



Insights: Transfer Pricing

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Chilean tax reform proposal to increase transfer pricing enforcement and expand specificity of acceptable methods

By Brian Vincent



The Chilean Internal Revenue Service will strengthen its oversight of transfer pricing regulations as a means of keeping pace with the changing international tax landscape while striving to achieve a broader goal of expanding the country's tax receipts to fund a variety of public sector initiatives. As outlined in a tax proposal set forth by the Chilean government in April, the incoming transfer pricing rules will provide taxpayers with specific guidance while increasing the burden and financial cost of compliance.

In a broad sense, the tax reform initiative has been crafted with the goal of raising more income for a variety of social development programs, including education, employment, and human development-focused efforts. In the meantime, the transfer pricing rules included as part of the reform initiative are expected to improve the sophistication of the Chilean Service as it strives to keep pace with more developed regimes in other Latin American countries. The Chilean Service has publicly expressed concerns over Chilean taxpayers' failure to provide sufficiently robust analyses in defense of their intercompany transfer pricing policies. Chile's current transfer pricing rules are promulgated under Article 38 of the Law on Income Tax. As published, Article 38 requires that taxpayers adhere to the arm's length principle yet provides little guidance on how arm's length transaction values should be computed or defended.

As proposed, the incoming rules will conform closely to the Organization for Economic Cooperation and Development's Transfer Pricing Guidelines (the OECD Guidelines) and are expected to increase the burden of tax compliance felt by Chilean taxpayers who transact with foreign related party counterparties. While Article 38 previously provided no guidance with respect to acceptable transfer pricing methods, taxpayers will soon be expected to conduct proper transfer pricing analyses by selecting the most appropriate method from those outlined in the OECD Guidelines. In addition, the proposed rules expand and detail the definition of related party, adding new relationship standards to clarify previous ambiguity in this area.

With regards to compliance, taxpayers will be required to maintain adequate documentation to show how prices are calculated as well as how those prices conform to arm's length conditions. Should a taxpayer fail to demonstrate that its related party transactions were set at normal market values or returns (i.e., at arm's length values), the Chilean Service will reasonably determine appropriate values and corresponding income adjustments. When the Chilean Service determines that prices

have been calculated incorrectly, the corresponding tax shortfall will be characterized as distributed profits. Any adjustments identified will be subject to a 35% tax plus a five percent penalty. The rules also contain significant and specific penalties and fines for taxpayers who fail to comply with the new documentation requirements. Taxpayers will be obligated to file a specific transfer pricing return along with a sworn statement acknowledging that the information provided in the return is both accurate and complete. The specific transfer pricing return will incorporate information on the methods used for determining prices, the characteristic (type and amount) of material cross-border transactions, and various identifying information on the related parties. Lastly, the rules allow taxpayers to make correlative adjustments.

If implemented, the new rules are expected to create a substantial increase in the cost of transfer pricing compliance for Chilean taxpayers that engage in substantial cross-border transactions. Not only will companies need to prepare adequate levels of documentation but the incoming rules may force companies to educate themselves on the methods available for establishing and defending intercompany prices that make sound commercial sense and also comply with the arm's length standard.

Brian Vincent
Principal
Washington, DC
+1-202-662-7881
bvincent@crai.com

www.crai.com/transferpricing



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