



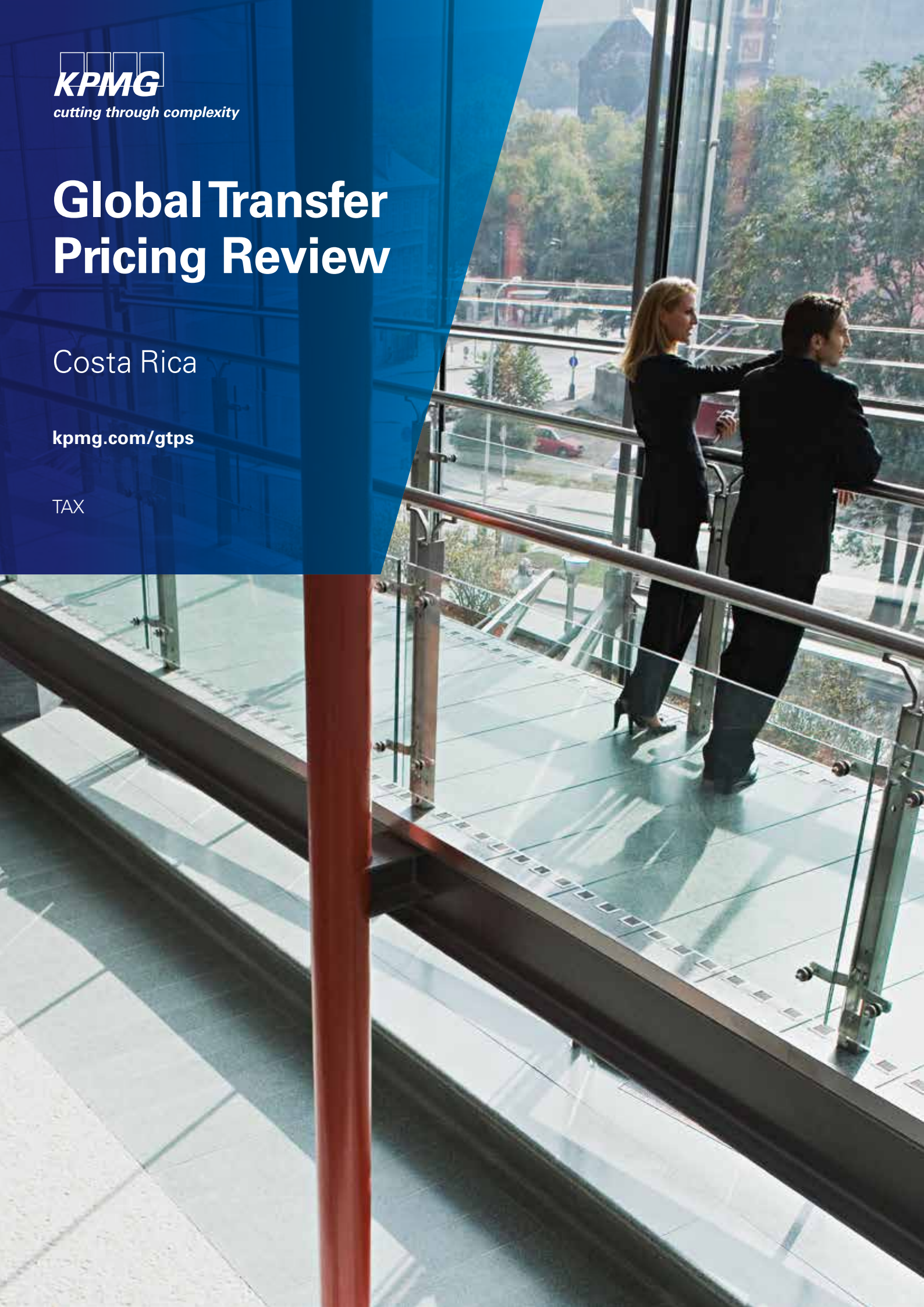
cutting through complexity

Global Transfer Pricing Review

Costa Rica

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TAX



Costa Rica

KPMG observation

The Costa Rican transfer pricing regulations, enacted in September 2013, not only require Costa Rican taxpayers to carry out their intercompany transactions at arm's length following the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines but also have established formal transfer pricing obligations to be completed annually. Taxpayers have been required to prepare transfer pricing studies since 2013. The transfer pricing information return will have to be completed starting with a taxpayer's fiscal 2015. Specific regulations regarding the filing of this return are yet to be enacted.

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.

In recent tax audits, the Tax Authority has requested the 2013 transfer pricing report of companies classified as large taxpayers.

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Applicable	Required to be contemporaneous
Legal requirements	●	●
Protection from penalties	●	●
Reduce risk of adjustment	●	●
Shifts burden of proof	●	●

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 four 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 submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. 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 submit disclosures?

Failure to prepare or submit disclosures may result in a penalty equivalent to two 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

Can documentation be filed in a language other than the local language? If yes, which ones?

No.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, for all transactions.

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

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Yes. 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.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 10 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

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

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

In principle dispute resolution options are available. However, 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 defenses are available with respect to penalties?

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). For example, 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. In such cases, the Tax Administration has applied the price used in the transactions with the third party distributors to the transactions with 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?

There are no official requirements.

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes, always.

Does the tax authority have other preferences in benchmarking? If so, please describe.

Due to lack of publicly available local information, international companies are accepted as comparables.

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

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

Are there limitations on deductibility of management fees beyond the arm's length principle?

Yes. Several conditions must be met in order to avoid some limitations on the deductibility of management fees:

- the taxpayer needs to provide evidence that the services were actually rendered and be able to prove that they were necessary to generate taxable income
- the taxpayer needs to prove that the services were not duplicative of other functions carried out within Costa Rica. If no support can be provided, then the Tax Administration will consider them as non-deductible
- the taxpayer needs to have a contract in place and abide by the terms of the contract. Lack of a contract or a contract that does not correspond with the services actually provided or the parties actually involved may create tax risks; and
- any applicable withholding must be levied.

Even if the above conditions are met, there are limitations in the law as to the amount of fees that a taxpayer may deduct. Specifically, a cap equal to 10 percent of a taxpayer's gross sales.

Are management fees subject to withholding?

Yes.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

Yes. Several conditions must be met in order to avoid some limitations on the deductibility of royalties:

- the taxpayer needs to provide evidence that the royalties paid were necessary to generate taxable income

- the taxpayer needs to have a contract in place and abide by the terms of the contract. Lack of a contract or a contract that does not correspond with the intangible that was licensed or other inaccuracies, or the parties actually involved may create tax risks; and
- any applicable withholding must be levied.

Even if the above conditions are met, there are limitations in the law as to the amount of royalties that a taxpayer may deduct. Specifically, a cap equal to 10 percent of a taxpayer's gross sales.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes. These adjustments must be explained in the book to tax reconciliation. Year-end adjustments may be captured in this reconciliation.

Other unique attributes?

None.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

There is only one double tax treaty currently in effect with Spain. Double tax treaties with Germany and Mexico have been signed, but have not yet been approved by the Legislative Assembly.

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 three 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 this matter.

Advance pricing agreements

What APA options are available, if any?

Unilateral.

Is there a filing fee for APAs?

Not applicable. The specific regulation is not yet published.

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.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

Not applicable. This program has not yet started.

KPMG in Costa Rica

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