

“TRANSFER PRICING REFORM ANALYSIS: IMPLICATIONS OF LEGISLATIVE ACT 1663”.

Legislative Act 1663 will take effect on January 1, 2025, introduces modifications to the Tax Law, specifically concerning the valuation methods applicable in the field of transfer pricing. This analysis explores the implications of these changes, their justification and potential consequences.

PRECEDENTS AND CONTEXT:

The transfer pricing issue in Peru is not new. Legislative Act 1312, published on December 31, 2016, had already introduced the possibility of using “other methods” of valuation. However, the lack of adequate regulatory development left this provision in limbo, resulting in the rejection of its application by the Tax Court several times. In that sense, Legislative Act 1663 comes to correct this deficiency, providing a more robust and detailed regulatory framework.

MAIN MODIFICATIONS:

Legislative Act 1663 introduces several significant changes that will transform the transfer pricing landscape in Peru:

- **New valuation methods for transfer pricing:** other valuation methods are incorporated for transfer pricing transactions, aiming for a better reflection of the economic reality of the transactions.
- **Conditions for the use of other methods:** specific conditions are established for the use of alternative methods, including that the prices correspond to values between independent parties and that the chosen method is the most appropriate to reflect the economic reality.
- **Specific methods for not listed shares:** for not listed shares or participations, the discounted cash flow method, the multiples method, the equity method and appraisal are permitted.
- **Extension of methods for other transactions:** the discounted cash flow method, the multiples method, equity method, appraisal and the Multi-Period Excess Earnings method (MPPE) are included.
- **Discounted cash flow method limitations:** cases are established where this method cannot be applied, like when the participation is less than 5% or the company's income does not exceed 1700 Tax Units.
- **Technical report requirement:** contributors must have a technical report to credit the determination of the market value when using these alternative methods.
- **Effectiveness and regulation:** the changes will take effect on January 1, 2025, and regulatory standards will be dictated for their correct implementation.

REFORM’S JUSTIFICATION:

The explanatory statement of Legislative Act 1663 presents a series of arguments justifying the need for this act:

- **Equity value concentration:** The concentration of 90% of equity value (S/. 5,832 billion) in just 1,532 contributors in 2021 highlights a significant disparity. This concentration not only emphasizes the importance of an accurate regulation in equity valuation, but also underlines the potential tax impact of related party transactions in this small but powerful segment.

- **Raising volume and value of transactions:** The substantial raising in the number of transactions (84,385 in 2021) and, more significantly, the raising in the nominal value transacted outside centralized mechanisms from S/ 15,194 million in 2019 to S/ 32,091 million in 2021, reflects an evolving market dynamic. This growth demands more sophisticated valuation methods that are adaptable to the complexity of these transactions.
- **Rise of intangible assets:** The soaring increase in the aggregate value of intangible assets, from S/ 142,056 million in 2016 to S/ 218,688 million in 2021, represents a paradigm shift in the composition of corporate assets. This trend underscores the urgent need to implement valuation methods that can adequately capture the value of these increasingly prevalent and complex assets.
- **Escalating royalty expenses:** The near doubling of deductible royalty expenses to non-domiciled, from S/ 1,278 million in 2017 to S/ 2,403 million in 2022, raises concerns about the potential erosion of the taxable base. This increase calls for more stringent regulation and more accurate valuation methods to ensure that these transactions truly reflect the arm's length principle.
- **Inadequacy of current methods:** The fact that 55.66% of transactions reported by 3,204 contributors in 2023 used the Transactional Net Margin Method is indicative of the limitations of existing methods. This predominance suggests a lack of adequate options to value more complex transactions, evidencing the urgent need to expand and diversify the available valuation methods.

IMPLICATIONS AND CHALLENGES:

The implementation of this reform brings with it both significant opportunities and challenges. On the one hand, it promises to improve accuracy and fairness in the valuation of related party transactions, aligning with OECD guidelines and strengthening Peru's position in the international tax arena. On the other hand, it presents considerable challenges in terms of implementation and adaptation, both for the tax administration and contributors.

The success of this reform will depend mostly on how the regulations are implemented and on the appropriate guidance provided by the tax administration to contributors. Anticipation and preparation will be critical for a successful transition to these new valuation methods.

APPLICATION OF SIMILAR METHODS IN THE INTERNATIONAL CONTEXT

The implementation of alternative transfer pricing valuation methods is not unique to Peru. Several countries, especially those adhering to the OECD guidelines, have adopted similar approaches:

1. Colombia has been a pioneer in the region by explicitly incorporating the discounted cash flow method in its regulations. Article 260-3 of the Colombian Tax Statute establishes that for Sales and Purchase Agreements of not listed shares, commonly accepted financial valuation methods must be used, prioritizing the calculation of the market value through the present value of future income.
2. Since 2018, Argentine legislation establishes in Law No. 862/2019 that "Other methods" may be used to set prices in transactions involving valuable intangible assets or not listed financial assets without comparable. This option is valid when

the characteristics of the activity prevent the use of traditional methods and adequate documentation is available. This flexibility is similar to the Peruvian approach to complex assets.

3. Chile, according to Article 41 E of the Tax Law, allows the use of residual methods to determine transfer prices in situations where conventional methods are not applicable. The contributor must justify the choice of this method and select the most appropriate one according to the characteristics of the case, considering the advantages and disadvantages of each one.
4. In the European context, Spain offers a relevant example. Article 18 of the Spanish Corporate Tax Law foresees that, when it is not possible to apply traditional methods, other generally accepted valuation methods and techniques that respect the arm's length principle may be used.
5. The United States, through its Internal Revenue Service (IRS) regulations, also allows the use of unspecified methods when they provide the most reliable measure of the arm's length result.

The incorporation of alternative valuation methods in transfer pricing represents a global trend towards greater flexibility and precision, with an increasing emphasis on the valuation of intangible assets and complex transactions. This regulatory evolution, observed in various countries including Peru, maintains as its foundation the arm's length principle aligned with OECD guidelines, and reflects a concerted effort to adapt tax rules to the complexities of modern transactions in an increasingly globalized and digitized business environment.

What do you think? How are these changes going to affect you? Let us know in the comments.

***For further detail, check: <https://spijweb.minjus.gob.pe/wp-content/uploads/2024/09/DL-1663.pdf>**



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