la Nación (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 the import-export clause 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 tax authority had found that the export prices for cars sold to Volkswagen do Brazil were significantly lower than those in the local market, and therefore understood that the local market price should be taken as valid. However, the court rejected this possibility, as it considered that the wholesale price in the country of destination should have been used for the comparison.

Cargill S.A.C.E.I. (ruling of 2011 by the Cámara Nacional de Apelaciones en lo Penal Tributario - CNAPT, National Appeal Court for Tax Crimes; relating to fiscal years 2000-2003): 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.

Nidera S.A. (ruling by TFN ratified by the Camara Contencioso Administrativo Federal (CCAF) in 2013 and revoked partially by the CSJN in 2016[34]; relating to fiscal year 1999): Nidera S.A. exported commodities (cereals and oils) through intermediaries resident in tax havens, and argued that its export prices were based on the export prices at the date of the agreement. The case discussed whether the Sixth Method, the import-export clause (Ley de Impuesto a las Ganancias -LIG-, in Spanish), or the Comparable Uncontrolled Price (CUP) Method should have been applied. The tax authority finally stipulated the use of the CUP Method (Article 15 of the LIG) based on prices published by the Secretary of Agriculture in Argentina at the shipping date and corresponding to an 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 S.A.C.I.F.I.A. (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. In the transfer pricing documentation presented by the taxpayer, Deloitte used the CUP method to validate Oleaginosa Moreno's prices, comparing the company's averaged prices with the ones published by the Secretary of Agriculture for the invoice date. The tax authority made the tax adjustments based on the highest price (referring to Article 8 of the LIG, although it did not use the prices at destination and nor did the taxpayer) 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 tax authority also observed that the exports made to an independent party in Chile had been priced using the quotes published by the Secretary of Agriculture for the invoice date. The adjustments made by the tax authority reduced the tax loss carry forward of the taxpayer. The taxpayer questioned the use of the shipping date, alleging that the Sixth Method had been applied retroactively; and it objected to the internal comparables (the transactions with the independent party in Chile) used, alleging that the transactions had significant differences for which no adjustments had been made. 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. The TFN also observed that the transactions with the independent party in Chile could not be used as a reference for the date to be used due to the significant differences they had with the transactions with related parties. 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.

Oleaginosa Moreno S.A.C.I.F.I.A. (ruling by CSJN of 2014 relating to fiscal year 2000): The AFIP objected to the export price of commodities sold to Atlantic Oils & Meals, a related party located in Switzerland, because for 36 transactions the price had been documented as an average instead of individually. The AFIP proposed that such prices should be calculated individually and in relation to the price at the shipping date. The TFN partially confirmed the AFIP`s position, observing that the legislation in place was consistent with the methodology chosen by the AFIP, although the use of the contract date could also be permitted – as suggested by the company – since the legislation in place at the time of the operations did not indicate the use of any specific date. The AFIP had also observed a difference between the price paid for the export of commodities to related parties and to independent parties located in Chile. However, the TFN accepted the complaint of the company observing that there were differences in the conditions of these transactions that precluded such transactions from being used as internal comparables. Both the AFIP and Oleaginosa Moreno appealed to the CCAF, which ruled in favour of Oleaginosa Moreno, and the AFIP's further appeal to the CSJN was also rejected.

Alfred C. Toepfer Internacional (ruling by CCAF of 2016 relating to fiscal year 1999) had been selling commodities to its related parties through traders resident in tax havens. The Tax Authority argued that the Sixth Method was applicable. The TFN and CCAF initially ruled in favour of the Tax Authority, but Toepfer appealed to the CSJN and the CSJN requested the CCAF to review its ruling in 2015. In 2016, the CCAF issued a revised ruling in which it gathered information on all exports of the fiscal year 1999 and determined that 50% had been made to related parties in which (i) the country of destination of the merchandises was different than the country where the client was located; (ii) there was no reference in the contracts to the value at the shipping date that could help explain the differences in prices; (iii) some sales were made on purchases made at a date later at a higher price of goods that were in transit; (iv) some suppliers from abroad sold merchandise that was of Argentine production; (v) various suppliers and intermediaries where located in tax havens. Regarding the use of the price at the shipping date, the CCAF considered that this was consistent with the CUP method, as it had been argued by Toepfer that the Tax Authority had made a retroactive application of the Sixth Method.[35]

Endnotes:

1 Profit Tax Law ("Ley de Impuesto a las Ganancias" -LIG-, in Spanish), text organized in 1997 and its modifications.

2 Relevant parts of this section have been extracted from BMG (2015a); and CIAT (2013).

3 See appendix for a brief description of Argentine court cases relating to the application of the Sixth Method.

4 See Argibay Molina (2013).

5 Relevant parts of this section have been extracted from Grondona, Knobel (2017). In this section, only court cases that have resulted in legislative changes are mentioned.

6 According to the Roca-Runciman pact, the UK agreed to keep buying Argentine meat, as long as its price was lower than that of other suppliers.

7 CIF is the price at destination including the costs of carriage, insurance and freight (CIF).

8 Article 7 of Decree 18.229/1943 required that the value of exported goods, for the purpose of the determination of income, should be established '(…) subtracting from the wholesale price at destination the cost of such goods, transport and insurance expenses, sales commissions and expenses, and other expenses incurred in Argentina'; while the value of imported goods should be determined based on the wholesale price at origin plus transport and insurance costs to Argentina.

9 Since 1946 for export cases, and since 1973 to export and import cases.

10 However, such criteria were not applied to transfer pricing cases until 1961, when the tax court ruled in the case of Refinerías de Maíz. The case was brought to the National Supreme Court of Justice (CSJN, Spanish acronym), and on 10 June 1964, the CSJN ruled that royalty payments should be considered contributions to the income of the parent company (deemed dividends) and could not be deducted for income tax calculation purposes, since the parent company owned 96 per cent of the stocks of the Argentine affiliate, and hence such enterprises could not be considered to be independent. The underlying argument was the economic reality principle.

11 A description of these rulings and their implications, and an analysis of the regulatory changes which resulted, can be found in Martínez de Sucre and Corti (1976), Corti (1985), and Corti (2012).

12 In Argentina, tax decisions including transfer pricing-related rulings, once the administrative process is complete, can be challenged legally at three levels (in ascending order): the National Tax Court (TFN); the National Federal Administrative Litigation Appeal Chamber (CCAF); and the National Supreme Court of Justice (CSJN).

13 It was not until the modifications to the LIG introduced by Laws 25.063, in 1998, and 25.239, in 1999, that the treatment to be given to foreign subsidiaries was clarified. For a brief discussion

on the treatment given between 1992 and 1998 to profits of foreign sources, see Gilardo (2007).

14 Law 25.063 of 7 December 1998 modified Article 8 of the LIG. Also, Decree 485 of 7 May 1999 introduced equivalent changes in Article 11 of the Regulatory Decree 1344/1998. Before these changes, the regulations under the LIG, approved by Decree 1344 of 19 November 1998, indicated in Article 11 of Decree 1344/1998 that once the existence of an economic relation had been verified (Article 8 of the LIG) the Argentine Federal Administration of Public Revenue (AFIP, Spanish acronym) could also determine the value attributed to the products involved in the transaction taking the wholesale price in the seller's market in case of an export, or the wholesale price in the buyer's market in case of an import. In any case, when the real prices of export or import were respectively higher or lower, such prices should be considered.

15 Modifications introduced by Law 25.784 of 2003.

16 See OECD (2017).

17 It should be noted that if such written arrangement did exist, it should not be considered as a contract, since a contract is legally understood to be an arrangement between two parties with equal negotiating conditions.

18 In the comments to the OECD's Discussion Draft on the valuation of cross border transactions (OECD, 2015), there is some confusion between the interpretation of the Argentine legislation made by the tax authorities and the courts, and the Sixth Method itself; and on some replies, the Uruguayan Sixth Method is described as providing more certainty. However, it needs to be understood that the difference in interpretation of the Sixth Method in both countries could be based on the evolution of Argentina's legislation up to the moment of the Sixth Method. Such historical process evolved from the use of the import and export clause which considered that the highest price between the price of the export and that of the wholesale price at destination should be the one to be taken to the application of the Sixth Method in cases where an intermediary without economic substance was used and an international quote was available.

19 Legislative Decree 1312 of December 2016.

20 There are some court cases on the banana, flower and lumberjack markets that would be interesting to analyse further in another study.

21 Resolution No. NAC-DGERCGC16-00000531 of the Ecuadorian Tax Authority (SRI, Spanish acronym).

22 Law 5061/13.

23 Normative Instruction RFB 1312 modified by Normative Instruction RFB 1395 of September 13, 2013, subsection V, article 34.

24 Practice Note 1/2008 also introduced a Norm Value for the payment of royalties on the production of minerals (paragraph 4.3), and Practice Note 2017 updated the royalty rates.

25 Zambia Revenue Authority, Unofficial Consolidation of the Income Tax Act, 2017, Section 97A(13) and (14).

26 Relevant parts of this section have been extracted from Grondona and Burgos (2015) (2016).

27 Spontaneous adjustments occur when an entity has presented its tax declarations, but when later filing the transfer pricing report and forms observes that it cannot justify the value of the transactions under the current legislation, and thus makes 'spontaneous adjustments' to its taxable base.

28 Relevant parts of this section have been extracted from Grondona and Burgos (2016) (2015).

29 LDC Argentina S.A. has been controlled since 2007 by Galba SA (75 %), a company resident in Switzerland, and related to LDC. The headquarters of the LDC group are in the Netherlands. Ultimate control is in a trust named Akira, whose beneficial owner is the Luis Dreyfus family.

30 In the specific case of Argentina, the Ministry of Agriculture also publishes soybean product prices used by the Tax Authority for the application of the sixth method, but these are not market quotes. These prices follow those on the Gulf of Mexico.

31 This has been attempted in Cobham, Jansky, and Prats (2014).

32 Argibay Molina (2013, pp. 82-84) presents the case of over-invoicing of transport costs, which requires for it to be possible that the exporter has a related party located in a jurisdiction that could, for example, be the Netherlands, that acts as an intermediary for the transport transactions. The company actually rendering the transport service does not need to be related. What happens in practice is that the exporter pays its related party for the transport service, and this intermediary pays the actual non-related service provider but keeps a margin for itself. In this way, the transport is over-invoiced, but the actual non-related service provider is paid at a market price. The intermediary may later transfer such margin to another related party in a tax haven or secrecy jurisdiction.

33 This section contains significant extracts from Grondona and Knobel (2017). For a complete list of Argentine court cases on transfer pricing, see Grondona and Knobel (2017).

34 See https://www.adelaprat.com/2017/02/impuesto-a-las-ganancias-exportacion-a-entidad-radicada-en-paraiso-fiscal-la-csjn-revoca-aspecto-de-la-sentencia-que-invoca-incorrectamente-el-principio-de-valor-de-mercado-abierto-y-solo-para-las-ope/.

35 See https://www.cronista.com/fiscal/Comentario-del-fallo-de-precios-de-transferencia-por-exportaciones-realizadas-entre-empresas-vinculadas-20170814-0010.html.

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The South Centre
Chemin du Champ-d'Anier 17
PO Box 228, 1211 Geneva 19
Switzerland
Telephone: (4122) 791 8050
Fax: (4122) 798 8531
E-mail: south@southcentre.int
http://www.southcentre.int