



New Rule Adopted on Transfer Pricing Methodology, Requirements

by António Corte-Real Neves and Bruno Santiago

The Portuguese government recently approved Rule 1446-C/2001 on Transfer Pricing, which regulates new article 58 of the Corporate Income Tax Code (CITC) and follows the 1995 OECD transfer pricing guidelines for multinational enterprises and tax administrations.

The main purpose of the rule is to determine transfer pricing methods and the nature and type of supporting documentation and secondary adjustments required, but the rule also regulates in detail areas already covered by article 58. The new rule applies the separate entity approach to intragroup transactions, taxing individual group members as if they were acting at arm's length.

The rule is applied to:

- operations between residents with a special relationship (as defined by article 58 of the CITC);
- operations between residents and nonresidents with a special relationship; and
- operations between a nonresident and its permanent establishment in Portugal and between the PE in Portugal and any other PEs of the nonresident.

To adjust the intragroup transaction to meet the arm's-length principle, the rule adopts the following transfer pricing methods: the comparable uncontrolled price method, the resale price method, the cost plus method, the profit split method, the transactional net margin method, and others.

The taxpayer is obliged to maintain for 10 years records that can prove that it followed the most correct transfer pricing method provided in the rule, unless its profits were less than €3 million the

preceding year. The records must include, among other items, a description of the special relations between associated enterprises (origins, evolution, and so on), contracts between them, an explanation of the method used to comply with the arm's-length principle, proof that the taxpayer used the most suitable method to determine transfer pricing, and strategies and business policies that influenced the transfer pricing determination.

Those examples demonstrate the completeness and complexity of the records and suggest the difficulties enterprises will face in complying with the rule, difficulties that surely will be a point of discussion between tax authorities and taxpayers. For that reason, tax authorities are preparing an administrative guideline.

Another area addressed in the rule follows the recommendations of the Commission for Portuguese International Taxation Reform on agreements between enterprises with a special relationship. The relevant agreements are:

- cost contribution agreements, in which two or more companies agree to proportionately share the costs and risks of the production, development, or acquisition of any rights or services; and
- intergroup service agreements, in which one company of the group offers or provides extensive activities to the others.

Correlative adjustments between residents occur when tax authorities make an adjustment to a company's taxable profits as a result of adjusting the taxable profits of the associated company because of the application of the arm's-length principle to

transactions conducted between them. In that case, tax authorities will, *ex officio*, make correlative adjustments within 180 days after the first adjustments were made.

Also, if the tax authorities of another state with which Portugal has entered into a double taxation convention make an adjustment to the taxable profits of a company or PE in that state due to transactions made with a company or PE in Portugal with which it has special relations, Portuguese tax authorities can make the correlative adjustments under the terms established in the convention. In that case, the Portuguese company or PE in Portugal must make a request to Portuguese tax authorities,

along with the documentation established in the rule. The request will be decided within 120 days after the agreement obtained with the tax authorities of the other jurisdiction, as provided in the convention.

Other than adjustments to taxable profits by tax authorities, no penalties have been established for those who fail to comply with the significant obligations established by the rule. ◆

◆ *António Corte-Real Neves and Bruno Santiago, associate lawyers, Marais Leitão, J. Galvão Teles & Associados*