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Transfer Pricing Forum

Transfer Pricing for the International Practitioner

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Argentina

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1. Per the OECD, the impact of the COVID-19 pandemic on economic activity would far outweigh anything experienced during the global financial crisis in 2008-09. What similarities and differences do you see between the 2008 crisis and the current pandemic so far on the practice of transfer pricing in your jurisdiction?

As regards the similarities with the 2008-9 financial crisis or, in Argentina's case, the economic downturn experienced in 2002 (which followed a material devaluation of the Argentine peso and unprecedented levels of domestic inflation), the author's view is that Argentine multinational enterprises (MNEs) will likely be required to make the same extraordinary loss adjustments as they did back then. Extensive bad debt write-offs are also expected, while the government has put in place counter measures in the form of subsidies with a view to mitigating the adverse effects of COVID 19.

At the same time, the unique nature of the pandemic has given rise to a number of new tax issues — for example, the need to assess the financial impact of abnormal expenditures that would not be incurred in the ordinary course of business, such as the cost of sanitizers, gloves, masks and temperature measuring equipment for screening employees and customers. The crisis has also made it necessary for companies to assess whether their employees having to remain outside their home country because of restrictions on mobility imposed because of the pandemic could give rise to agency permanent establishments (PEs). This is quite a common situation for cross-border workers. International travel restrictions implemented to limit the spread of COVID-19, could also give rise to a services PE, which could, in turn, create obstacles to servicing customers abroad as initially contracted. In addition, since the pandemic is expected to last for some time, some companies are also developing restructuring strategies that could trigger the need to value assets, risks or functions relocated out of Argentina. Finally, restrictions imposed as a result of the pandemic could also lead to a change in the place of effective management of a company, which typically decides corporate tax residence under treaty tie-breaker rules applying in the case of dual tax-resident companies. While, in principle, the extraordinary travel restrictions should not generally affect corporate tax residence, the Argentine Revenue Service has remained silent on the issue. No past economic crisis has witnessed such far-reaching tax consequences.

The Argentine Revenue Service (ARS) recently responded to the crisis by extending the deadlines for filing transfer-pricing reports and meeting associated compliance requirements by means of General Resolution 4733, which was published in the Official Gazette on June 5, 2020.

2. Business performance as a result of the COVID-19 pandemic:

a. What do you see as the impact of the COVID-19 pandemic on low-risk entities (which typically bear limited risks, and record limited profit margin when the principal entity incurs a loss) in your jurisdiction? Do you see your jurisdiction accepting that such entities can lose money during this unusual economic downturn?

It is certainly possible for low-risk entities to lose money in this unprecedented environment. However, the transfer pricing outcomes reflecting this should be properly substantiated by reference to a set of comparable companies. According to Tax Court case law, the burden of proving that similar profit margin reductions would be expected in transactions with unrelated parties in comparable circumstances lies with the taxpayer. In *Boehringer Ingelheim* (Tax Court, 9.2.14), the Tax Court held that, once a taxpayer has filed its annual transfer pricing analysis, the ARS, if it wishes to challenge the taxpayer's analysis, has the burden of countering the taxpayer's position by advancing a solidly-reasoned alternative transfer pricing analysis. The Court's opinion is that the burden of proof is thus shared by the taxpayer and the tax authorities, so that, if it is to succeed in a dispute, the ARS must have well-supported evidence, grounded in the facts and the relevant law, that calls into question the taxpayer's transfer pricing criteria. In arriving at its decision, the Court required the ARS to produce a

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reasoned alternative to the taxpayer's analysis that "would reproduce business decisions that are compatible with those that unrelated parties would undertake." This standard is also helpful, in general terms, in that it offers a reasonable construction of Argentina's transfer pricing framework: in no case is it valid for the tax authorities to challenge business-oriented, arm's length behavior. Consequently, if comparable companies experience revenue losses as a result of COVID 19, the transfer pricing outcome for the tested party may well be similar.

b. Are there MNEs in your country who are experiencing or likely to experience increased or expanded business opportunities despite the current pandemic? What strategies should these entities be mindful of with regards to their transfer pricing models?

Unfortunately, it does not seem likely that Argentine MNEs will enjoy such opportunities in the current environment—quite the contrary, the overall economic downturn in Argentina's economy is in excess of 10% of gross domestic product (GDP) (*https://www.dw.com/es/econom%C3%ADa-de-argentina-cae-115-por-pandemia/a-53519265*).

c. How are MNEs in your jurisdiction addressing comparability issues, or how would you advise them to address comparability issues? How should they treat loss-making comparables, to ensure that any adjustments factor in the current global epidemic and adequately reflect economic reality?

In previous major economic downturns, Argentine MNEs were allowed to segregate extraordinary losses from their financial statements in order to make them comparable with the market set. While comparable companies are expected to be adversely affected in much the same way as local tested parties, given the almost universal impact of the current pandemic environment, past experience has shown that the magnitude of such downturns is usually greater in developing economies, such as Argentina's. For this reason, loss-segregation comparability adjustments can be expected and, indeed, there is case law to support the making of such adjustments. In the leading case in this area, *Toyota* (*Toyota Argentina SA vs. AFIP, Federal Supreme Court 9.2.14*), the car manufacturing company was successful in defending its use of such methodology. Toyota's first comparability adjustment was focused on idle capacity, i.e., losses resulting from fixed costs that could not be set off against the reduced sales volume resulting from an unprofitable business cycle. The ARS challenged the adjustment, arguing that a taxpayer, i.e., the tested party, may not make unilateral loss-segregation adjustments, unless it proves that the comparables it uses did not experience similar extraordinary losses. Of course, it is always difficult to produce evidence to prove a negative with respect to comparables. However, the Tax Court sided with Toyota, since the company's expert witness was able properly to demonstrate the negative cycle that the company experienced and to measure the magnitude of the resulting extraordinary loss by comparing actual production with the regular level of production, which was not achieved because of the economic downturn. Consequently, losses resulting from fixed costs could not be set off against the reduced sales volume, thus requiring these abnormal losses to be excluded from the company's financials to make them comparable with the market set. The taxpayer also segregated extraordinary losses resulting from a government plan that burdened the company with abnormal expenses. The Tax Court upheld the criteria used by the taxpayer in this context as well, since it found that the company had demonstrated that the government had never paid the subsidies to the company, thus triggering extraordinary losses that would have rendered the tested party not comparable with the market set unless the losses were segregated from the financial statements. It is expected that such comparability adjustments will have to be made in the current pandemic environment, which requires the incurring of abnormal expenditure on items such as sanitizers, gloves, masks and temperature measuring equipment for screening employees and customers. Such extraordinary losses would be segregated to the extent they exceed amounts incurred by comparables.

There is little case law on the subject of loss comparables. *Boehringer Ingelheim* (referred to above) permits the conclusion that loss comparables are not prohibited *per se*, but should be supported by the incurring of losses by companies falling within the range of comparables.

d. How likely are the tax authorities in your jurisdiction to consider ''economic circumstances'' as a relevant comparability factor?

Case law does not support the making of country risk comparability adjustments. In *Boehringer Ingelheim* (see a., above), the Tax Court held that, although transfer prices for the same goods or services may vary within the different geographic markets in which the tested party or the comparable companies operate (and therefore it is necessary that such markets be comparable or subject to appropriate adjustments), country risk adjustment was not valid, since there is no reliable methodology for testing it.

3. How do you see the pandemic affecting APAs? What adjustments are MNEs making – or what adjustments should they make – to ensure that they will be considered to be in compliance with their agreements? Are companies looking to amend (or should they look to amend) their APAs, or are they just documenting changes in anticipation of possible future amendments?

The tax reform that was passed as Law 27,430 and took effect from June 1, 2018, amended the Tax Procedure Act with respect to the regulation of "joint transfer pricing assessments," i.e., APAs. The ARS is still in the process of training a team of professionals to take responsibility for the recently implemented APA procedures. As of the time of writing, no APAs have effectively been implemented yet, so it is not possible to comment on the effect of the pandemic on such agreements.

4. Do you think there is a ''silver lining'' or bright spot about this economic situation that MNEs should be mindful of? What are possible opportunities that otherwise would not be sustainable in the absence of an economic crisis? Reset possibilities? Location-specific advantage?

Some companies are restructuring their businesses in neighboring countries such as Uruguay, which have lower tax burdens than does Argentina. Such strategies require careful scrutiny of the new transfer pricing rules on business restructuring, in particular General Resolution 4717. Section 26 of General Resolution 4717 requires that an exit fee be accounted for by an Argentine affiliate that restructures any line of business into a foreign related party, in order to reflect the income, indemnification or gain that would have been collected by an unrelated third party in comparable circumstances.

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