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THE TRANSFER PRICING PROBLEM: THE ARGENTINE EXPERIENCE (1932-1998)

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Introduction

For more than a half a century the Argentine Government has been concerned about international tax avoidance techniques based on transfer pricing¹. The central reason for this concern has been justified on the following grounds: "... according to well informed surveys, Argentina is losing at least US\$ 1,5 billion of revenue per year due to transfer pricing abuses..."².

This essay examines the various approaches that Argentina has developed to address this

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¹ The first Argentine rule on transfer pricing (TP) was issued by 1932 (see below at II.1). Other Latin American countries regulated this issue much latter in the century. For example, Brazil did it by 1996 (see Alejandro E. Messineo, *Transfer Pricing in Latin America: New rules in Mexico and Brazil*, 42-50 at 47, 1997, International Bureau of Fiscal Documentation, Vol 4 N°2, March/April 1997 [hereinafter, Messineo, *Transfer Pricing*]). Mexico's TP rules were first established in 1992 (see *International Transfer Pricing 1998-1999*, PriceWaterhouseCoopers, at 344, CCH Editions Limited).

² *House of Representatives Committee Report on the 1998 Tax reform*, September 9th and 10th, 1998, at 56. No survey was identified to back this statement. The Bill was proposed by the Menem administration.

problem in the income tax area. The period studied runs from 1932, when the first transfer pricing provision was passed, up to the 1998 Reform that, according to what was stated in a recent New York conference, embodies "... the [1995] OECD guidelines related to Transfer Pricing methods and rules..."³.

Two main questions are focused on. First, what were the principal features of the approaches employed by Argentina from 1932 to 1997 to curb transfer pricing (TP) abuses; and what were, if any, their central policy weaknesses. Second, to what extent does the 1998 reform embody the 1995 OECD guidelines⁴; and what the central implications of this reform could be⁵.

The first point argued in this paper is that Argentina has developed six different approaches to the TP problem since 1932 up to 1998⁶. These approaches broadly back the proposition that the structure of the government revenue-system generally is a function of the socio-economic development of a given country⁷. In effect, by 1943 Argentina introduced a scheme based on the arm's-length standard (ALS) targeted to curb TP manipulation only in the context of import and export of goods (this was a substantial problem of the Argentine economy that by then was centred in cross-border transactions of agricultural products). The arm's length standard was later extended to other types of transactions by 1946. However, it was so poorly drafted that the issue of TP abuses in transactions different from export and imports of goods only started to be address from the early sixties (when the Argentine economy moved to its early industrial stage).

³ F. Horacio Crespo, *Introduction to the Argentine Tax System*, 89-124 at 105, published in *Argentina's New Tax Environment*, Conference Reports, Insight Information Co., Insight Press, Toronto, Ontario, 1998 [hereinafter, *Argentina's New Tax Environment*]. The conference was held in New York on December 10-11, 1998.

⁴ The 1995 OECD guidelines are officially entitled *Transfer pricing guidelines for multinational enterprises and tax administrations*, July 1995. This document is also referred in this essay as the 1995 OECD Report.

⁵ This essay covers up to 7 May, 1999. On the 1998 Argentine tax reform see: *Argentina's New Tax Environment*, quoted above in footnote 3; Humberto J. Bertazza et. al, *Reforma Tributaria del '99. Análisis crítico de la ley 25063 [The 1999 Tax Reform. Analysis of the Act 25063]*, Errepar, 1999, Buenos Aires; Alejandro Messineo, *Transfer Pricing Rules under tax reform Bill*, 264, *International Transfer Pricing Journal*, Volume 5, Number 6, International Bureau of Fiscal Documentation, 1998.

⁶ The 1998 Reform represents the sixth approach.

⁷ On the relationship between the structure of government-revenue systems and socio-economic development, see Harley H. Hinrichs, *A general theory of tax structure change during economic development*, at 1, The Law School of Harvard University, Cambridge, 1966.

Since 1961 up to the mid-Seventies courts were activist in the TP arena. They decided to employ the general-anti-avoidance-rule (GAAR) as an alternative way of focusing TP abuses. This reaction was triggered for a number of reasons, such as the lack of precision and fairness of the ALS (as implemented by the 1946 legislation) and the perception that some multinationals were engaged in aggressive transfer pricing manipulation. The case law approach, backed by a 1973 Act passed by an unanimous Congress, led to a number of unsatisfactory consequences –mainly discrimination against foreign multinationals *vis à vis* national multinationals thus deterring foreign inward investment. The 1976 Reform, passed a few days after the 1976 military coup, attempted to produce a balanced approach towards national and foreign multinationals. However, it also failed to curb TP abuses because key concepts of the system (such as that of comparable transactions) were not defined.

The second point argued in this paper is the following. Contrary to what was argued in a recent New York conference⁸, we take the view that the 1998 Reform implies that Argentina is not following the trend started by Mexico in 1996 to amend its TP legislation to fully implement the 1995 OECD Report. This is so for, at least, four reasons. First, the 1998 reform, instead of redrafting the TP scheme from scratch, adds new paragraphs to the old ones. Hence, many of the former provisions –such as the 1976 version of article 14⁹– remain largely unchanged. Second, the 1995 OECD Report pricing methods only apply by default in the import and export clause. Third, in transactions other than export and import of goods these pricing methods apply as primary tests but on the basis of the *best method rule* – an approach implicitly rejected by the OECD. Fourth, the export and import clause empowers the tax authority to make primary adjustments even if the parties are not associates. This rule violates article 9 of the OECD Model Tax Convention on Income and on Capital (OECD Model Treaty) and may produce international double taxation.

Despite these weaknesses, the 1998 reform is the most well-drafted and comprehensive TP framework produced in Argentina so far. Furthermore, it does not repeat the main policy errors made during the previous five (unsuccessful) approaches.

In order to demonstrate these two propositions this paper is divided in four parts. In the first

⁸ See the second paragraph of the introduction of this paper.

⁹ The 1976 version of Article 14 establishes, inter alia, that intra-firm transactions of foreign MNEs must be consistent with the arm's length standard (see below chapter II.5.a).

part, the root of the transfer pricing problem is explored and the basic issues faced by emerging Latin American countries are stated. In the second part, the interaction between the Argentine Congress and the Supreme Court (or the bodies that replaced them during the military regimes) for the design of the TP policies are analysed. In the third chapter the focus is to ascertain the extent to which the 1995 OECD guidelines influenced the 1998 Reform. The conclusions are presented in the fourth chapter.

The study of how the Argentine tax authority applied the TP approaches in cases that did not reach the courts is beyond the scope of this paper. This is so because no empirical survey has been produced on this issue so far despite its critical relevance when assessing the effectiveness of TP policies¹⁰.

1- The root of the problem

The process of cross-border corporate decentralisation, which led to the creation of multinational enterprises (MNEs), begun by the end of the nineteen-century¹¹. One of the prevailing justifications for this is that multinational enterprises are the consequence of a market failure: the relatively high cost of certain market transactions. Thus, MNEs attempts to solve such a failure through the internalisation and reduction of these transaction costs¹².

This explanation can be illustrated by the following example. Suppose that a French multinational (*FM*) manufactures cars in France and owns a valuable intangible: the know-how in the marketing of its cars. *FM* is willing to expand its business to country *X*, however intellectual property rights are not properly enforced in such a country. Due to this market failure *FM* decides, instead of supplying its intangible to *Indep Co.*, (an independent reseller in country *X*), to create a wholly-owned subsidiary there in charge of selling its vehicles (*FM sub*). Thus, this strategy allows *FM* to expand its business to country *X* minimising the risk of damaging its intangible via the internalisation of this transaction

¹⁰ It has been argued that "... tax administration plays a crucial role in determining the real (or effective) tax system, as opposed to the statutory tax system ...". See, Milka Casanegra de Jantscher and Richard M. Bird, *The Reform of Tax Administration*, 150-164 at 150, published in Argentina's New Tax Environment quoted supra in footnote 3.

¹¹ Sol Picciotto, *International Business Taxation. A study in the internationalisation of Business Regulation*, at. 2-3, Law in Context, Weidenfeld and Nicolson, London, 1992 [*hereinafter*, Picciotto, *International Business taxation*].

¹² Christos N. Pielis and Roger Sugden, *On the theory of the transactional firm*, 9-15 at 9, published in *The nature of the transnational firm*, edited by said authors, Routledge, London and New York, 1996.

cost¹³.

This example shows that multinationals are generally able to replace the arm's length market in products and services (the external market) for an internal market of inputs¹⁴. In other words, they are able to replace the *FM-Indep Co.* for the *FM-FM sub* relationship.

The external and internal markets of inputs differ at least in the following significant respect: the pricing mechanism applies in the former but not in the latter¹⁵. Conversely, in the internal market there works a system called transfer pricing, that is, "...the unit price assigned to goods and services between the parent company and subsidiaries or between divisions within the same firm..."¹⁶.

This difference is relevant because while multinationals in principle do not control market prices, they are relatively free to set the transfer pricing of their intra-firm transactions. Consequently, this power may be used abusively in a way illustrated by the following example¹⁷.

Recall *FM* case above. *FM* is a manufacturer of cars that is a resident of France and *FM Sub*, its wholly owned subsidiary in charge of reselling the cars to independent customers, is a resident of country X. The taxable income of the subsidiary is basically determined by three variables: i) the reselling price of the cars to independent customers; ii) the expenses paid for all its inputs (except for the cars) and, iii), the expenses incurred for purchasing the cars from the manufacturer. The market generally determines the first two variables. Conversely, the third variable (the price paid by the subsidiary for buying the cars) is under the manufacturer's control. Therefore, if the effective tax rate of the manufacturer's

¹³ Another answer to the question why do MNEs exist is generally labelled the "divide and rule" approach. This states that some multinationals are created in order to divide its workers into country-specific groups and, thus, "... employers improve their bargaining position and thereby gain at the expense of the worker" (See Roger Sudgen, *op. cit.* above in footnote 12, at 187-89).

¹⁴ The *external market* is where interdependent activities are co-ordinated by the market forces rather by the alternative: the *internal market* (where such activities are centrally co-ordinated by a firm). On the internal-external market distinction, see Roger Sudgen, *op. cit.* above in footnote 12, at 169.

¹⁵ Robert G. Eccles, *The Transfer Pricing Problem. A theory for Practice*, at 19, Lexington Books, Mass. 1986.

¹⁶ See André Gabor, *Pricing. Concepts and methods for effective marketing*, at 113-114, University Press, Cambridge, Great Britain, 1988.

¹⁷ Transfer pricing is not only a tool for minimising the tax liability of multinationals. It is also instrumental for MNEs to evaluate the performance of their own profit-centers (see 1995 OECD Report at I-2).

jurisdiction is higher than that of its subsidiary, then the manufacturer can charge the lowest possible transfer price to its subsidiary in order to channel the profits of the multinational enterprise to the lowest tax jurisdiction. On the contrary, if the manufacturer's effective rate is lower than that of its subsidiary, the manufacturer can charge the highest possible price to its subsidiary. The net effect of this transfer pricing strategy is to increase the after-tax return of the multinational enterprise¹⁸.

Transfer pricing manipulation produces at least two consequences. Firstly, as the last example shows, it puts national tax jurisdictions under stress because it is an income-shifting system that allows multinationals to maximise their after-tax profits by channelling their taxable income to low-tax jurisdictions. Secondly, it provides a substantial advantage to multinationals in comparison with non-multinational firms because only the former can use this strategy.

Since 1915, when the UK implemented the first regulation on this area, tax jurisdictions have been exploring ways to curb transfer-pricing abuses in order to minimise the consequences pointed out in the previous paragraph¹⁹. From this exploration two competing anti-avoidance mechanisms have emerged: i) the arm's length standard that enjoys a fairly wide international consensus and is backed by the Organisation for Economic Co-operation and development (OECD), and ii) the global formulary apportionment, that has been explicitly rejected by the OECD²⁰.

The arm's length standard (ALS) attempts to replicate the "... the working of the open market in cases where goods and services are transferred between associated enterprises..."²¹. Hence, the ALS requires a multinational to set the TP of its internal transactions in such a way as if they were entered by independent parties in similar circumstances. In other words, the role of the ALS is to contrast an intra-firm transaction

¹⁸ This example has been based upon the developed in Reuven Avi-Yonah, *The Rise and the Fall of the Arm's Length: a study in the evolution of U.S. International Taxation*, Virginia Tax Review, 89-75, at 89, Summer 1995. A similar example may be found in Peter Muchlinski, *Multinational enterprises and the law* (1995), Blackwell, Oxford UK & Cambridge, at 289.

¹⁹ Herbert Bettinger Barrios, *Precios de Transferencia. Sus Efectos Fiscales*, Ediciones Fiscales ISEF, S.A., 1996, Mexico.

²⁰ See the 1995 OECD Report III-19/24.

²¹ 1995 OECD Report, op. cit. above in footnote 4, at I-6. A central assumption of the ALS is that in principle the profit-units of a multinational shall be deemed separate legal entities.

with a comparable standard. Thus, if a given transaction does not pass this standard, tax authorities are generally empowered to adjust the TP in order to achieve consistency²².

By contrast, the global formulary apportionment (GFA) method allocates the global profit of a MNE on a consolidated basis on the grounds of a predetermined formula²³. Therefore, GFA disregards both the separate entity approach to MNE and the transactions entered among their different profit-centres. It is used principally by some countries' political subdivision such as California. There are some isolated countries that have decided to employ it (such as Indonesia)²⁴.

Neither the ALS nor the GFA provide satisfactory answers to the central issue of how to apportion the multinational enterprises' income tax base among different tax jurisdictions. The former generally implies high compliance and litigation cost and may be subject to manipulation, for instance, when selecting the comparable standard to apply in a given case. By the same token, the matter may also be subject to manipulation on the basis of the factors employed in the formula. These are some reasons why the TP problem will remain a topical tax issue during the foreseeable future.

2- Transfer pricing abuses in Latin American emerging economies

At least since the early forties, the central transfer pricing abuse faced by Latin American emerging economies has been the overcharging of domestic subsidiaries by foreign associated enterprises²⁵. This abuse was triggered by a number of factors such as currency restrictions, high dividend taxes and the absolute refusal to deduct certain expenses²⁶.

The overcharging issue will remain as a key problem during the nineties and beyond despite that some factors that promoted it, such as currency restrictions, no longer persist in this region. This is so because emerging economies like Argentina, Brazil, Chile and

²² See the OECD Model Tax Convention on Income and on Capital, June 1998, second paragraph of article 9 (1).

²³ 1995 OECD Report, III.19, op. cit. above in footnote 4.

²⁴ Guillermo Campos, *Transfer Pricing Survey of Major Trading Nations, 1996 International Bureau of Fiscal Documentation*, May 1996, 212-222 at 218.

²⁵ Stanley Surrey, *Reflections on the Allocation of Income and Expenses among National Tax Jurisdictions*, *Law & Policy in International Business*, 499-460 at 433, Vol. 10:409, 1978 [hereinafter Surrey, *Reflections*].

²⁶ Surrey, *Reflections*, op. cit. above in footnote 25, at 437.

Mexico are either high or medium-tax countries *vis à vis* the rest of the sub-continent²⁷. Consequently, this scenario may encourage a MNE to base subsidiaries in low-tax jurisdictions, such as Uruguay, in order to channel its profits there in order to minimise its overall tax liability.

This risk of tax avoidance has led several countries to reform their TP legislation during the last few years. This is the case, for example, with Mexico (1996)²⁸, Chile (1997)²⁹ and Argentina (1998)³⁰. A common feature of these reforms is that they are influenced, to varying extent, by the same source: the 1995 OECD Report. Brazil seems to be an exception to this trend because its 1997 reform does not follow the OECD Report but a global formulary apportionment method³¹.

The reason why several Latin American countries are willing to use the OECD Report as the source of their TP reforms is two-fold. First, to prevent international double taxation that may derive from TP rules inconsistent with those suggested by the OECD –an international organisation that gathers major capital exporting countries. And, therefore, to encourage foreign inward investments.

II- The Argentine approaches to the transfer pricing problem

From 1932 up to 1997, Argentina has employed five different approaches to the TP problem and the 1998 Reform embodies the sixth approach. Since this reform does not amend several provisions that were introduced in previous reforms, it is necessary to study their main features in order to facilitate the understanding the 1998 Reform. In this chapter the first five approaches will be studied.

1- First period (1932-1942): Presumption based on the separate accounting principle

The income tax was made law by a 1932 decree passed by the first military government of

²⁷ See Parthasarathi Shome, *Taxation in Latin America: Structural Trends and Impact of Administration*, at 14, February 1999, International Monetary Fund, Fiscal Affairs Department, Working Paper 99/19, 1999.

²⁸ Messineo *Transfer Pricing*, op. cit. above in footnote 1.

²⁹ *Transfer Pricing*, vol. 7, no.25 at 970, published by Tax Management Inc., April 21, 1999.

³⁰ John A. Mc Lees and Cristian Rosso Alba, *Argentina Enacts New Tax Reform Law* [hereinafter Mc Lees, *Argentina Enacts New Tax Reform Law*], Tax Notes International, January 18, 265-285, 1999.

³¹ 7 *Transfer Pricing Report* 128, at 129, published by Tax Management Inc., January 7 1998.

Argentina³². It was exclusively based on the source principle, that is, only income from a domestic source was taxable. The justification for choosing this method of taxing jurisdiction was based on the fact that Argentina was a capital-importing country³³.

Up to 1942, tax revenues derived from cross-border transactions were not significant *vis à vis* those from internal transactions³⁴. This explains why the transfer pricing problem was not high on the agenda of the government and, consequently, there was only one provision in the income tax law addressing this issue. Subsidiaries domiciled in Argentina were subject to the following article:

*The income registered as sourced in Argentina in the accounting books of enterprises under foreign control is presumed as such, saved proof to the contrary (article 20)*³⁵

Article 20 embodied a presumption that worked as follows. Subsidiaries based in Argentina were required to have a separate accounting from their foreign home-office; and it was deemed that in principle they properly reflected the income sourced in Argentina. Hence, only if such a presumption was rebutted, was the tax authority empowered to adjust the subsidiary's accounting books.

Soon after 1932, the tax authority started to notice that subsidiaries manipulated the price of their intra-firm transactions in order to shift the tax base to foreign jurisdictions³⁶.

³² 11682 Act, January 12, 1933, [1920-1940] A.D.L.A. at 303-309.

³³ See Dino Jarach, *Las empresas con intereses internacionales frente al impuesto a los réditos [The enterprises with international interests under the profit tax]*, Jurisprudencia Argentina, 1946-III, 21-33 at 21, Buenos Aires, Argentina [hereinafter, Jarach, *The enterprises with international Interests*].

³⁴ Roberto T. Alemann, *Breve historia de la Política Económica Argentina 1500-1989 [Brief history of the Argentine Political Economy]*, at 192, Breve Historia Claridad, Editorial Claridad, third edition, Buenos Aires, 1997 [hereinafter, Alemann, *Brief History*].

³⁵ Art. 20 of the Act 11682 as consolidated in 1932 via Decree 112578. The author of this essay has translated the provisions quoted hereinafter.

³⁶ The Committee of Legal Experts that made the draft that would be Decree 18.229/43 (to be studied below) stated the following regarding transfer pricing abuses during the first period.

“... According to officers of the Profit Tax Department, there are cases where certain enterprises associated with foreign companies are trying either to shift or to hide income sourced in Argentina in order to avoid paying all or part of their Argentine Profit Tax liabilities. The evasion is done via manipulating the purchase price in the case of importers, or the selling price in the case of exporters, in such a way that the economic activity developed in Argentina derives almost no profit subject to [the Argentine Profit] Tax...” (See *Modificación de leyes impositivas y creación de nuevos gravámenes [Amendment of tax Acts and Enactment on New Taxes]*, chapter entitled *Commentary on the Profit Tax Amendment Bill*, at 213, Buenos Aires, Ministerio de Hacienda de la Nación, 1944.

However, article 20 proved to be ineffective for curbing this abuse because of, at least, three different reasons. First, the legislation provided no explicit test to determine the *proper* transfer prices. Second, the burden of the proof of any manipulation was in charge of the tax authority whose cost for having access to relevant information –such as the foreign home office accounting’s books- was high. Third, article 20 required the unrestrained application of accounting standards to assess the business tax base. This application was required despite the different purposes generally sought by accounting standards vis à vis tax policy (for example the need to use some subjective factors when evaluating the business performance of a given firm as opposed to the need to measure business taxation in light of rules as objective as possible)³⁷.

The overall effect of this system was to make the presumption embodied in article 20 difficult to rebut. Consequently, far from deterring TP manipulation this system may have promoted it. This realization seems to have been the main reason why, eleven years after the tax was introduced, the government decided in 1943 to change the system established by article 20³⁸. This was the starting point of the second period.

2- Second period (1943-1946): Presumption based on the classic arm’s length standard

By 1943, the government’s role in the economy started to increase substantially due to its rising intervention in the market –the statization of public services is a case in point³⁹. This new pattern pressed the government to increase the tax revenues. Not surprisingly, the elimination of tax-avoidance schemes was high in its priorities.

The Ramírez military government focused on TP manipulation in the context of export and import of goods (leaving for future reforms the TP problems arising from other types of transactions). The 1943 TP regime was justified on the grounds that “the demand and supply” law does not apply in the area of intra-firm transactions; consequently MNEs can

³⁷ Geoffrey Whittington, *Tax Policy and Accounting Standards*, British Tax Review, 452-456, London, Sweet & Maxwell, 1999.

³⁸ Article 7 of the Decree 18229/43 passed by the Military Government of Ramírez on December 31, 1944 [IV] A.D.L.A. at 49 [hereinafter Decree 18229]. Article 7 was mainly based on a bill proposed to Congress by the Federal Executive Power on 19 April 1941 that had been rejected by Congress [see *Diario de Sesiones de la Cámara de Diputados*, año 1942, volume IV, at 1010].

³⁹ Alemann, *Brief History*, at 276, op. cit. above in footnote 34.

determine their transfer pricing according to their own interest in order to “evade the tax”⁴⁰. It was suggested that these problems also put MNE at a comparative advantage with regards to non-MNEs⁴¹.

Article 7 of the Decree 18229/43 was passed in order to address these problems (the export/import clause). It provided the following:

“The determination of the income derived from the export and import of goods shall be subject to the following principles:

- a) *Income derived from the export of goods produced, manufactured, processed or purchased in the country shall be deemed sourced in Argentina.*

The net income shall be determined deducing from the wholesale price at the place of destination, the cost of such goods, the expenses of transportation and insurance up to such a place, the commission and selling expenses and the expenses incurred in Argentina. Where the price is not established, or that declared is lower than the wholesale price at the place of destination, it shall be presumed, unless evidence to the contrary is submitted, that there is an economic link between the local exporter and the foreign importer, it then being in order to take the wholesale price at the place of destination for determining the value of the goods exported. Also regarded as export is the shipping abroad of goods produced, manufactured, processed or purchased in Argentina through subsidiaries, branches, selling agents or other intermediaries of persons or entities that are foreign residents.

- b) *Income obtained by foreign exporters by the mere introduction of their products into Argentina is deemed not sourced in Argentina. However, where the price of the sale to the local purchaser is higher than the wholesale price in the country of origin plus transport and insurance expenses up to Argentina, it shall be deemed, unless evidence is submitted to the contrary, that there is an economic link between the Argentine importer and the foreign exporter, the balance being income sourced in Argentina, and both parties are jointly liable for it.*

In the cases where in accordance with the preceding provisions the wholesale price

⁴⁰ Decree 18229/43, at 55.

⁴¹ *Ibidem.*

controls but it is not publicly and commonly known, the calculation of income sourced in Argentina shall be made on the basis of the profits obtained by independent enterprises engaged in identical or similar activities”

This clause establishes a general rule according to which the price attached to exports and imports must be equivalent to the wholesale price of comparable products –unless the parties prove that they are not associated⁴².

The drafters of this rule explained its rationale. They reckoned that the wholesale price is a proxy of the price that independent parties would agree to if placed in similar circumstances. This reasoning shows that they were implicitly embodying a pricing method based on comparable products: the comparable uncontrolled price method (CUP)⁴³. This is the most traditional way of applying the arm’s length standard that was thus introduced for the first time into the Argentine law.

The export/import clause was a response to the lesson learned during the first period according to which a pricing method, such as the ALS, is in principle necessary for deterring TP abuses. (It should be recalled that during the first period there was no pricing mechanism that caused that anti-avoidance provision to fail). In addition, the export and import clause reverses the burden of the proof onto the taxpayers –thus reducing the tax authority’s information cost that would otherwise borne for applying this anti-avoidance scheme. (This was the second lesson learned from the first period because in such a period the tax authority had to bear the entire information cost –a burden that also contributed to the failure of that scheme).

Finally, the export and import clause establishes a default rule for cases in which the foreign wholesale price is not available. In such circumstances, the profit sourced in Argentina has to be determined upon the basis of the income derived by “[...] independent enterprises involved in identical or similar activities [...]”. Hence, the default rule was also based on comparables.

The Supreme Court applied this clause for the first time *in re S.A. SIA*, decided on

⁴² The source of article 7 was Article 45, Regulation 86 (1935) of the US Revenue Act of 1934 [See Joseph P. Crockett, “*Tax pattern in Latin America*”, at 103, National Tax Journal, Volume XV, N 1, March 1962 [hereinafter Crockett, Tax Pattern]. The entire regulation is quoted in *Essex Broadcasters, Inc. v. Commissioner*, 2 T.C. 523, 528 (1943).

⁴³ The CUP method is defined below in section III.2.a.3 entitled “Pricing Methods”.

September 6th 1967⁴⁴. The taxpayer, a corporation resident in Argentina, had exported horses to Peru, Venezuela and the United States of America. It was stated in the corporation's tax return that these transactions had produced losses because the selling price had been lower than the costs. The tax authority decided to monitor such transactions under the export and import clause; that is, according to the wholesale price at the place of destination. The conclusion was reached that, contrary to what had been argued by the taxpayer, such transactions produced profits. It based this statement on foreign magazines on the horse-business (that explicitly referred to the horses of the taxpayer and the transactions involved in this case).

The Supreme Court maintained that since the evidence on which the tax authority based its argument was not attacked by the taxpayer, it had to be deemed that they correctly reflected the wholesale price of the horses. Thus, the adjustment was considered valid. The judgement of the SIA case shows that the export and import clause was precise enough to be put into action.

The export and import clause was drafted taking into account the experience learned from the first period. In this sense it deemed to be a clear improvement from the previous approach for the reasons stated above. However, the clause had a number of aspects that did not work well. In effect, soon after 1943 the government realised that this article had two main problems. First, it was based on a key assumption: comparable transactions would always be available. Nevertheless, this assumption was quickly proved wrong when the tax authority faced difficulties in finding them. Therefore, the question regarding the standard to be used, when no comparables could be found, remained unanswered by this clause. Second, this clause left open a loophole; that is, transfer pricing abuses in areas other than the export and import of goods. These two main problems were the target of the third period.

3- The third period (1946-1960): the erosion of the arm's length standard

Early in 1946, the Farrel military administration decided to substantially amend the transfer

⁴⁴ CSJN 266 Fallos 514 (1967).

pricing scheme. No formal justification to this amendment was provided⁴⁵. However, from the wording of the new provisions it can be inferred that the 1946 Reform sought two main goals. First, to provide a response to the import and export TP cases where no comparables could be found⁴⁶. Second, to extend the ALS to transactions other than import and export of goods. This extension was surely motivated by the need of further tax revenues.

The military government failed to successfully implement these goals. This failure produced the erosion of the ALS because it was introduced in such a vague way that tax avoidance was made a relatively easy task. This section is devoted to explaining the reasons of the failure of the 1946 reform and its far-reaching implications in the following decades.

a- Export and imports of goods

Neither subsection “a” nor “b” of the export and import clause was amended. Hence, the CUP was maintained by the 1946 Reform as the primary pricing mechanism for checking transfer pricing in both the export and import of goods. However, significant changes were introduced in the default rule of this clause. The default rule was redrafted as follows:

In the cases where in accordance with the preceding provisions the wholesale price at the place of origin must be applied but it is not publicly and commonly known, or there are doubts about whether it refers to the same goods as imported or to similar ones or where comparison is difficult due to other reasons, the calculation of income sourced in Argentina shall be made on the basis of the percentage of profit obtained by independent enterprises engaged in identical or similar activities. In the absence of an identical or similar activity, the tax authority is hereby empowered to apply the net percentage that it establishes on the basis of branches of trade that have certain analogies to the one under consideration ⁴⁷.

The 1946 Reform to the default mechanism produced different consequences in the area of import as compared to export of goods. In effect, the export of goods was implicitly excluded from the scope of the default mechanism because it only referred to the problem

⁴⁵ Decree 14.338/46 was passed on May 20, 1946, [VI] A.D.L.A. at 477.

⁴⁶ The Supreme Court studied no case on the issue of lack of comparables in the area of the export and import clause (as it was worded during the second period).

⁴⁷ Last paragraph of Art. 9 of the 11682 Act, as amended by the 1946 Reform.

of absence of comparables in the context of imports of goods⁴⁸.

As a result of the 1946 Reform, transfer pricing in the context of export of goods could only be monitored via the CUP method regulated in subsection “a” of the export and import clause. Consequently, this reform gave exporters room for tax planning because the CUP method is ineffective when comparable goods cannot be found. For example, a given exporter was able to establish a subsidiary in a tax haven, such as Uruguay, in order to export his goods to this country manipulating the transfer pricing of the transaction --with the net effect of shifting the tax base to Uruguay. If he was able to export goods with some unique feature, his TP abuse was beyond the control of the Argentine tax authorities for two reasons: neither the CUP nor the default mechanism could be applied.

The exclusion of exports from the scope of the default mechanism is hardly justifiable. This is so because the import and the export of goods can both be used to implement transfer pricing manipulation. Hence, this exclusion produced a horizontal inequality between exporters vis à vis importers.

The unjustified exclusion of exports from the scope of the default mechanism could have been either the consequence of bad drafting or the pressure of exporters’ interest groups. The latter alternative appears more likely than the former given the large economic interests at stake.

b-Transactions other than import and export of goods

The second significant novelty introduced by the 1946 amendment is article 14. Its main role is to establish the general rule for deterring transfer pricing abuses whose scope only excluded the export and import of goods (because they were regulated by the provision

⁴⁸ Note that the default mechanism was only triggered when either of the following conditions were satisfied: i) The wholesale price *at the place of origin* had to be applied but it was not publicly and commonly known; ii) When there were doubts about whether the wholesale price refers to the same goods *as imported* or to similar ones. Another novelty of the 1946 Reform in the area of imports of goods was the following. This reform expanded the scope of the default mechanism because it was applicable not only when the wholesale price was unavailable (as it was stated in the 1943 Reform), but also when there were doubts on whether the wholesale price referred to goods identical or similar to those involved in the import. In addition, the 1946 Reform establishes a second default rule under a more relaxed standard of comparability than both the CUP and the first default rule: *In the absence of an identical or similar activity, the tax authority is hereby empowered to apply the net percentage that it establishes on the basis of branches of trade that have **certain analogies** to the one under consideration.* The creation of a second default method suggests that the government was unsatisfied with the performance of tests based on close comparables and, consequently, it was trying to move to alternative tests.

studied above). Furthermore, article 14 exclusively refers to foreign MNEs that have either branches or subsidiaries based in Argentina, that is, it does not include Argentine MNE because they were principally created several decades letter.

This pattern shows that the classic arm's length standard started a process of erosion –i.e. a movement away from close comparables.

Article 14 stated that:

(1) The tax authority shall assess the net income of branches and subsidiaries or entities of foreign enterprises on the basis of their separate accounting records, making the necessary corrections for assessing the real profits of these establishments.

(2) In the absence of sufficient accounting records, or where such records do not show accurately the net income arising in Argentina, the tax authorities may, for the purpose of the tax, deem that the branch or subsidiary and the head office form an economic unit and asses the net taxable income.

The regulations of article 14 stated:

When the results of the activities carried out cannot be easily and accurately determined by the accounting records of the subsidiary or branch, income arising in Argentina will be determined on the basis of the results obtained by independent enterprises engaged in the same or similar line of business. The tax authority, when circumstances so require, may adopt other indices (article 15 of Decree 10439/47, hereinafter regulations of article 14)⁴⁹.

Broadly speaking, the article 14 regime states that the separate accounting principle (SAP) is the primary method for allocating profits among the profit-units of a foreign MNE⁵⁰. In addition, both the economic unit principle and the ALS are applied as secondary pricing

⁴⁹ Article 15 of Decree 10439 was passed on April 18, 1947 (see [VII] A.D.L.A. at 608). This provision was not substantially amended up to the 1998 Reform. However it was re-enacted via the following seven decrees. A) article 14 of Decree 6188, passed on March 27, 1952 (see [XII-A] A.D.L.A. at 411); B) article 14 of Decree 10653, passed on June 15, 1956 (see [XVI-A] A.D.L.A. at 546); C) article 14 of Decree 4778, passed on June 14, 1961 (See. [XXI-A]

A.D.L.A at 604); D) article 12 of Decree 786 (passed on July 23, 1970); E) article 15 of Decree 2126 passed on December 30, 1974 (see [XXXV-A] ADLA at 155; F) article 19 of Decree 2353 passed on December 2, 1986 (see [XLVII-A] A.D.L.A. at 285. G) Finally, this provision was re-enacted in article 19 of Decree 1344 (passed on November 25, 1998).

⁵⁰ Article 14 (1).

methods⁵¹. Let us examine some of the issues of this regime.

The application of the SAP, as implemented by article 14, must have been unsatisfactory. This is so because the successful application of the SAP presupposes highly developed accounting standards⁵² –a requirement not met by Argentina by that time considering that the SAP had failed when it was implemented during the first period. Moreover, as Carroll suggests, “[...] conflicting viewpoints as to what is a fair transfer price [are not solved by the SAP]”⁵³.

On the other hand, the application of the secondary pricing methods did not provide satisfactory results because there was uncertainty regarding the scope of these two methods. In effect, both of them were triggered when the SAP was not applicable, however only one of them (i.e. the principle of economic unit), was established by article 14 and there was no provision delegating jurisdiction to the Executive Power to pass the alternative secondary pricing method (i.e. the ALS). To make this legal scheme more complex, article 14 (2) does not compel the tax authority to use the economic unit principle because this article uses a discretionary language –the tax authority *may* use it-. Whereas the regulations of article 14 employed an imperative language regarding the ALS (“... income arising in Argentina *will be determined...*” in light of ALS if the separate accounting method does not apply). This tension between the two secondary pricing methods and their interaction with the primary pricing method made the 1946 version of article 14 an obscure legal regime.

The military government did not explain what the sources of article 14 were. However, there are reasons to believe that the 1933 Carroll Report⁵⁴ was the main source of article 14

⁵¹ The economic unit principle is embodied in article 14 (2) whereas the ALS is embodied in the regulations of article 14 (1).

⁵² *Taxation of Foreign and National Enterprises* (volume IV), *Methods of Allocating Taxable Income* by Mitchell B. Carroll, League of Nations, Geneva, 1933, at 47, hereinafter the Carroll Report.

⁵³ Carroll Report at 47, op. cit in footnote 52.

⁵⁴ After explaining the root of the TP problem, Mitchell B. Carroll said the following for justifying why the SAP should be used as the primary pricing method (and what should be done if the SAP does not apply). “... The tax official in each country where there is an establishment has at his immediate disposal only accounts (if any) of the local establishment, and it is necessary for him to ascertain whether or not they reflect the true profit attributable to that establishment. ... This entails, in some cases, allotting to it the capital normally required to carry on its activities, and, in every case, billing to it or making charges at the same rates as it would to an outsider. Unfortunately, however, the local establishment is not so treated by the great majority of enterprises, and the tax inspector finds it necessary to adjust the accounts after securing whatever additional

(1) and its regulations. In effect, Carroll advocated “[...] the adoption of separate accounting as the primary method of allocating income to the various countries in which an enterprise has permanent establishments [...]”⁵⁵ and this proposition was embodied in article 14 (1). He also focused on the problem that arises “[...] when accounts pertaining to the local establishment are insufficient, or the business is of such a nature that appropriate accounting methods to reflect its taxable income cannot readily be devised [...]”⁵⁶. In these circumstances Carroll said, “[...] tax administration should be required to limit its assessment to what would be earned by an independent enterprise engaged in similar activities under similar circumstances [...]”⁵⁷. In other words, Carroll suggested the arm’s length standard as the secondary pricing method –this rule was established in the regulations of article 14 but they clashed with article 14 (2).

Finally, article 14 (2) is a rule based upon the substance-over-form doctrine specifically tailored for the area of transfer pricing⁵⁸. This article implies a departure from the Carroll Report because the League of Nations 1935 Draft Convention for the Allocation of Business Income between States for the purposes of Taxation –which mostly reflected Carroll’s position- seemed to reject the possibility of treating subsidiaries as part of a single unit⁵⁹.

c- The 1946 Reform: an obscure transfer pricing scheme

The 1946 Reform retained the ALS as the primary pricing mechanism in the context of the import and export of goods. In addition, it extended via article 14 the ALS to the broader area of transactions other than export and import –where without any explanation the ALS was only given the role of a secondary pricing method.

This reform left unanswered many questions. Article 14 was unclear regarding how ALS

information is available, or to make an assessment on an empirical or fractional basis [...]”, *The Carroll Report* at 12, paragraph 6, op. cit. above in footnote 52.

⁵⁵ Carroll Report, at 189 paragraph 671, op. cit. above in footnote 52.

⁵⁶ Carroll Report, *ibidem*, at 190.

⁵⁷ Carroll Report, *ibidem*, at 190.

⁵⁸ Jarach, *The enterprises with international interests*, at. 28-29, op. cit. above in footnote 33. Francisco Martinez, *Derecho Tributario Argentino [Argentine Tax Law]*, Tucumán, Imprenta de la Universidad de Tucumán, at 54, 1956.

⁵⁹ Piccioto, *International Business Taxation*, at. 32, op. cit. above in footnote 11.

would interact with both the separate accounting method and the principle of economic unit. Key concepts for implementing the ALS were not defined, such as comparable transactions or associated enterprises. The sources of the 1946 Reform were not stated. The obscurity of article 14 explains, at least in part, why it remained a *dormant clause* throughout decades⁶⁰. Last but not least, it was a mystery why exports of goods were subject to less transfer pricing controls than imports of goods.

These features of the reform probably arose for a number of reasons. For example, the lack of political commitment⁶¹ of the military government to effectively deter transfer pricing abuses and the unjustified lobbying by exporters of goods. The practical consequence of this lobby was that TP manipulation in the context of export of goods largely remained beyond tax authority control for twenty-seven years: from the 1946 reform up to the 1973 (as it will be explored below).

The overall effect of the 1946 Reform was that it paved the way to a tax avoidance industry that came to light by at least 1961. This perception led to the fourth period where courts started to search an alternative legal basis to focus on transfer pricing abuses: the general anti-avoidance provision. This will be the focus of the fourth period.

4- The fourth period (1961-1976): the demise of the arm's length approach

The fourth period runs from 1961, when the Tax Court decided the case *Refinerías de Maíz*, up to the 1976 military coup. One of the main features of this stage was that large sectors of the Argentine society had a hostile attitude towards multinationals --a mood that was first shared by most judges of the Tax Court, then by all the members of the Supreme Court and, finally, by an unanimous Congress.

A number of reasons seem to explain this hostile attitude. On the one hand high levels of external indebtedness, particularly from the early seventies⁶², resulted in economic austerity policies creating recession and made levels of return unattractive to MNEs. This scenario

⁶⁰ As it will be seen below in section II.4.b, courts applied article 14 (1) only once in the period that runs from 1946 (when it was introduced) up to 1976 (when its text was changed).

⁶¹ On the relevance of political commitment as a factor for achieving a successful tax administration in developing countries, see Milka Casanegra de Jantscher and Richard M. Bird, *The Reform of Tax Administration*, 1-15 at 13, *Improving Tax Administration in Developing Countries* edited by these authors, International Monetary Fund, 1992.

⁶² Aleman, *Brief History*, at 298, op. cit. above in footnote 34

led to a decline in the MNEs investment to Latin America⁶³. On the other hand, high-inflation and currency and foreign exchange control⁶⁴ paved the way to transfer pricing abuses fostered by poorly drafted anti-avoidance provision. In sum, a sharp decrease in MNEs' investment flows and an awareness of transfer pricing abuse⁶⁵ was the context in which courts decided the cases described below.

Since 1961, most of the chambers of the Tax Court focused transfer pricing cases upon the basis of the general anti-avoidance provision –without even referring to the arm's length standard embodied in the regulation of article 14. This pattern was also followed by the Supreme Court itself from 1973. Thus, it is necessary to briefly explore the main features of the general anti-avoidance rule and its relationship with the arms' length standard.

a- The general anti avoidance rule: three open-ended questions

The general anti-avoidance-rule, whose main source is a similar provision in German Law⁶⁶, was introduced into Argentine Law by 1946⁶⁷.

The text of the GAAR was never amended and is currently stated in the Federal Act on Tax Proceedings n° 11683 that provide:

“In determining the true substance of a taxable event, the actions, situations and relations of an economic nature which the taxpayers actually perform, seek or establish shall be taken into consideration. When the legal forms or structures used by the taxpayers for those actions, situations or relations are not clearly those which the private law offers or authorises to adequately reflect their economic intention, the inadequate legal forms or structures shall be set aside in considering the real taxable event and the real economic situation shall be deemed to fall under the forms and structures that private law would

⁶³ See Peter Muchlinski, *Multinational Enterprises and the Law*, at 31, Blackwell, Oxford UK & Cambridge USA, 1995 [hereinafter, *Muchlinski, Multinational Enterprises*].

⁶⁴ Surrey, *Reflections*, at 437 and 442, op. cit. above in footnote 25.

⁶⁵ This perception was not backed by any empirical survey. Nevertheless, since 1960 there was a substantial decrease in the ratio of tax revenue collected via Income Tax *vis á vis* total tax revenues (see below footnote 90).

⁶⁶ See Martínez, *Argentine Tax Law*, at. 42, op. cit. above in footnote 58.

⁶⁷ Decree 14341/46, [VI] A.D.L.A. at 49.

allow the taxpayers to adopt as the best suited to their real intention”⁶⁸.

This article embodies a system similar to what is known in common law jurisdictions as the substance-over-form-doctrine⁶⁹. It gives judges a powerful tool: if certain circumstances are met, they may *disregard* the juridical forms employed by taxpayers and *re-characterise* them. However, the GAAR neither provides a precise test to determine when it is triggered nor how such a recharacterization shall be employed⁷⁰. The tax policy implicit in the GAAR can be worded as follows: the more obscure its scope the wider its anti-avoidance effect.

The application of GAAR in transfer pricing cases raises, at least, three questions: a) how the GAAR interacts with the specific anti-avoidance rule for transfer pricing --i.e., the arm's length standard?; b) if GAAR may be applied to transfer pricing cases, under what circumstances is its mechanism triggered?; c) how shall transactions be recharacterized when they are looked at in the light of GAAR? In the next chapter it will be seen how courts answered these three questions during the fourth period.

b- Tax Court case law: the GAAR in action

The leading case *Refinerías de Maíz*, decided on December 6th 1961, is the first time in which the Tax Court focused a transfer pricing problem using the GAAR. Corn Products Refining Co. was a U.S. corporation that held 96.6 % of the shares of its Argentine subsidiary, Refinerías de Maíz, that was in charge of selling commodities to independent parties. They entered into a licence contract under which the subsidiary would pay royalties to the head-office for having the right to use in Argentina certain trademarks. The amount of the royalties was fixed and had to be paid by the subsidiary even when it was unable to make profits.

This case arose because the tax authority adjusted the subsidiary's tax accounts on the basis that the royalties could not be deducted because they were *hidden profits* of the subsidiary.

⁶⁸ Art. 2 of Decree 821/98 that consolidated the Federal Tax on Proceedings. It is published on the Internet: www.dgi.gov.ar).

⁶⁹ Guillermo Teijeiro, *The Argentine Tax Treaty Network: A Safe Harbour for Foreign Taxpayers*, Tax Notes International, January 18, 1999, p. 287, paragraph 20.

⁷⁰ Sergio Le Pera and Pedro Lessa, *The disregard of a legal entity for tax purposes*, Cahiers de Droit Fiscal International, at 165, Volume LXXIVa, 1989.

The tax authority argued that under the GAAR such royalties had to be deemed profits because the concept *contract* presupposes, at least, two different parties with opposing interest –a requirement not met in the instant case given that the US Corporation was the controlling shareholder of the subsidiary.

The taxpayer's main argument was that the subsidiary was a legal entity independent of its head-office and that the amount of the royalty was *reasonable and normal*. Thus, it concluded, the royalties had to be considered an allowable expense.

The Tax Court accepted the tax authority view. It held that since Corn Products had over 90% of the shares of the subsidiary they could not be deemed independent entities. Therefore, “[...] the royalties perceived [by the head-office] were, due to its economic effects, a way that [the head-office] obtained additional profits from its subsidiary”.

The taxpayer had implicitly referred to the arm's length standard when it was argued that the *reasonable and normal test* should be applied to this case. However, the Tax Court, without giving any justification, considered it irrelevant to solving this case.

The Tax Court did not explicitly refer to the legal basis of its decision to disregard the legal personality of the subsidiary and to re-characterise the payment made to the head-office. However, it seems clear that the GAAR, and not the economic unit principle, (within the words of article 14 (2)) was the legal basis of its reasoning. This is so because on subsequent cases the GAAR was explicitly quoted by the Tax Court⁷¹.

To conclude, in *Refinerías de Maíz* the Tax Court employed the GAAR to establish a presumption – which was not rebuttable- according to which royalties remitted by subsidiaries to their head offices under licence contracts could not be deducted from the subsidiaries' tax accounts. Moreover, the Tax Court did not explain why GAAR took precedence over article 14 and its regulations⁷².

Parke Davis is an extension of the *Refinerías de Maíz* ratio to the pharmaceutical

⁷¹ The proposition that the Tax Court grounded its reasoning on the GAAR (despite the fact it did not referred to it), is also backed by the fact that the Court of Appeals, when it affirmed the Tax Court decision, explicitly employed GAAR as its main legal basis

⁷² The Tax Court decision *in re Refinerías de Maíz* was upheld by the Court of Appeals on October 14, 1963 (Derecho Fiscal XIV-332). It was also upheld by the Supreme Court on July 10th 1964 on procedural grounds (CSJN 259 Fallos 141 –1964-).

industry⁷³. Parke Davis Co. was a U.S. Corporation that held the 99.95 percent of the shares of Parke Davis y Cia -its Argentine subsidiary. They had entered into a licensing contract that allowed the subsidiary to use, inter alia, certain chemical formulas in exchange of the payment of royalties to the US head-office. The contract was not sham and the amount of the royalties was considered normal by the tax authorities.

The Tax Court said, in a 2 to 1 decision, that since the US Corporation held almost the entire capital of the Argentine *sociedad anónima* they could not be considered separate legal entities. Hence, under the *substance-over-form-doctrine* the parent/subsidiary relationship had to be deemed a parent/branch relationship. Thus, Parke Davis of Argentina was not allowed to deduct from its tax accounts the payments made to its US head-office.

Unlike the *Refinerías de Maíz case*, the GAAR was explicitly employed in re *Parke Davis* for disregarding the legal personality of the subsidiary and recharacterising the payment despite the fact that the transaction was not a sham and that the amount of the royalties were considered *normal*.

The Tax Court's majority vote made no explicit reference to the ALS. However, it implicitly took it into account when it accepted that the amount of the royalties had been *normal* –i.e. under arm's length conditions. In other words, this implicit reference shows that the Tax Court was aware of the tension between GAAR and ALS. Nevertheless it decided to give precedence to the former over the latter without making any justification for doing it. This dogmatic argument shows the impact the hostility towards MNE had on legal reasoning.

The Parke Davis dissenting opinion in the Tax Court is noteworthy because it was the first opportunity in which the arm's length standard was employed to solve a TP case. It was argued that the GAAR did not allow the legal personality of the subsidiary to be disregarded when dealing with its foreign parent corporation. This proposition was based on the fact that GAAR had to be construed narrowly because the economic circumstances prevailing when it was passed, i.e. 1946, were very different from those when this case was decided. No reference was made to the economic unit principle embodied in article 14 (2) despite its close relationship with the GAAR.

⁷³ The *Park Davis* case was decided by the Tax Court on 24 March 1970.

The dissenting judge then maintained that this case had to be resolved under the *normal transaction test* according to which the subsidiary may deduct royalties paid to its foreign parent company if two requirements are met. First, if the license contract is not a sham, and, second, if the amount of the royalties is normal. He said *obiter dictum* that only the excess of the royalties that does not meet the normal transaction test could be recharacterized as, for instance, profits remitted to the parent corporation. He concluded that in the instant case the royalties were allowable because the tax authority had failed to show that either the first or the second requirements were not satisfied.

It is remarkable that the *normal transaction test* stated in the dissenting opinion was not grounded on article 14 of the Income Tax or its regulations (in fact these provisions were not even referred in the decision). This test was extrapolated from the regulations of the Capital Tax Act (CTA) that had been passed in 1965⁷⁴. This extrapolation was probably made in order to avoid the problems of the ALS as implemented by article 14 of the Income Tax⁷⁵. The National Court of Appeals upheld the *Parke Davis* Decision on grounds similar to those developed by the Tax Court's majority vote⁷⁶.

The *Productos Químicos CIBA* case was also related to the pharmaceutical industry with one distinguishing feature: it was the only unanimous Tax Court case resolved during the fourth period on the grounds of the arm's length standard⁷⁷. It was decided by a Tax Court chamber that was aware of the source of article 14 –i.e. the Carroll Report⁷⁸.

Ciba Societe Anonyme was a Switzerland corporation that held more than the 99% of the shares of its Argentine subsidiary --Productos Químicos CIBA Sociedad Anónima. They entered into both licence and loan contracts and the issue was whether the subsidiary could deduct from its tax accounts the royalties and interest paid to the foreign head-office.

The Tax Court held that the issue had to be decided on the grounds of the normal transaction test *implicitly* established in article 14 (1) of the Income Tax. Such a test

⁷⁴ This Capital Tax Act was called “Impuesto sustitutivo a la transmisión gratuita de bienes”. The regulation on which the dissenting opinion grounded the arm's length standard was article 12 of Decree 3745/65.

⁷⁵ Some of these problems have been stated above section II.3.b.

⁷⁶ The Court of Appeals decided the *Parke Davis* case on August 31st, 1971.

⁷⁷ The Chamber A of the Tax Court decided the *Ciba* case on February 9th, 1972.

⁷⁸ This awareness is suggested by the fact that the only academic article that referred to this issue (i.e., Jarach, *The enterprises with international interests*, op. cit above in footnote 33) was quoted in the *CIBA* case.

empowered the tax authority to adjust the taxpayer's account if they do not reflect the transaction that would have been "[...] entered between separate or independent enterprises [...]" in similar circumstances.

The Tax Court then said that this case was not governed by GAAR but by article 14 (1). This was so because article 14 (1) envisaged a scheme specially tailored for checking intra-group transactions on the basis of the ALS -without disregarding the legal personality of subsidiaries. This point was supported by the regulations of article 14⁷⁹.

In light of the *normal transaction test*, it was decided that the royalties paid by the Argentine subsidiary to its head-office could be deducted because for two reasons. The transfer of technology contract was not a sham transaction and the amount of the royalties was normal. In contrast, the interest paid to the head-office was disallowed because it did not satisfy this test (the agreed interest was deemed not normal).

c- The Supreme Court followed the prevailing Tax Court approach

Early in 1973, the Parke Davis case reached the Supreme Court. It was the first opportunity the Court had for addressing the merits of a transfer pricing case. It had to choose between two competing approaches: a) the substance-over-form doctrine as developed by Tax Court majority vote in re *Parke Davis* or b) the arm's length standard as used in the *Ciba* case. The Supreme Court decided to follow the former approach.

The reasoning of the court had the following steps. The starting point was that under the Civil Code, the concept of *contract* assumed the existence of, at least, two parties with non-aligned interests. Thus, the transaction entered between the foreign head-office and its local subsidiary cannot be deemed a valid contract since the former wholly-owns the latter. This conclusion made the regulations of article 14 invalid –in the paragraph that referred to the ALS- because, under the Supreme Court view, they wrongly assumed the existence of a contract.

Under the substance-over-form doctrine, both parties shall be deemed members of an *economic unit*. Therefore, the intellectual rights assigned by the head-office to the wholly owned subsidiary had to be considered an equity contribution to the latter. In addition, the royalties paid to the head-office shall be deemed the subsidiary's profits. Consequently, the

⁷⁹ The text of this regulation is quoted above in section II.3.b.

so-called royalties cannot be deducted from the subsidiary's tax accounts.

The Supreme Court re-inforced its holding as follows. The foreign head-office received in the relevant fiscal years: a) the royalties stemming from the assignment to its subsidiary of the right to exploit the marks and patents in Argentina; b) the profits derived by its subsidiary from the exploitation of such marks and patents. “[...] Therefore, if the royalties could be deducted from the subsidiary it would be equivalent to a tax exemption that was not established by the income tax Act [...]”.

The decision of the Supreme Court in *Parke Davis* amounted to an unrebuttable presumption according to which transactions entered by the foreign head-office with its subsidiary resident in Argentina had to be recharacterized as either equity contribution or dividends⁸⁰. This presumption, based upon the substance-over-form doctrine, repealed the arm's length approach as embodied in the regulations of article 14. However this decision to repeal the ALS was beyond the Supreme Court jurisdiction since the ALS had not been questioned on constitutional grounds.

The *Parke Davis* holding implied an absolute denial of any deduction based on charges for intragroup transactions between the foreign head-office and its local subsidiary –a policy that was common in Latin America during the Seventies⁸¹. A major consequence of this case was the discrimination of enterprises on the grounds of nationality. In effect, Argentine companies were put at a comparative advantage *vis à vis* foreign multinationals because only the former were allowed to deduct from their tax accounts the royalties paid to non-resident enterprises. This is surely the reason why the ratio of *Parke Davis* discouraged foreign direct investment in Argentina⁸². Moreover, this type of discrimination is prohibited by article 24.4 of the OECD Model Convention⁸³ -an influential model tax

⁸⁰ See José María Martín, *El principio de la realidad económica y los abusos de las estructuras societarias [The Principle of Economic Reality and the abuses of corporate structures]*, Jurisprudencia Argentina, at 1039-1042, Buenos Aires, 1973. Martín argued that the federal Constitution does not empower the Supreme Court to issue such a presumption.

⁸¹ Surrey, *Reflections*, at 448/449, *op. cit.* above in footnote 25.

⁸² No empirical survey has been produced on the impact of *Parke Davis* on foreign inward investment.

⁸³ The text of this provision *inter alia* states: If the arm's length standard is met, “...interests, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first mentioned State”.

convention on income and on capital backed by major capital exporting countries.

d- The GAAR/ALS tension: How it was addressed in the fourth period

As it was said, the application of the GAAR in the area of TP cases opened three difficult questions. It is time to explore how courts answered them during the 1961/76 period.

The first question focuses on how GAAR interacted with the specific anti-avoidance rule for transfer pricing, that is the arm's length standard. The majority of the chambers of the Tax Court and the unanimous Supreme Court decided to implicitly repeal the arm's length standard and to employ the GAAR to all kinds of TP cases (in the way developed in the Parke Davis case)⁸⁴. This repeal was facilitated by a number of factors. On the one hand, the ALS was so poorly drafted that even its legal basis was unclear. In this respect it is pertinent to recall the different views that were developed in the Ciba case⁸⁵ and the Parke Davis dissenting opinion⁸⁶. On the other hand, judges probably were more familiar with the GAAR than with a cryptic ALS whose rationale was not explained by its drafters. Moreover the only academic who wrote briefly about its sources, Professor Dino Jarach, referred to a bibliography not written in Spanish but in French, English and German⁸⁷. This language barrier surely made difficult to both taxpayers and judges to improve their understanding of the ALS.

Finally, the information cost of applying ALS was much higher than that of GAAR. In effect, the former had to be applied on a case-by-case basis evaluating complex facts and making difficult decisions –e.g. whether a given transaction is comparable to the one at issue. In contrast, the GAAR, as construed by the Supreme Court in re *Parke Davis*, could be applied virtually on a mechanical basis. The sole fact that a given transaction was entered into between a foreign head-office and its local subsidiary was enough to refuse the deduction of the payments in the subsidiary's tax account.

The second question focuses on the circumstances under which the GAAR may be applied

⁸⁴ None of the courts that employed the GAAP to TP cases attempted to explain what was the scope left to the arm's length standard.

⁸⁵ In the CIBA case it was argued that the legal basis of the ALS was the regulation of article 14 of the Income tax.

⁸⁶ It was maintained that the ALS was embodied in article 12 of the regulations of the Capital Tax Act referred above in footnote 74.

⁸⁷ See Jarach, *The enterprises with international interests*, at 28, op. cit. above in footnote 33.

to transfer pricing cases. The case law ruled that under GAAR, the fact that the foreign head-office had at least 80% of the equity of the local subsidiary made an un rebuttable presumption that such enterprises were members of an *economic unit*⁸⁸. Hence, the subsidiary was unable to deduct from its tax accounts the payments made to its head office.

The third question focuses on how transactions had to be recharacterized under GAAR. As was maintained by the Supreme Court in *re Parke Davis*, they had to be considered either equity contribution or profit remittance.

e- Congress backed the case law⁸⁹

One of the main objectives of the 1973 Reform was to address the problem of the tax avoidance industry in the income tax area. Tax avoidance was perceived as the main reason why the income-tax ratio to total tax revenues had substantially fallen from the early sixties⁹⁰. In addition, the Senate Committee Report described that the tax system in effect at that time was "... so unjust that through its loopholes the tax burden [was] shifted from upper to lower income taxpayers"⁹¹.

Within the context of this anti-avoidance climate, the Perón administration sent to Congress the tax reform Bill that explicitly addressed the transfer pricing problem.

The export and import clause⁹² was changed only to expand the scope of its default mechanism to include both export and import transactions, thereby eliminating the 1946

⁸⁸ The 80% of equity requirement was established by the Tax Court in *re Le Carbone Lorraine S.A.I.C.*, decided on November 17, 1969. On this case, see *Criteria for the Allocation of items of income and expense between related corporations in different states, whether or not parties to tax conventions*, Report on Argentina by Alberto Rubén López, Cahiers de Droit Fiscal International, Washington 1971, Volume LVIIb, II/51-II/85 at II-77.

⁸⁹ The 20628 Income Tax Act was passed by Congress on December 27, 1973. It became effective since January 1, 1974.

⁹⁰ The House of representative Committee Report on the 1973 Tax Reform stated: "... By 1941 [the income tax] amounted 13,72 % of the total tax revenues; by 1942 it went up to 18,92; by 1943 it raised again to 22,86%, and from 1952 to 1959 the figure was about 30% of the total tax revenues. Since 1960 there was a clear fall in the revenues collected from the income tax...", *Libro de Sesiones de la Cámara de Diputados de la Nación, Speech of congressman Díaz Ortiz, December 6, 1973, Meeting 47th at 4675.*

⁹¹ *Libro de Sesiones de la Cámara de Senadores de la Nación, December 21, 1973, speech by senator Romero at 3029.*

⁹² Article 8 of the 20628 Act.

unjustified exclusion of exports⁹³. A unanimous Congress passed the new wording of the export and import clause where no congressman made comments about it⁹⁴.

Hence, from the 1973 Reform onwards both import and export transactions could be controlled via the same set of methods: the CUP and two different types of secondary pricing mechanism⁹⁵. Thus horizontal equity was brought again to this area.

The 1973 reform of article 14 was the target of many fiery speeches inflamed by hostility towards foreign multinationals⁹⁶. The House of Representatives Committee Report described as follows the main transfer pricing abuses that article 14 was addressed to solve.

“[...] A number of Argentine subsidiaries of foreign enterprises [...] shifted real income to their countries via technical assistance transactions, royalties paid as consideration for the assignment of patents, marks, formulae, etceteras. They also made this shift through payment of interest due to financial contributions. Therefore they remitted to foreign jurisdictions large amounts of revenues that were deducted from their Argentine subsidiaries”⁹⁷. “It is a well known fact that via contracts of transfer of technology whose consideration are not related to the services received, enterprises under foreign control remit abroad profits subject to a lower tax liability than the liability that correspond to

⁹³ The new default provision of the export and import clause was amended as follows: *“In the cases where in accordance with the preceding provisions the wholesale price at the place of origin or destination must be applied but it is not publicly and commonly known, or there are doubts about whether it refers to the same goods as imported or exported or to similar ones or where comparison is difficult due to other reasons, the calculation of income sourced in Argentina shall be made on the basis of the percentage of profit obtained by independent enterprises engaged in identical or similar activities. In the absence of an identical or similar activity, the tax authority is hereby empowered to apply the net percentage that it establishes on the basis of branches of trade that have certain analogies to the one under consideration”* (emphasis added).

⁹⁴ See Libro de Sesiones de la Cámara de Senadores de la Nación, House of Representative Report, December 6, 1973, Meeting 47th at 4702.

⁹⁵ See above footnote 48.

⁹⁶ Article 14 *“... embodies the political philosophy of our great movement in its fight towards the independence from foreign economic ties. It is a process to regain the entire control of economic decisions* (see Libro de Sesiones de la Cámara de Diputados de la Nación, House of Representative Committee Report at 4683).

⁹⁷ See Libro de Sesiones de la Cámara de Diputados de la Nación, House of Representative Committee Report, December 6, 1973, Meeting 47th at 4683.

dividends”⁹⁸.

Congress, in a unanimous vote⁹⁹, decided that the Supreme Court judgement in *re Parke Davis* was the proper approach to curb the overcharging abuses described in the previous paragraph¹⁰⁰. Hence, the 1973 Reform of article 14 was an attempt to embody in a legislative provision the ratio of *Parke Davis*. Article 14 was redrafted as follows:

Branches and subsidiaries of foreign enterprises must produce its accounting records on a separate basis from their foreign parent companies, making the necessary corrections for assessing the net real profits sourced in Argentina.

In the absence of sufficient accounting records, or where such records do not show accurately the net income arising in Argentina, the tax authorities may deem that the branch or subsidiary and the head office form an economic unit and assess the net taxable income.

The consideration for financial or technological (including technical advice) contributions made by the head-office, an affiliate, branch or a financially related third party to a foreign enterprise in Argentina can not be deductible in the tax balance sheets of the payor. Such payments shall receive the tax treatment that governs the profits of branches¹⁰¹.

The same rule applies even failing evidence of ties between the local enterprise or person and the foreign recipient if the analysis of the former’s financial situation reveals that the centre of its decisions is not in the hands of its natural authorities, or that the contract or agreement under which the obligation arises would not have been entered into with a third party under the usual practices of international trade

Any contract between companies or persons covered by this article will have no tax effects, and the payments made shall be treated in accordance to the principles governing equity contribution and profits.

⁹⁸ See the 1974 Report issued by the Perón Administration on the Transfer of Technology Bill that was passed by Congress as 20794 Act (Libro de Sesiones de la Cámara de Diputados de la Nación, Meeting 26th, at 2790, 1974).

⁹⁹ See Libro de Sesiones de la Cámara de Diputados de la Nación, at 4702, meeting 47, December 6, 1973.

¹⁰⁰ See, for instance, the House of Representative Committee report at 4683, where the full text of the *Parke Davis* decision was published.

Article 14 referred to enterprises that were both explicitly under foreign control, such as subsidiaries or branches, and those in which such foreign control was implicit but could be inferred, for example, from the structure of its capital. Then article 14 established a rule under which interests and royalties remitted by such enterprises to their associated foreign entity had to be deemed profit remittance. Hence, these payments could not be deducted from the payer's tax accounts and had to be subject to the tax treatment of branches –i.e. they were subject to a 45% tax rate while the standard rate was 22%.

The 1973 version of article 14 implied a substantial change of approach to the transfer pricing problem. Instead of focusing TP abuses upon the basis of the arm's length standard (as was suggested by the provisions effective up to the 1973 reform), Congress decided to apply a new methodology. That is, an absolute denial of any type of deduction based on charges for transactions entered between an enterprise under foreign control and its associated entity¹⁰².

This rule was an extension of the holding of Parke Davis. In effect, it was extended from licence contracts concluded in the pharmaceutical industry between an Argentine subsidiary and its foreign controlling shareholder to any type of transaction concluded in any type of industry between an enterprise under foreign control and its associated entity –whether controlling shareholder or not. Furthermore, article 14 also implied that the separate entity approach was repealed in the area of foreign MNE –but not in respect of Argentine MNE.

Even assuming, for the sake of argument, that article 14 effectively curbed transfer pricing abuses, it hardly outweighed an unavoidable effect produced by this article. That is, the discrimination of enterprises under foreign control *vis à vis* enterprises under Argentine control and the corresponding deterrence of foreign direct investment.

The Argentine government was aware of this direct discrimination effect based on nationality. Indeed, it decided to denounce a tax treaty with West Germany that had an anti-discriminatory provision based on article 24 of the OECD Model tax Convention on

¹⁰¹ Under Article 63 (b) of the Income Tax Act, the tax rate applicable to branches was 45%. Note that the standard rate was 22%.

¹⁰² See Surrey, *Reflections*, at 448/449, *op. cit.* above in footnote 25.

Income and Capital¹⁰³.

In conclusion, the 1973 reform brought about the demise of the ALS for transactions other than export and import of goods. This demise was the result of extending the GAAR to the transfer pricing area thereby producing economic effects that seems to have been overlooked by the 1973 Congress¹⁰⁴.

5- The fifth period (1976-1998): the renaissance of the arm's length standard

a-Transactions other than export and import of goods

On March 24, 1976 there was another military coup in Argentina. The new government decided, less than ninety days after it took office, to repeal article 14 as amended in the 1973 reform¹⁰⁵. It also decided that the arm's length approach would be the prevailing methodology to address the problem of TP abuses. This new policy was embodied in article 14 by the 1976 Reform¹⁰⁶.

Such a substantial policy change was justified on the following grounds. It was reckoned that the tax legislation passed by the 1973 Reform was an attempt to curb transfer pricing manipulation. However it produced a serious market distortion: the discrimination of enterprises under foreign control *vis à vis* national enterprises. It was argued that the practical effect thus produced was “[...] to try to solve an abuse by making the opposite abuse [...]”. The military government considered that this type of discrimination deterred foreign inward investment, a point that was high in its agenda¹⁰⁷. The 1976 Reform reworded article 14 reads as follows:

¹⁰³ See *Allocation of expenses in international arm's length transactions of related companies*, Cahiers de Droit Fiscal International, Report on Argentina by Curt A. Tutzer, II-17/ II-27, London, 1975.

¹⁰⁴ Günter J. Glogauer argued that the “... The arm's length criteria can not be applied since the reasoning of the Court [that was followed by the 1973 reform] does not take into consideration economic reality, even though it pretends to, but prefers the Organic Theory [based on the GAAP]”, *Tax treatment of the importation and exportation of technology, know-how, patents, other intangibles and technical assistance*, Cahiers de Droit Fiscal International, Report on Argentina, II/27-II/53 at II-50, London, 1975.

¹⁰⁵ The military revolution was on 24th March 1976 and the Economic Ministry stated the new transfer pricing policy on June 16, 1976 (see the Statement of Motives of the Foreign Investment Bill that would be 21382 Act).

¹⁰⁶ The Income Tax 1976 Reform was passed by Act 21481 -effective as of January 5, 1977.

(1) Branches and other permanent establishments of enterprises, persons or foreign entities must keep separate accounting records from those of their parent company and other branches and other permanent establishments or subsidiaries, and must adjust them if necessary in order to assess the net income sourced in Argentina

(2) In the absence of sufficient accounting records, or where such records do not show accurately the net income arising in Argentina, the tax authorities may deem that the foreign and national entities referred in the previous paragraph form an economic unit and assess the net taxable income.

(3) Transactions between a local enterprise of foreign capital and the individual or legal entity domiciled abroad that either directly or indirectly control such enterprise shall, for all purposes, be deemed to have been entered into between independent parties, provided that the terms and conditions of such transactions are consistent with normal market practices between independent entities, with the following limits: A-Loans: They have to be consistent with article 20 (1) of the 21382 Act¹⁰⁸.

B-Contracts covered by the Transfer of technology Act: According to what it is established by such an Act¹⁰⁹.

(4) When the requirements provided [in this article] to deem such transactions as concluded between independent entities are not met, they will be subject to the principles of capital contribution and profit.

(5) For the purposes of this article, local enterprise of foreign capital will be the enterprise that meets the requirements established in the Article 2 (3) of the 21382 Act¹¹⁰.

¹⁰⁷ The justification of the new approach to the transfer prices problem from the 1976 onwards was developed by the Minister of Finance (see his statement on the bill that latter was the Foreign and Investment Act 21382, 16 June 1976, XXXVII-B A.D.L.A. 894).

¹⁰⁸ “[...] Loans will be subject to [the arm’s length standard] provided they are not objected by the Central Bank of the Republic [...] on the grounds of the particular conditions of the transaction or in the improper debt/equity ratio of the borrower”.

¹⁰⁹ The outline of this regime is made below in this sub-chapter.

¹¹⁰ “Local enterprise of foreign capital: enterprise domiciled in Argentina in which individuals or legal entities not domiciled in Argentina own either directly or indirectly more than 49% of the equity or hold

The first paragraph embodies the policy of the military government not to amend the rule that enterprises under foreign control must have separate accounting from the other profit-units of the MNE –a rule that was introduced in the 1932 Reform and maintained since then. The second paragraph, similar to that introduced in the 1946 Reform, was envisaged as a two-fold device. First, to encourage enterprises to have *sufficient accounting records* (this concept was not defined) and, second, to make such records *show the net income arising in Argentina*. Moreover, the second paragraph also establishes a punitive device (an undefined profit based mechanism for allocating income), that was triggered if the separate accounting rule was not met

The third paragraph explicitly introduced the ALS in the act itself for the first time. The interaction between the three central concepts of article 14 was made clear: the separate accounting principle, the ALS and the economic unit principle. In effect, it was established that the ALS must be used for adjusting the separate accounting records of enterprises under foreign control in order to make them reflect the true profit attributable to it¹¹¹. In other words, they both integrate the primary pricing method of intra-firm transactions. In addition, the principle of the economic unit was given the task of the secondary pricing method when some requirements regarding the separate accounting rule are not satisfied.

Hence, the 1976 version of article 14 was the result of the lessons learned during the first period (when no methodology was given to adjust separate accounts¹¹²) and the third period (when neither the legal basis of the arm's length standard was clear nor how it interacted with the economic unit principle).

The definition of “enterprise under foreign control” (provided in article 14 (5)) is precise enough to make it workable. However, no definition was provided for the concept of comparables despite its key relevance to the ALS¹¹³.

either directly or indirectly the voting power necessary to prevail in the shareholder meetings or partner meetings” (Foreign Investment Act. 21382, art. 2(3).

¹¹¹ The 1976 Reform did not expressly state which had been the sources of article 14.

¹¹² See above at II.1.

¹¹³ See Cahiers De Droit Fiscal International, 46th Congress of the International Fiscal Association, Cancún 1992, Volume LXXVIIa, General report at 19/75, 30-31 where it stated that the arm's length standard was not defined in Argentina. See also Enrique Jorge Reig, *El grupo de sociedades como unidad contribuyente*

The government assumed that the ALS, as defined in article 14 (3), might not be effective for deterring transfer pricing manipulation in the area of loans and transfer of technology. Without departing from such standard, it established special guidelines to determine under what circumstances it could be deemed that loans and transfer of technology meet the ALS.

In the loans area article 14 established a fixed-ratio approach¹¹⁴. In effect, in order to provide a clear guide regarding when a loan can be considered to meet the ALS, a debt/equity ratio was established. And the Central Bank was empowered to determine, within a certain period of time, if a loan does not meet this rule.

In the area of transfer of technology the ALS worked as follows: A) it was established that there had to be a *fair relationship* between the consideration paid and the technology transferred¹¹⁵. In order to facilitate the application of this *fair-relationship-test* the following alternatives were provided: a) a safe harbour¹¹⁶; and b) the approval of the contract by the government justifying why the transaction at issue met the ALS¹¹⁷. The royalties paid in consideration for the use of marks were disallowed¹¹⁸.

The fourth paragraph of article 14 –based on the Supreme Court judgement in *re Parke Davis*¹¹⁹– is a punitive device triggered if the arm’s length standard is not met. In this case, any rendering of goods or services by the foreign controlling shareholder to its subsidiary would be re-characterised as capital contribution. Conversely, any consideration paid by the latter to the former will be considered as either profit remittance or capital repatriation (the

[*Group of companies as tax unit*], Derecho Fiscal T. XXVI, 1977, 385-407, at 392 where is emphasised the lack of precision in the regulation dealing with the meaning of the arm’s length standard.

¹¹⁴ On the application of the fixed ratio approach to loans, see *Model Tax Convention on Income and on Capital*, Updated as of 1st November 1997, Volume II, Thin Capitalisation Report, R (4)-14.

¹¹⁵ See article 5 of the 22426 Transfer of Technology Act.

¹¹⁶ It was presumed that the fair relationship test was met if the royalties paid did not exceed 5% of the net value of the goods and service produced using this technology as input (see article 5 of Decree 580/81).

¹¹⁷ Art. 2 of the 22426 Act.

¹¹⁸ The rationale of this rule was based on the following grounds: “[...] *To avoid the difficulties that would arise in the process of determining the fair valuation on a case-by-case basis [...]*” (see the Memorandum addressed to the Executive Power attached to the Transfer of technology Bill, ADLA XXXVII-C at 2565, second column).

¹¹⁹ See paragraph 11 of the Supreme Court decision in *re Parke Davis*. The direct source of article 14 (4), as of 1976, was the 1973 version of article 14 (5).

capital-contribution-and-profit rule)¹²⁰.

b-Export and import of goods

The military government decided not to amend the export and import clause passed by the 1973 Reform¹²¹. However, the Supreme Court substantially narrowed its scope in the leading case *Eduardo Loussinian S.A.* -decided in 1983¹²².

Loussinian S.A. was an enterprise resident in Argentina that was in the business of importing and selling rubber and latex. It concluded a supply contract with a non-resident subsidiary of a foreign MNE. Under this contract the parent-corporation of the MNE, ACLI International Incorporated (ACLI), would provide Loussinian such goods from early January 1974 up to the end of 1975.

After the contract was entered into, the international market price of rubber and latex fell substantially¹²³. However, Loussinian kept importing the goods from ACLI in spite of the big losses derived from it. The tax authority decided that there was an overcharging problem in this contract and that the export and import clause should control this case¹²⁴. Thus, it considered that the difference between the wholesale price of the goods at the place of origin and the price agreed on the contract (less some expenses), was income sourced in Argentina that Loussinian S.A. should have withheld when it made the payments to ACLI. Both the Tax Court and the Court of Appeals upheld the tax authority decision.

The Supreme Court said that despite the fact that the purchasing price was higher than the wholesale price, the latter could not be applied to this case to determine the income sourced

¹²⁰ The scope of the capital-contribution-and-profit-rule was substantially narrowed by regulations under which this rule only had to be applied to the excess of a given price over the *normal* price (see art. 20 of Decree 1344/98). The friendly treatment that enterprises under foreign control enjoyed since the 1976 Reform can be inferred from the fact that none of these punitive devices were ever applied (see Cahiers de Droit Fiscal International, 46th Congress of the International Fiscal Association, Cancún 1992, Volume LXXVIIa, Argentine Report by Jorge Asiain, at 275, 1992).

¹²¹ See the Income Tax reform Act 21481, Anuario de Legislación 1977-A at. 6.

¹²² The Loussinian case was decided by the Supreme Court on September 20, 1983 (See Revista Jurídica Argentina La Ley 1983 D-559).

¹²³ The Supreme Court decision does not state how substantial was the decrease of the market price of the goods involved in this case.

¹²⁴ Recall that under the export and import clause if there is a gap between the wholesale price and the agreed price, it will be presumed that the parties are associated -unless proof to the contrary (see above section II.3.a).

in Argentina. This was so because it considered that Loussinian had rebutted the presumption under which both parties had to be deemed “associated” due to this gap between prices.

The Supreme Court argued that there was no evidence that the parties were associated because, *inter alia*, it was not proved that ACLI had “[...] shares of Loussinian S.A. during 1974, 1975 and 1976 [...]”. In addition, the Court argued, the fact that ACLI had appointed Loussinian in charge of selling ACL’s products in Argentina was not a proof that the parties were associated. It also maintained that, given that the parties were not associated, the export and import clause did not compel Loussinian to justify a payment substantially above the wholesale price.

From an empirical perspective, the Loussinian case made it very easy for the taxpayer to rebut the presumption of control provided in the export and import clause. In effect, under the ratio of the Supreme Court, only structural control between the parties was relevant for applying the export/import clause. Hence, the scope of the wholesale price method as an anti-avoidance mechanism was substantially narrowed from 1983 up to the 1998 Reform.

In sum, the 1976 Reform and the Loussinian case produced the following legal scheme to deter transfer pricing. The general rule was the arm’s length standards as established in article 14 (3).

However there were three areas in which this rule had special features: i) the export and import of goods, ii) loans and iii) transfer of technology. This scheme was implemented without discriminating between foreign and Argentine MNEs.

The Loussinian case introduced a major distortion in this legal scheme. This because it envisaged a concept of control in the export and import area that was substantially narrower than the concept applied by article 14. In effect the definition in the area of export and import of goods only included direct structural control –such as the parent/subsidiary relationship. Whereas article 14 also includes non-structural control, for example that derived from an *indirect* holding of voting power of an enterprise necessary to prevail in its meetings¹²⁵.

Hence, there were two different definitions of control playing in the transfer pricing

¹²⁵ On the definition of control under article 14 (version 1976) see above footnote 110.

regulations. The practical consequence of this asymmetry was that it was much easier to manipulate transfer pricing in the area of export and import of goods than in other types of cross-border transactions.

c- The GAAR/ALS tension: how it was addressed in the fifth period

It is useful to recall the first question asked in the early Sixties when the GAAR was first applied in the area of transfer pricing: a) how the GAAR interacts with the specific anti-avoidance rule for transfer pricing -i.e., the arm's length standard?

The 1976 Ministry of Finance memorandum on the 1973 Tax Reform focused on this question. It clearly showed that the military government was committed to prevent the GAAR from being applied in the area of transfer pricing. This was so because the government considered that its application, in the way developed in *re Parke Davis*, lead to the discrimination of enterprises under foreign control *vis à vis* their national counterparts -thus deterring both foreign inward investment and transfer of technology¹²⁶.

The military government intention of preventing the courts from applying the GAAR to TP cases can also be inferred from the 1976 comprehensive legal scheme, described above, that left no room to its application in the TP area. Therefore the remaining two questions¹²⁷ were irrelevant in this period.

III- The sixth period: the 1998 Reform¹²⁸

Argentina began moving towards a free-market economy in 1991, away from the price-controls and state-owned industries of the earlier decades¹²⁹. This trend encouraged MNEs to either start or substantially increase their investments in Argentina, which helped

¹²⁶ The 1976 military government did not provide a response to the 1973 Supreme Court argument *in re Park Davis* regarding the inapplicability of the concept of contract to intra-group transactions. This lack of response was probably because *stare decisis* has a narrow scope at the Argentine Supreme Court level. In effect, most of its members generally feel obliged to follow case law only when they themselves have participated in them. This tradition is surely the result of the frequent changes in the Supreme Court personnel since 1930. The 1976 military government appointed all the members of the Supreme Court. (See below footnote 169).

¹²⁷ The remaining two questions are the following: a) if GAAR may be applied to transfer pricing cases, under what circumstances its mechanism is triggered?; b) how transactions shall be recharacterized when they are focused in the lights of GAAR?

¹²⁸ The reform was passed via 29053 Act that was published in the Official Gazette on December 30, 1998.

¹²⁹ *Tax Bill With Transfer Pricing Provisions Likely Will Be Law by Year End, attorneys says*, 7 Transfer Pricing Report, 128-129 at 129, 7 January 1998.

the Argentine gross domestic product to soar during the main part of the nineties.

By the same token, MNEs were relatively free to manipulate their transfer pricing. In effect, the narrow scope of the export and import clause produced by the *Loussinian* case and the lack of key definitions¹³⁰ for making article 14 workable encouraged tax planning. This led Argentina to lose US\$ 1,5 billion in tax revenue per year due to transfer pricing abuses¹³¹. This was the scenario faced by the 1998 Congress that made TP reform a compelling issue.

1-An overview of the 1998 Reform

The drafting policy of the 1998 TP Reform was basically to add new provisions to the old ones – instead of producing a new regime from scratch. Thus, for example, the reform introduces no relevant amendment to article 14 (as passed by the 1976 reform¹³²) and the primary pricing method of the import and export clause, that is, the wholesale method, remains largely unchanged. The main novelties of the reform are the paragraphs added to article 15 (to be explored below).

This drafting policy is debatable taking into account, for instance, that the structure of article 14 is the product of historical accident that makes this provision difficult to understand without knowing its kafka-esque evolution. Moreover, there is no substantial case law grounded on the wording of article 14 that would have justified this drafting policy¹³³.

The pricing methods stated in the 1995 OECD Guidelines are introduced in the Argentine legislation. However relevant qualifications should be made to this statement. In effect, these pricing methods only apply by default in the key area of export and import of goods.

¹³⁰ Such as the concept of comparable transaction.

¹³¹ Libro de Sesiones de la Cámara de Diputados de la Nación, Committee Report, at 56, September 9th and 10th, 1998. Government officials have been quoted to estimate US\$ 1 billion in new tax revenues as a result of new transfer pricing rules (Horacio Peña, *Transfer Pricing in Argentina*, at 707, published in Argentina's New Tax Environment, op. cit. above in footnote 3.)

¹³² The text of article 14 is quoted above at II.5.a.

¹³³ This drafting policy may be justified under other circumstances. In effect, when there is substantial case law grounded on specific words of a given legislation, the drafting of legislation from scratch may imply the implicit abrogation of jurisprudence increasing legal uncertainty (On this problem see *Tax Law Rewrite. The way forward*, section 2 entitled *General Drafting Approach*, paragraph 15. It is published on the Internet: www.inlandrevenue.gov.uk/condoc2s.htm).

In other types of transactions, these pricing methods apply as primary tests but on the basis of the *best method rule* –an approach implicitly rejected by the OECD as will be explored below.

Finally, primary adjustment may be made in the area of export and import of goods even if the parties are not associated. This may lead to international double taxation and the corresponding deterrence of foreign inward investment.

Despite these weaknesses, the 1998 reform establishes the best TP regime produced in Argentina so far. This is so because it does not attempt not to repeat the main policy errors made during the previous stages since 1932. First, it embodies a system under which the tax authority is empowered to assess the apportionment of the taxpayer's profits starting from his separate accounts using the ALS as the primary pricing method. This method is clearly stated in the Act itself in order not to repeat the error made during the first and third period. Second, the reform attempts to deter transfer pricing manipulation without discriminating foreign MNEs *vis à vis* Argentine MNEs. Consequently, both capital import neutrality and horizontal equity between domestic and foreign taxpayers are brought into this area –in order not to repeat the error made during the fourth period. Third, the reform envisages a system where the TP key concepts (such as the definition of comparables) and the sources of the reform are known –thus learning from the fifth period.

2-Analysis of main issues of the 1998 Reform

The working of the 1998 TP reform varies according to the underlying transaction, that is, transactions different from export and import of goods on the one hand, and export and import of goods on the other. These two categories, rooted in the Argentine law since the 1946 Reform, will be explored separately.

a- Transactions other than export and import of goods

The 1998 Reform introduces no relevant amendment to article 14 -as passed by the 1976 Reform¹³⁴. Thus, the article 14 main role is to establish a general rule according to which enterprises under foreign control have a duty to follow the separate accounting principle that must be consistent with the arm's length standard. The main novelty of the 1998 TP reform is article 15 that states the following:

¹³⁴ The text of article 14 is above at II.5.a.

(1) Where by reasons of the nature of the operations or the organisational characteristics of the enterprises, the income arising in Argentina cannot be accurately determined, the tax authority may determine the taxable net income on the basis of averages, indexes or coefficients based on non-associated enterprises engaged in the same or similar characteristics.

(2) The local enterprises of foreign capital that enter into transactions with non-resident legal entities or individuals or groups of individuals that participate either directly or indirectly in its capital, control or management, or with other non-resident enterprises or establishments in whose capital the said non-resident legal entities or individuals or groups of individuals or the local enterprise either directly or indirectly participate, are compelled to determine their consolidated [acumulables] profits and allowed deductions, valuating these transactions at arm's length conditions¹³⁵.

(3) Saved proof to the contrary, it is presumed that the transactions referred in the previous paragraph are not at arm's length when entities or individuals organised or domiciled in low-tax jurisdictions take part in these transactions¹³⁶.

(4) The tax authority will require the local enterprise of foreign capital to submit special tax reports containing detailed information including data and supporting evidence in order to check if the controlled transactions are under arm's length conditions.

(5) In order to determine whether a transfer pricing is under arm's length conditions, the most suitable pricing method will be applied (taking into account the type of transaction under review) from the methods listed below or from the similar methods that may be established by regulation. It is not applicable in this area the fiscal privacy right provided in article 101 of the 11683 Act (consolidated as of 1998) regarding information about third party taxpayers if: a) this information is necessary to apply the comparability test to be established by regulation and b) this information must be provided as evidence in cases. a) Comparable Uncontrolled Price Method...; b) Resale Price Method ...; c) Cost Plus Method ...; d) Profit Split ...; e) Residual Allocation ...; f) Transactional Net Margin Method....

¹³⁵ The source of article 15 (2) is the first sentence of article 64-A of the Mexican Income Tax Act, as of December 30, 1997 [hereinafter, the Mexican Income Tax Act].

¹³⁶ The source of this paragraph is the last sentence of article 64-A of the Mexican Income Tax Act.

(6) *It will be deemed that transactions or enterprises are comparable if there are no differences among them that materially affect the price or value of the consideration or the profit margin ... and if there are such differences, they can be adjusted reasonably*¹³⁷.

(7) *The proceedings established in this article are applicable to transactions entered into by national enterprises abroad.*

a.1- Definition of control

The definition of control is critical under the 1998 Reform because only transactions that are included in this definition are under the scope of article 14 and 15. This definition provides: *Local enterprise of foreign capital: Any enterprise domiciled*¹³⁸ *in Argentina in which either individuals or legal entities domiciled abroad are owners either directly or indirectly of more than 49% of its capital or hold enough voting power to control its meetings*¹³⁹.

*Controlled enterprises domiciled abroad: Any enterprise in which either individuals or legal entities domiciled*¹⁴⁰ *in Argentina are owners either directly or indirectly of more than 51% of its capital or hold enough voting power to control its meetings*¹⁴¹.

These definitions refer to two different types of control between enterprises. The structural control (i.e. the parent/subsidiary relationship) and the non-structural control, that is where the association between enterprises is implicit. Note that there is no difference in the definition of non-structural control between foreign and Argentine MNEs. However, there is an unexplained difference regarding the structural control. In effect, while the holding of 49% of equity by a foreign entity is enough to deem that it controls a local enterprise, this rises to 51% to deem that an Argentine entity control a foreign enterprise.

This 2% gap is small. However, it may be misleading for foreign investors because it may

¹³⁷ The sources of this paragraph are the third sentence of article 64-A of the Mexican Income Tax Act and the 1995 OECD Report at G-2.

¹³⁸ Enterprises are deemed domiciled in Argentina if they are incorporated in this country (see art. 69 (b) of the Income Tax Law, as consolidated via Decree 649/97).

¹³⁹ Art. 14, last paragraph, that refers to Article. 2 (3) of the Foreign Investment Act.

¹⁴⁰ See footnote 138.

¹⁴¹ Art. 130 of Act 29053 as of 1998.

be read as hidden hostility towards foreign MNEs by Congress –a mood remaining from the fourth period. Moreover since there is no other evident factor in the Income Tax Act that compensates for this gap, it implies a discrimination against foreign MNEs that clashes with article 24 (1) of the OECD Model Tax Convention on Income and Capital. This problem should be solved in order to provide tax equity by residence and to make the system as much neutral as possible.

There are quite a few foreign MNEs in this borderline situation. Therefore, it could be argued, this issue may be ignored for the time being. Nevertheless, under the current tax competition among latin American countries this gap may mean that foreign inward investment may be diverted away from Argentina¹⁴².

The 1998 reform then defines some nuances of the definition of control, that is, the *economic link*. It states the following:

For the purposes of article 8, 14 and 15, the economic link between an enterprise domiciled in Argentina and another domiciled abroad will be determined, among other factors, on the basis of the origin of its capital; its effective management; the distribution of profits; the existence of financial or commercial influence or in the making of decisions; thin capitalization; main activity related only to other enterprise; administrative or functional dependence. The Executive Power is empowered to regulate this article¹⁴³.

The main function of this article is to provide eight alternative tests for determining cases of non-structural control and it applies to enterprises based in Argentina under foreign control. This article was recently regulated by the Executive Power who decided to merge all the eight tests into one (probably for the sake of simplicity). Under this regulation, the economic link is deemed when the foreign enterprise “...has enough decision power to define the activities [of the enterprise based in Argentina]”¹⁴⁴.

The test of *enough-decision-power* does not provide any objective criteria for determining when there is non-structural control. Hence, it brings uncertainty to this area thus making the litigation cost of this provision high. From an empirical perspective, this test implies a delegation of broad definitional powers from the executive power to the courts –a

¹⁴² On tax competition see *Harmful Tax Competition. An Emerging Global Issue*. OECD 1998.

¹⁴³ This article was added after article 15 by the 1998 Reform.

¹⁴⁴ Article 1 (C), Decree 485/99, passed on May 7, 1999.

delegation not allowed by Congress under the article above.

a.2- Definition of comparables

For the first time a definition of comparables is provided via article 15 (6)¹⁴⁵. This definition seeks to facilitate the identification of either comparable transactions or enterprises –the standards under which intra-firm transactions are tested according to the ALS.

There is a noteworthy difference between the Mexican and Argentine approaches in this area. While in the former the legislation itself provides what factors are relevant to evaluate if a transaction or enterprise is comparable, the latter delegate this matter to the regulations. The Argentine policy of leaving this issue to regulations seems a better approach than the Mexican one because it makes the system more responsive to future developments in this field.

The Argentine Executive Power has recently issued the regulation of article 15 (6). It states the following:

*In order to determine the factors of comparability for the purposes of article 15, it must be taken into account, among others factors, the special and general characteristics of the relevant goods and services, the way that the business activities are carried, the contractual conditions and the risk assumed by the parties*¹⁴⁶.

Despite its broad regulatory power in this area, the Argentine Executive Power has produced a regime that is less comprehensive than the Mexican one. For example, it does not include the *business strategy factor* –such as market penetration schemes that may produce the result that a taxpayer temporarily charges a price lower than that of comparable products without violating the ALS¹⁴⁷. This omission may be significant because this factor is explicitly stated in both the OECD Guidelines¹⁴⁸ and the Mexican Income tax Act¹⁴⁹. The open question here is whether the Argentine Executive Power is implicitly rejecting

¹⁴⁵ See above section III.2.a

¹⁴⁶ See Decree 485/99 article 1 (C), passed on May 7, 1999.

¹⁴⁷ See the OECD Report I-13

¹⁴⁸ See the OECD Report I-13

¹⁴⁹ See Article 64-A of the Mexican Income Tax Act.

this factor as relevant in this area. The same open-ended question applies to the *economic circumstance factor* (such as the extent of competition in a given market) that is also omitted.

There is another weakness in the Argentine regulation. It refers to “the special and general characteristics of the relevant goods and services”. However it does not state what aspects of such characteristics are relevant to consider when evaluating a potentially comparable standard. In contrast, the Mexican provision provides guidance in this respect. For example it states: “In the case of financial transactions the aspects to be considered are, inter alia, the following: the amount of the principal, the terms, the debtor’s solvency, the interest rate”¹⁵⁰.

In sum, the Argentine commitment to define comparables should be welcomed. However, better drafting seems necessary to increase predictability in this key area. In effect, better drafting is especially relevant because predictability can not be given by alternative avenues (such as Advance Pricing Agreement) under current Argentine Law¹⁵¹.

a.3-Pricing Methods

A number of pricing methods for applying the ALS is listed in article 15 (5). They are the following.

The *comparable uncontrolled price method* (CUP) is especially reliable when there is an independent party that sells the same product as sold between associated enterprises. Moreover both the independent party and the associated enterprise shall be under similar circumstances –such as equivalent risks. If these requirements are met, the price charged for this product in the controlled transaction must be similar to the price charged in the

¹⁵⁰ Ibidem.

¹⁵¹ The 1995 OECD Report defines Advance Pricing Arrangement (APA) as an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria for the determination of the transfer pricing for those transactions over a fixed period of time (see 1995 OECD Report at G.1). General Resolution 182/98, issued by the (Argentine) Federal Administration of Public Revenues, establishes a system of tax ruling that can be used before a given transaction is made –thus meeting the first APA’s requirement. However, it fails to fulfil the second requirement under which the TP criteria must last for a fixed period of time. In effect, tax rulings under GR 182/98 are valid “[...] up to the issuance of new regulations of the Federal Administration of Public Revenues that amend the said criteria [...]”. Consequently Argentina currently lacks a legal system for APAs.

uncontrolled transaction¹⁵².

The *resale price method* is particularly useful when applied to marketing operations. It seeks to identify the arm's length price of a transaction between associated enterprises -one of which is in charge of providing products (the supplier) and the other is basically involved with marketing them to independent parties (the reseller). This method starts with the price charged by the reseller to an independent enterprise (the resale price). The resale price is then reduced by a gross margin representing the expenses and profits borne by comparable parties under similar circumstances to the reseller. What is left after subtracting the gross margin and other costs from the resale price is deemed the arm's length price of the original transaction between the associated enterprises, that is, the supplier and the reseller¹⁵³.

The *cost plus method* is especially reliable when semi-finished goods are sold between associated parties¹⁵⁴. It begins with the cost born by the supplier in a controlled transaction. Then a mark up is added to this cost for determining the supplier's profits considering the functions it has performed (i.e. the supply of semi-finished goods between associated enterprises). The value so reached is deemed as the arm's length price of the controlled transaction. Both the cost and the profit are taken from comparable enterprises under similar circumstances¹⁵⁵.

The *profit split method* is useful when controlled transactions are so inter-linked that it is not possible to examine them on a separate basis. The first step of this method consists of determining the total profit derived to the related parties from a set of transactions. Then the profits are split in such a way as to replicate the division that independent parties would have agreed if they were in similar circumstances taking into account, for example, the functions performed by them¹⁵⁶.

The *transactional net margin method (TNMM)* focuses on the net profit margin that a taxpayer derives from a controlled transaction relative to a determined base such as assets

¹⁵² 1995 OECD Report, II.2

¹⁵³ 1995 OECD Report II.5.

¹⁵⁴ 1995 OECD Report II-11.

¹⁵⁵ Ibidem.

¹⁵⁶ 1995 OECD Report at III.2.

or sales. Ideally, the net profit margin shall be established by reference to the net profit margin that the same taxpayer realises from comparable transactions with independent entities¹⁵⁷.

These methods seek to facilitate the application of the ALS to a broad variety of factual scenarios – such as marketing operations or transactions with semi-finished products. They are either focused in transactions (such as the CUP) or in profits (such as the profit split method). This is the reason why this list of methods is usually divided into two categories: transactions and profit-based methods.

As was expressly stated by the Senate Committee Report¹⁵⁸, this pricing mechanism of the 1998 Reform is based in the 1995 OECD Report. Hence, Congress is conveying an implicit message to both the taxpayer community and courts that can be expressed as follows. Reference to the 1995 OECD Report (and other commentary produced by the OECD Committee of Fiscal Affairs on this issue) can solve doubts that may arise regarding the application of the new pricing scheme. If the courts, especially the Supreme Court, take into account this message, it may be possible to develop a common cross-border interpretation of the OECD Report that may minimise the risk of double taxation; and, thus, inbound investment in Argentina may be promoted¹⁵⁹.

Moreover, since these methods have been defined by the 1995 OECD Report, the information cost required by foreign investors for understanding their rationale and application is reduced. This may help to promote inward investments. Contrast the opposing approach of Brazil that has developed *sui generis* methods that are only applicable in Brazil.

Article 15 (5) also establishes the *best method rule* (BMR) for selecting pricing methods. Therefore, it is up to the taxpayer to apply the method that, according to his judgement,

¹⁵⁷ 1995 OECD Report III.9.

¹⁵⁸ See the Senate Report presented by congressman Verna, provisional version, at 7, December 7, 1998.

¹⁵⁹ The fact that the OECD Report is in English will not prevent judges and taxpayers to explore this report because English is a language currently well-known by most of them (unlike what happened during previous decades). Telecommunications will facilitate the access to updated versions of the 1995 OECD Report. There are cases decided by the highest courts of a number of countries that followed the OECD commentaries (see Australian case in *re Thiel v. FCT* (1990) ATC 4717 (HC Aust., discussed in [1991] Intertax 184-88). This trend may be followed by the Argentine Supreme Court given the compelling evidence that the OECD Report was instrumental in the design of the 1998 TP Reform.

provides the most reliable estimate of the ALS.

The adoption of this rule by the 1998 Argentine Reform implies a main departure from the 1995 OECD Report because the OECD implicitly rejects such a rule¹⁶⁰. In this aspect, the main sources of the 1998 Reform are the US Internal Revenue Code regulations¹⁶¹.

The adoption of the BMR has been justified in the USA as follows. According to twenty years of experience "... the increasing complexity and diversity of inter-company transactions make a simplistic prioritization of pricing methods unworkable..."¹⁶².

The decision to extend the BMR to Argentina is not convincing. It may provide more flexibility to the pricing mechanism *vis à vis* the OECD pattern. However, it is uncertain whether this advantage outweighs the number of disadvantages that it may produce in the context of a developing country such as Argentina –mainly increased compliance and litigation costs. Moreover, the substantial gap between the USA/Argentine economic development seems to show that the justification developed in the USA for adopting the best method rule can not still be applied to Argentina.

Argentina is the first Latin American country that adopts the BMR. This opens a number of questions such as the following two: I) is the Argentine appeal system sophisticated enough to apply this complex system¹⁶³? II) Given the disadvantages stemming from the application of the BMR, has Argentina put itself into a comparative disadvantages *vis à vis* its main competitors of the region, such as Mexico?

Consequently, the adoption of the BMR seems at least premature and clashes with the Congress' intention to base article 15 (5) on the 1995 OECD Guidelines.

¹⁶⁰ The 1995 Report states that "... *Traditional transaction methods are to be preferred over transactional profit methods as a means of establishing whether a transfer price is at arm's length...*" (See III-16). Note that Mexico decided not to adopt the best method rule.

¹⁶¹ The US Treasury Regulations section 1482-1 states: "... *The arm's length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result*".

¹⁶² Harlow Higinbotham et al, "An economic perspective of the Best Method Rule", *Tax Notes International*, March 22, 1993.

¹⁶³ The Argentine Supreme Court was completely or partially restructured seven times since 1930. On this problem see William C. Banks and Carrió, Alejandro, *Presidential Systems in Stress: Emergency powers in Argentina and the United States*, *Michigan Journal of International Law*, Vol. 15.1, Fall 1993, 1-43 at 25.

b-Export and import of goods

This clause is amended in 1998 for the first time since 1973. It was reworded as follows:

The determination of the income derived from the export and import of goods shall be subject to the following principles:

c) Income derived from the export of goods produced, manufactured, processed or purchased in the country shall be deemed sourced in Argentina. The net income shall be determined deducting from the selling price, the cost of such goods, the expenses of transportation and insurance up to this place, the commission and selling expenses and the expenses up to the place of destination, the commission and selling expenses and the expenses incurred in Argentina, provided they are necessary to obtain the taxable income.

Where the price is not established, or the [price] declared is lower than the wholesale price at the place of destination, it must be taken, saved prove to the contrary, the wholesale price at the place of destination for determining the value of the goods exported.

The Tax Authority [...] may establish that the value of the exported goods shall be determined according to the wholesale price at the place of origin. However, when the real price of the export were higher [than either the wholesale price at the place of origin or destination], the real price will take precedence over them.

Also regarded as export is the shipping abroad of goods produced, manufactured, processed or purchased in the country through subsidiaries, branches, representatives, selling agents or other intermediaries of persons or entities from abroad.

d) Income obtained by foreign exporters by the mere introduction of their products into Argentina is deemed not sourced in Argentina. However, where the price of the sale to the local purchaser is higher than the wholesale price in the country of origin plus transports and insurance expenses up to Argentina, it shall be deemed, unless evidence is submitted to the contrary, that the balance is income sourced in Argentina for the foreign exporter.

The Tax Authority [...] may establish that the value of the imported goods shall be determined according to the wholesale price at the place of destination. However, when the real price of the import were lower [than either the wholesale price at the place of origin or destination], it will take precedence over them.

In the cases where in accordance with the preceding provisions the wholesale price at the place of origin or destination must be applied but it is not publicly and commonly known, or there are doubts about whether it refers to the same goods as imported or to similar ones or where comparison is difficult due to other reasons, the calculation of the prices and income sourced in Argentina shall be made on the basis of the provisions or article 15.

This article will be applied even in the cases where there is no economic link [between the exporter and importer]”¹⁶⁴.

The 1998 Reform amended the export and import clause in order to substantially expand its scope. In effect, this clause not only applies to parties that are associated but also to non-associated parties. This feature of the clause can probably be explained on historical grounds. It appears to be Congress’ over-reaction to the Supreme Court case in re Loussinian, which narrowly construed the definition of *control*, making this clause virtually inapplicable from 1983 up to the 1998 Reform.

The tax authority is thereby empowered to make primary adjustment to the taxpayer’s accounts if the wholesale price test is not satisfied (even if the taxpayer is not associated with the other party). There may be a risk of double taxation. In effect, due to the following reasons it is unlikely that the foreign country in question will be willing to make a secondary adjustment in the taxpayer’s accounts. First, the system of secondary adjustment, as established in article 9 (2) of the OECD Model Treaty, seeks to give relief to the double taxation generally produced by primary adjustments. However, this system presupposes that the parties are associated. Second, the fact that a given transaction does not meet the *wholesale price test* does not necessarily mean that it also violates the arm’s length standard (as envisaged by article 9 (1) of the Model Treaty). This is so because there are circumstances that are consistent with the ALS but not with the wholesale price test –such as market penetration strategies that may produce a temporal reduction of prices below the

¹⁶⁴ Art. 8 of the Act 29053.

wholesale market price.

This risk of double taxation justifies the amendment of this clause in such a way as to return, in this respect, to its 1973 version -plus an additional paragraph referring to the definition of control stated in the 1998 Reform. Hence, both article 15 and the export and import clause would be based on a similar definition of control giving symmetry to this area of the TP regulations.

Another issue regarding the scope of the export and import clause relates to whether it can be applied to transactions with intangibles¹⁶⁵. This is very unlikely taking into account both the history and the wording of the clause. In effect, when this clause was passed in 1946 the main concern of its drafters was the export and import of tangible goods because the Argentine economy was focused on cross-border transactions of agricultural products¹⁶⁶. This purpose is reflected in the text itself of the provision that uses the expression *product* four times –a word that in Spanish only means tangible goods¹⁶⁷. Moreover there is no case law applying this clause to intangibles.

Last but not least, the 1998 Reform repealed the default rule of the export and import clause and redrafted a new one -allowing the employment of the pricing methods listed in article 15 on the basis of the BMR. Hence, the new system works as follows. The wholesale price test is the primary pricing method in the export and import area. However, if it can not be applied (for example, because it is not known) the transaction and profit based methods enumerated in article 15 can be applied on the basis of the BMR.

There is no empirical survey regarding the percentage of cases in which the primary pricing method of the export/import of goods clause can be applied successfully. However, it can be inferred that in the majority of cases it is successfully applied because the wholesale method was the first introduced into the Argentine Law (i.e. 1943) and it remained largely unchanged despite the opposing ideologies of the different Argentine administrations since then. Consequently, the default pricing mechanism (based on the method listed in article 15) will surely play a minor role in the short run.

¹⁶⁵ This issue was raised by Horacio Peña in *Transfer Pricing in Argentina* at 710, op. cit above in footnote 131.

¹⁶⁶ The word used in Spanish is “productos”.

3-The GAAR-ALS tension: How it should be addressed in the sixth period

The 1998 Reform, following the pattern started by the 1976 Reform, has established a detailed scheme for applying the ALS to TP cases. This comprehensive scheme shows that Congress' intention is that TP abuses shall be addressed in the light of ALS instead of the GAAR. In other words, the message conveyed by Congress seems to be that courts are not allowed under the 1998 Reform to apply GAAR in the TP area. This prohibition is probably a result of the undesired effects that this application produced during the fourth period. Moreover, there is no statutory basis in the 1998 Reform that could justify the use of the GAAR to fill gaps left opened by the ALS.

This intention of the 1998 Congress seems consistent with the purpose of the drafters of the GAAR. In effect, the ALS was introduced in the area of export and import of goods in 1943 and then extended to other types of transactions in the 1946 Reform. In 1946 the GAAR was also introduced into Argentine Law. Therefore, the fact that both ALS and GAAR were passed in the same year shows that their drafters wanted to give them different scopes. This 1946 rationale seems to be shared by the 1998 Congress.

IV- Conclusions

The first point argued in this paper is that Argentina has developed six different approaches to the transfer pricing problem since Income Tax was introduced in 1932 up to the 1998 Reform.

These approaches fairly support the proposition that the structure of the government revenue-system generally is a function of the socio-economic development of a country. In effect, Argentina passed in 1943 a legal scheme based on the arm's length standard targeted to curb transfer pricing (TP) manipulation only in the context of import and export of goods. (This type of manipulation was a problem to the Argentine economy that, by then, was centred in cross-border transactions of agricultural products.) The arm 's length standard was later extended to other types of transactions by the 1946 Reform. However, it was so poorly drafted that the issue of TP abuses in transactions other than export and imports of goods only started to be seriously addressed from the early Sixties (when the

¹⁶⁷ Guillermo Cabanellas de las Cuevas, Eleanor C. Hoague, *Diccionario Jurídico*, Volume II, Editorial Heliasta, 1990, at 517.

Argentine economy moved to its early industrial stage).

Since 1961 up to the mid-Seventies courts were activist in the TP arena. They decided to employ the general-anti-avoidance-rule as an alternative legal basis to combat TP abuse. This reaction was triggered for a number of reasons, such as the lack of precision and fairness of the arm's length standard (as it had been implemented by the 1946 Reform) and the perception that some multinational enterprises were engaged in aggressive transfer pricing manipulation. This judge-made approach, backed by a 1973 Act passed by an unanimous Congress, led to a number of unsatisfactory consequences –mainly the discrimination against foreign multinationals *vis à vis* national multinationals that produced a non-neutral capital import system thus deterring foreign inward investment.

The 1976 Reform, passed a few days after the 1976 military coup, attempted to produce a balanced approach towards national and foreign multinational enterprises. However, it also failed to curb TP abuses because key concepts of the system (such as that of comparable transactions) were not defined.

The second point argued in this paper is the following. The 1998 Reform implies that Argentina is not following the trend started by Mexico in 1996 of amending its TP legislation to fully implement the 1995 OECD Guidelines. In effect, the 1998 Argentine Reform does not fully embody these guidelines for, at least, four reasons.

First, the 1998 Reform, instead of redrafting the TP scheme from scratch, adds new paragraphs to the old ones. Hence, many of the former provisions –such as the 1976 version of article 14¹⁶⁸ remain largely unchanged. Second, the 1995 OECD Guidelines pricing methods only apply by default in the import and export clause (the primary pricing method is the wholesale price test that under certain circumstances may conflict with the arm's length standard). Third, in transactions other than export and imports of goods, the pricing methods backed by the 1995 Guidelines apply as primary tests; however this is on the basis of the *best method rule* – an approach that has been implicitly rejected by the OECD. Finally, the export and import clause empowers the tax authority to make primary adjustments even if the parties are not associated. This rule violates article 9 of the OECD Model Tax Convention on Income and on Capital and may produce international double taxation.

¹⁶⁸ Article 14 establishes, inter alia, that intra-firm transactions of foreign multinational enterprises must be consistent with the arm's length standard (see above section II.5.a).

Despite these weaknesses, the 1998 Reform is the best-drafted TP framework produced in Argentina so far. This is because it does not repeat the main policy errors made during the previous five (unsuccessful) approaches.

This reform is also significant in the following respect. It is the first time that a non-military government explicitly backs the arm's length standard in Argentina. This factor is noteworthy because it gives to the 1998 Reform a better chance of continuity since it was the product of a consensus between the two leading parties.

Finally, the Argentine 1998 Reform may also have implications in Latin America. This is so because it has opened a fruitful debate among Latin American non-OECD members on the advantages and disadvantages of following the 1995 OECD Report when designing their TP schemes¹⁶⁹.

¹⁶⁹ See, for example, a recent conference held in Buenos Aires where representatives of several Latin-American countries joined to discuss transfer prices regulations of the region, the impact of the 1995 OECD Guidelines, and future trends (Transfer Pricing, Vol. 7, N 25, at 970, April 21, 1999).