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Transfer pricing issues in Central America

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- Tax control on transfer pricing (TP) has become a real and concrete need in the region, not because it is a standardized practice in the developed world. Growing non-CA corporations presence in the region, but also, recent local elites evolution, changing from local or national oligarchic monopolies in previous decades, to regional transnational corporations and groups and even in some cases, to global scale multinational corporations are among the main driving forces for the need to develop TP control capabilities in the region.

- Additional to common cases in which TP adjustments are applied world wide, some Central American particular cases could benefit from its special application. One example is the Guatemalan awkward income tax design, in which two optional regimes coexist simultaneously: a "real" income tax of 31% on net profits, and a simplified regime of 5% on gross income (the current equilibrium point between two regimes is when profits are equivalent to 16% of income). In this scheme, many Guatemalan corporations break down in 2 related sub-companies, one in each regime. By manipulating transfer prices they achieve to allocate profits over 16% in the simplified 5% regime on gross income, and profits below 16% in the 31% real income tax regime. In this particular case, Guatemalan tax administration should apply a transfer pricing tax control con operations between two Guatemalan related companies.

- In 2008, with the assistance of the International Monetary Fund and the Inter American Development Bank, the Central American council of ministers of public finance (COSEFIN), prepared a model of TP legislation, following the OECD model and guidelines. All 5 Central American countries have made TP legislation drafts, all based on the regional drafted model, and only 3 have approved weakened version of them: Guatemala, El Salvador and Honduras. In the particular case of Guatemala, the legislation applies only to multinational corporations, unable to tackle the problem of the two coexisting optional income tax regimes. Legislative approval was surrounded by stiff private sector resistance and distrusts in three countries, being excessive complexity and the burden of proof the main complaints.

- But, the enacted new TP legislation still far from effective. Central American Tax Administrations are building technical expertise and administrative framework. But, the main issue on the lack of effectiveness is political will, while elite power and State capture is still a big issue in the region: TP tax control in Central America is more a political challenge than a technical one.

- Nevertheless, there are big technical challenges. Available legislation is based on OECD guidelines, being complex and making very difficult to find viable comparables and concurrent prices. Therefore, Central America needs alternative methodologies, and test their practical effectiveness.

- ICEFI is studying some alternative methods. Simon Pak's price filter matrix application in Guatemala was studied, finding that Customs database is well suited for Professor Pak's methodology.[1] Brazilian approach to transfer pricing is another interesting and attractive option, since it relies on companies own data and applies to a more expanded group than the OECD guidelines. This last point makes the Brazilian approach interesting and attractive as an option to put to the test in the particular case of Guatemala.

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[1] Available free online at http://www.icefi.org/categories/16?clas=5&detail=239