



cutting through complexity

GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

Costa Rica

kpmg.com/gtps

TAX



Costa Rica



KPMG observation

The new Costa Rican transfer pricing rules enacted in September 2013 not only request Costa Rican tax payers to carry out their intercompany transactions at an arm's length value following the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines but also have established formal transfer pricing obligations to be accomplished annually. Specific regulations related to the formal obligations are still pending at this time.

Even though general transfer pricing rules have been recently enacted, the Costa Rican Tax Authority has been able to adjust intercompany transactions if they were not in accordance with the arm's length principle since 2003. Moreover, some transfer adjustments assessed by the Tax Authority for prior years have been ratified by the Constitutional Court and by the Supreme Court of Justice.

Basic information

Tax authority name

Dirección General de Tributación (DGT).

Citation for transfer pricing rules

Decree 37898-H published on 13 September 2013

Effective date of transfer pricing rules

New transfer pricing rules are effective since fiscal year 2013.

What is the relationship threshold for transfer pricing rules to apply between parties?

Parties will be deemed to be related if one of the following cases applies:

- when one person or company directs or controls the other, or holds, directly or indirectly, at least 25 percent of its capital stock or voting rights;
- when five persons or fewer direct or control both related parties, or possess, directly or indirectly, a participation of at least 25 percent in the capital stock or voting rights of both entities;

- when entities are considered to be part of the same business group (unidad de negocio), if one of them is a member or participant of the other and is related to it in any of the following situations: (i) holding a majority of voting rights; (ii) having the power to appoint or remove members or through its legal representative to intervene in the other entity; (iii) through agreements with another partner, having the majority of voting rights; (iv) having appointed the majority of the board members exclusively by their votes; or (v) a majority of the members of the governing body of the legal entity are ombudsmen, managers or board members of the related party or the other party dominated by it; or
- when two or more companies comprise a decision making bloc with regard to a third company, all them are considered to be a business group.

Also in the following situations:

- in a contract of collaboration or joint venture, when one of the participants holds, directly or indirectly, 25 percent of the results or profit under the contract;

- a resident in Costa Rica and a distributor or exclusive agent of a foreign jurisdiction;
- a distributor or exclusive agent, resident in Costa Rica, of a resident of a foreign jurisdiction;
- a resident entity and its permanent establishment abroad; or
- a permanent establishment resident in Costa Rica and its foreign parent company, as well as another permanent establishment of the same company or a person associated with it.

What is the statute of limitations on assessment of transfer pricing adjustments?

The normal statute of limitations is 4 years. This term is extended to 10 years for those taxpayers who (1) have not filed their tax returns, (2) have not registered as taxpayers before the Tax Administration, or (3) have filed tax returns that have been deemed fraudulent. The statute of limitations starts counting from 1 January of the year following that in which the tax should have been paid.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. Taxpayers must prepare the transfer pricing documentation demonstrating controlled transactions are at arm's length value. This documentation must be retained by taxpayers during the statute of limitations after submitting the income tax return.

Additionally, taxpayers categorized as large taxpayers or large territorial companies, or that operate under the free trade zone incentive system, must file, on an annual basis, an informational return by the deadline and under the conditions to be established by the Tax Authority.

What types of transfer pricing information must be disclosed?

The information must include data related to the group and to the taxpayer, as well as information regarding the controlled transactions, their nature and amount, the methods applied, comparable data used and results.

What are the consequences of failure to prepare or submit disclosures?

Failure to prepare or submit disclosures may result in a penalty equivalent to 2 percent of the taxpayer's previous year's income. This penalty has a minimum of 10 base salaries (approximately 7,270 US dollars (USD)) and a cap of 100 base salaries (approximately USD72,700). Furthermore, the Tax Administration would be entitled to make its own determination of what the appropriate price for related party transactions should have been.

Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

Yes, a transfer pricing study is required for all transactions carried out with related parties.

Failure to prepare a transfer pricing study may result in a penalty equivalent to 2 percent of the taxpayer's previous year's income. This penalty has a minimum of 10 base salaries (approximately USD7,270) and a cap of 100 base salaries (approximately USD72,700).

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

It can mitigate the risk the Tax Authority can adjust transactions without applying the arm's length principle. Also the burden of proof is also shifted to the tax authority.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

The transfer pricing documentation should be prepared contemporaneously with the tax return and should be submitted upon request of the DGT.

When a transfer pricing study is prepared, should its content follow Chapter V of the OECD Guidelines?

Yes.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes. But there is also the possibility of applying other methods to analyze export and import transaction of goods with international price quotations. Specific regulations regarding these other methods are still pending.

Is there a priority among the acceptable methods?

No.

If there is no priority of methods, is there a "best method" rule?

Yes. Taxpayers must apply the most appropriated method for each transaction under analysis.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, how long does the taxpayer have to submit its documentation?

The taxpayer has 10 work days to submit whatever information the Tax Administration requests.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

In principle yes, but it has been a very consistent practice of the government and of the State's Attorney's Office not to allow alternative dispute resolution options for matters regarding taxation.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

One of the following penalties may be applied:

- 50 percent of the incremental tax that is determined (this is the base case, applicable for 'inaccuracy' upon filing a tax return).
- 100 percent of the incremental tax that is determined (this penalty applies when the adjustment derives from information that had been withheld from the Tax Administration).
- 150 percent of the incremental tax that is determined (this penalty applies when the taxpayer has incurred 'substantial' anomalies in its accounting records, used falsified supporting documentation or used intermediate persons or entities with the purpose of hiding its identity).

To what extent are transfer pricing penalties enforced?

The Tax Administration automatically applies these penalties every time there is a tax adjustment, and they never negotiate.

What defences are available with respect to penalties?

The taxpayers need to demonstrate that they have been diligent. They need to convince the Tax Administration that they have analyzed the tax positions taken and that they are convinced that their position is in accordance with the law. The Tax Administration may disagree with the taxpayer in those cases and still make a tax adjustment, but that would allow the taxpayer to avoid a penalty. It is therefore very important to document the client's transfer prices. The use of an APA would also be a mechanism that would protect the taxpayers from harsh penalties.

What trends are being observed currently?

The Tax Administration has made a significant number of adjustments based on what they consider to be Comparable Uncontrolled Prices (CUPs). They have made several adjustments to companies that have a local manufacturing facility that sells both to local independent distributors and to related parties in other countries. The Tax Authorities have applied the price used with the third party distributor to related parties, without making adjustments (e.g. for volume, functions or risks incurred).

Special considerations

Are secret comparables used by tax authorities?

The Tax Administration has said that they will not use secret comparables. They have not used secret comparables in the past.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

No. There is very limited public local information.

Do tax authorities have requirements or preferences regarding databases for comparables?

No specific requirements have been officially made.

What level of interaction do tax authorities have with customs authorities?

They do not have a high level of interaction with customs authorities.

Are management fees deductible?

Yes. When evidence can be provided that the services were necessary and actually rendered. If no support can be provided, then the tax authority will consider them as non-deductible.

Are management fees subject to withholding?

Yes, they are subject to a 15 percent withholding tax when they are deemed to be Costa Rica source income. The Tax Administration has been aggressively expanding the definition of Costa Rica source income to include virtually all management fees.

Are year-end transfer pricing adjustments permitted?

To be determined. This type of adjustment is not mentioned by the new rules and there is no experience to date with the tax authority.

Other unique attributes?

None.

Other recent developments

Specific regulations regarding the transfer pricing informative return and the Advance Pricing Agreement (APA) program are expected to be enacted in the coming months.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Minimal.

If extensive, is the competent authority effective in obtaining double tax relief?

No experience.

When may a taxpayer submit an adjustment to competent authority?

Depends on the time frame allowed by the tax treaty. The only double tax treaty currently in effect is one with Spain, and it states a 3 year term from the first notice of the measure that may imply a taxation that is not in accordance with the provision of the treaty.

May a taxpayer go to competent authority before paying tax?

In principle yes, but there is no experience yet in Costa Rica regarding that matter.

Advance pricing agreements

What APA options are available, if any?

Unilateral.

Is there a filing fee for APAs?

The specific regulation is not published yet.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

Not applicable. This program has not yet started.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

Not applicable. This program has not yet started.

Language

In which language or languages can documentation be filed?

Documentation must be in Spanish.

KPMG in Costa Rica

Sergio Garcia

Tel: +(506) 2201 4100

Email: sgarcia1@kpmg.com

As email addresses and phone numbers change frequently, please email us at transferpricing@kpmg.com if you are unable to contact us via the information noted above.

kpmg.com/socialmedia



kpmg.com/app



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2014 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.

Designed by Evalueserve.

Publication name: Global Transfer Pricing Review

Publication number: 131196

Publication date: June 2014