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Your Partner in a Changing World

TRANSFER PRICING



**ARE YOU COMPLYING WITH THE
REQUIREMENTS ?**

Dear Sir, Madam,

The year 2008 has come to an end, and some of you are already starting with the preparation of the 2008 financial statements.

As we have informed you already in our previous **WTS** Tax Special, as per January 1, 2008 transfer pricing requirements were introduced. In this letter we would like to focus your attention on these requirements, since the Servicio di Impuesto y Aduana (the Aruba tax authorities, hereinafter: SIAD) is becoming much stricter in the event the documentation is not present.

Reasons for incorporating the transfer pricing requirements in the law

If related parties participate in transactions that can be deemed not at arm's length, profits can be shifted from one tax payer to another. In practice, some tax payers try to allocate profits to low tax payers, implying the tax burden is decreased. The SIAD can only challenge such profit allocations in case of shareholders' relationships. Since the at arm's length criterion has a broader interpretation, a new definition should be introduced.

Transfer pricing requirements – when applicable?

In case a corporate person or individual participates, directly or indirectly, in the management, supervision or the capital of two or more corporate entities, the conditions which are applicable to the supply of goods and the rendering of services between these entities must be arm's length, i.e. similar to the conditions that would have been closed with third, unrelated, parties.

Unfortunately, any participation already leads to application of the transfer pricing requirements. If one shareholder has 1% of the shares in company A and 100% of the shares in company B, a relation is deemed present. Also being a supervisory director of company A and being director of company B leads to a relation.

If applicable – what to do?

In case a relation via management, supervision or capital exists, documentation to substantiate the arm's length transactions must be kept in your administration. This documentation should include – according to the explanatory notes – e.g. (i) the agreement, (ii) the transfer pricing method that was chosen, (iii) why this method was chosen and (iv) how the consideration has been determined.

Of the documentation, choosing the best transfer pricing method will be the most difficult criterion. Generally, the following methods can be used (as per the OECD Committee):

- Comparable, uncontrolled, price, i.e. the price of the non-related, similar, transaction.
- Resale price.
- Cost-plus.
- Transactional net margin.
- Profit split.



Transfer pricing documentation – keep them in your administration

The transfer pricing documentation is included in the administration obligation of article 48, General State Ordinance on Taxes and allows the SIAD to determine if at arm's length transactions have taken place. Not complying with the documentation obligation may result in the reversal of the burden of proof.

Possible consequences if the transfer pricing requirements are not met

As mentioned above, not complying with the documentation obligation may result in the reversal of the burden of proof.

If the SIAD deems the pricing not at arm's length, the SIAD can transform the transaction into an at arm's length transaction. Usually the pricing will be amended. If for example the intercompany price is determined on 100, while the SIAD deem the at arm's length price 80, a correction of 20 will be made. The remaining 20 may be transformed into a dividend distribution. This deemed dividend is subject to dividend withholding tax, while the applicable rate varies between 0%, 5%, 7.5% and 10%, depending on the country of residence of the shareholder.

After the at arm's length transaction and pricing has been established, it will have to be determined if the payment is tax deductible for Aruba tax purposes. Summarizing, the payment is only deductible if your company can make credible that:

- The receiving entity is – from a fiscal point of view – not related^[1] to you; or
- The receiving entity is, directly or indirectly, for at least 50% of the shares and voting rights, listed at a qualified stock exchange; or
- The receiving entity pays an effective tax rate of at least 15% on the payment.

If one of these criteria is not met but the receiving entity is subject to a tax over its income, 75% of the payment can be deducted.

Transfer pricing documentation – examples of possible transactions

It is our experience that many intercompany transactions do not comply with the requirements per January 1, 2008. Not complying with the transfer pricing requirements may lead to corrections by the SIAD and even to the reversal of the burden of proof, i.e. you will have to prove that the estimates of the SIAD are incorrect. Intercompany transactions that may be subject to the documentation requirements are amongst others:

- Management
- Administration
- Royalty
- Loans
- Rent
- Supply of goods or rendering of services.



[1] A relation is deemed to exist if interests over 1/3. We will not elaborate in detail.

How may **WTS** assist you with the transfer pricing requirements?

The team of WTS can assist you with the following:

- Determine if a relation is present which could lead to the documentation obligation.
- Determine if the documentation present complies with the requirements.



If you would like to know if you are in compliance with the at arm's length requirements, we can perform a quick scan at your organization. A quick scan focuses on the most obvious comments the SIAD would have and identifies any visible exposure you may have. Contrary to a due diligence however, it is cost efficient and does not burden your organization. We would be happy to provide you with a fee proposal should you require so.

Additionally, **WTS** can also assist you with:

- Preparing or amending any documentation that is missing or incomplete.
- Determine if the pricing chosen can be deemed in accordance with the at arm's length requirements as per the OECD model convention.
- Determine if the – at arm's length – payments made are tax deductible.
- Make suggestions to mitigate the consequences of the limitations in the deduction of payments.

Should you have any questions, wish a fee proposal for a quick scan or would like a personal meeting, please contact us via:



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