INTRODUCTION

Why are the countries in Latin America, which are the richest in natural resources, condemned to be the poorest and most unequal in the world?

This question opens the debate on the paradoxical disadvantage of possessing territories that are abundant in minerals, hydrocarbons, soils, wood, biodiversity, water and other natural resources of strategic importance for the insatiable economic development of the developed countries, combined with the misfortune into which our countries fall in the insatiable ambition for power of only a few. The topic on the under-development of nations, whose economies are based on the extraction of their natural resources, is always current. We refer to the legal gaps in the tax system, the discrepancy between national and international tax laws and the universal declarations on human rights claimed in our constitutions.

We already have declarations that protect levying by foreign laws that undermine our national tax systems, such as the American Declaration of Man’s Rights and Duties established in 1948 at the IX International American Conference held in Bogota.

Article XXXV
Everyone has the right to cooperate with the State and the community in social assistance and security in accordance with their possibilities and the circumstances.

Article XXXVI
Everyone has the duty to pay the taxes established by Law to sustain the public services.¹

However, it was only when the process of Financing for Development (FpD)² was begun in Monterrey that the protection of these duties was assured on the international level – as well as the support of the foreign states in compliance with the duties of their citizens found in other countries. This declaration has resulted in placing more emphasis on international tax cooperation as a method for cooperation in development, technical assistance, and state cooperation in research and public policies.

‘Strengthen international cooperation in tax matters, improving the dialogue among national tax authorities and increasing the coordination in the work of the competent multilateral agencies and the pertinent regional organizations, paying special attention to the needs of the developing countries with economies that are in transition’ – Declaration of Monterrey 2002 Art 64

Rights cost money, and this cannot be achieved without a strong focus on paying taxes at all levels: national, regional, and international. Just like fulfilling rights, this is a budgetary cost to which individuals and companies must contribute with their fair share,
while States have to use these resources in a transparent, responsible manner. In none of the poor regions of the world has the economy taken off based on the exploitation of their natural resources. What is worse, the inhabitants have become poorer. With very few exceptions, those regions with abundant natural resources are under-developed today.

Graph 1: Gini Index on the per capita income in the home

Note: The Gini Index considered in each case corresponds to the last year for which there is available data during the period between 1995-2005.

But for some economies, this happens not despite their natural riches, but rather due to them, thus we find that in many Latin American countries, characterized by their low governance, institutional instability, the absence of democracy, a lack of transparency in government management and access to public information, the benefits generated by the exploitation of natural resources are to be found in an elite group with airs of a monopoly that limit social development without generating any social capital and economic development.

It is usually understood that a progressive tax system is the best way to reduce this inequality by means of a redistribution of the income.
The lack of this redistribution, transparency and good governance are amplified by the lack of an efficient, transparent tax system. This process of an unequal accumulation of resources introduces an illicit financial flow, defined as the use, transfer or illicit destination of the financial flow, including commercial flows and capital flows.

The regions that are affected by the curse of [having] natural resources are apparently condemned to depend more and more on the production of our main raw materials, even the Asian economies of today. This strengthens the oil income for those governments who benefit from the exploitation of these resources and grow as large economic groups, but the concentration of these resources leads to their political empowerment and a control that excludes more and more basic policies for the full development of the society to which the owe themselves.

Because they have exclusive control over transfers and taxes, which helps them to retain their political power, they give themselves the satisfaction of not listening to the real demands of their citizens, while they are co-opted by means of a clientele system that distributes handouts and help, useful mechanisms to discourage the citizen’s control over the public administration. Thus a vicious circle of mutual dependence is created, whose end result is corruption in every area of social and political life. A more transparent tax system, one that represents the citizens and their interests through stakeholders in non-government organizations, unions and professional associations, can break this vicious circle.

Considering the paradox presented above, this document refers to one of the mechanisms through which one of the most predominant areas of world economies, such as the case of oil and the riches that it generates, is transferred outside of the continent where it produces through the manipulation of the ‘transfer prices’. It defines a commercial transfer that takes place between the subsidiaries of the multinational itself, causing illicit flows that translate into a tax loss.

**Graph 2: Tax Losses caused by the Manipulation of Trade Prices**

<table>
<thead>
<tr>
<th>Country</th>
<th>In Millions of U.S. Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bolivia</strong></td>
<td></td>
</tr>
<tr>
<td>Average tax losses</td>
<td>27.8</td>
</tr>
<tr>
<td>Tax Income</td>
<td>1,919.8</td>
</tr>
<tr>
<td>Total (%)</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Ecuador /a</strong></td>
<td></td>
</tr>
<tr>
<td>Average tax losses</td>
<td>137.5</td>
</tr>
<tr>
<td>Tax Income</td>
<td>3,300.0</td>
</tr>
<tr>
<td>Total (%)</td>
<td>4.2</td>
</tr>
<tr>
<td><strong>Nicaragua</strong></td>
<td></td>
</tr>
<tr>
<td>Average tax losses</td>
<td>217.0</td>
</tr>
<tr>
<td>Tax Income</td>
<td>783.3</td>
</tr>
<tr>
<td>Total (%)</td>
<td>27.7</td>
</tr>
</tbody>
</table>

*Source GFI 2010, prepared by Kohonen, 2011.*
As we can see in the graph, the oil producing countries are the most affected in the region. Trade Prices include the ‘transfer prices’ between the subsidiaries of multinational companies, as well as the market prices between unrelated parties that connive to misprice commercial transactions.

Thus we find ourselves with a document that, besides having an ambition to reveal great truths on Latin America’s economy, deficits and social injustice, proposes case studies of three countries in the region – whose common denominator is the preponderance of oil in their economies, either as an exploited natural resource (Ecuador and Bolivia), in the exploration phase (Nicaragua), or as a private Agreement-Business between governments (PDVSA-Nicaragua).

**BASIC UNDERSTANDING ON THE MEANING OF THE TERM ‘TRANSFER PRICING’**

To understand how transfer pricing, *the value charged by a company for the sale or transfer of goods, services or intangible property to another related company* function, it is necessary to briefly determine the existing correlation between the functioning of the multinational corporations or companies and, of course, that of international taxation. Transfer Pricing comprise an instrument developed and widely used by the MNCs to avoid and evade tax charges.

In the current economy, it is recognized that transnational companies or corporations play an ever more prevalent role in world economy. To untangle the complex web that hides the opaque actions of the MNCs requires characterizing, defining, and conceptualizing certain aspects. We start from the concrete fact that ‘a disproportionate percentage of world trade is carried out’ inside the MNCs, equivalent to over 55 % of the world’s GDP. This implies that enormous amounts of capital that escape the control of national states are in transit. This phenomenon can be characterized as capital flight, in other words, *the expatriation of hidden money, voluntarily and illicitly, by physical companies or persons subject to taxes in the country of origin*, as a result of the harmful ‘tax planning’ practiced by the MNCs that allow them to avoid and evade their tax responsibilities, thus considerably increasing their benefits.

A foreign subsidiary is an incorporated or unincorporated company in which an investor, who resides in another economy, has a participation that permits a lasting interest in the management of that company. What constitutes a related entity is a matter of national legislation. It is conceptualized as a company that can be an affiliate and/or a subsidiary of a parent [company]. The prices of these transactions usually differ substantially from those that would be agreed upon between unrelated companies. According to the OECD, trans-border transactions of goods, services and intangible assets that are carried out between the different units of Transnational Corporations represent up to 60% of world trade.

The value of the transactions that are done inside the networks that form the transnational corporations (intra-firm relationships) comprise a large part of the trans-border transactions of goods, services and intangible assets between economic entities that are located in different countries that are done at prices that do not necessarily correspond to the prices that would prevail if said transactions should occur between independent companies in an open, competitive market.

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4 Acevedo 2011  
5 Acevedo 2011  
7 Acevedo 2011  
8 Kapoor 2006  
9 SOMO 2008  
10 From an international tax perspective, tax evasion is that kind of tax planning that complies with the law, in other words, it uses practices to minimize or evade tax obligations taking advantage of the cracks and opportunities that the law permits.  
11 Tax evasion is a taxpayer’s total or partial noncompliance in declaring and paying his legal tax obligations to the Treasury and, as such, it is susceptible of receiving the sanctions foreseen in the law if detected.  
12 CHRISTIAN AID, calculated that the loss of income suffered by developing countries deriving from company taxes due to practices of manipulating transfer prices and fake invoicing currently amounts to the sum of USD 160 billion a year. See Christian Aid 2008.  
13 Neighbour, 2002
We thus understand that an ever increasing amount of international transactions are no longer completely governed by the market forces, but rather they are driven by the common interests of entities in the group under which the transaction is structured. These comprise the cases of operations between companies that are formally composed of independent legal persons, but that directly or indirectly respond to the same owner(s), so their objective is to cooperate amongst themselves in seeking to maximize the group’s global profitability.

Here it should be noted that the Arm’s length Principle is that which is agreed upon between companies that do not have common interests; that do not have any relationship of dependence.14 The ‘status of the situation’ that permits the huge bleeding of economic resources from poor countries by rich countries is explained using different reasons, perhaps two of the most noticeable are the creation and functioning of the so-called ‘tax havens’15 and the existence of a body of lawyers, consultants, auditors and bankers who become facilitators, builders and defenders of a system of ‘tax injustice’ of worldwide scope.

In many senses, tax havens are fictitious places. Of course, there is a physical reality that bears the country or territory’s name, but in most cases the operations promoted by that tax haven are carried out or have recipients who are not residents, private parties or entities; moreover, they have an unusual characteristic in common which is that, although a bank or merchant society has been registered in the tax haven, they are not allowed to trade in that territory in accordance with the legal requirements that they need for their incorporation because it is expected that their commercial activity will take place outside of that environment. A British tax advisor told the press in 2003 that ‘it does not matter what the current legislation is; advisors and lawyers will always turn it around. Norms are norms, but they are there to jump over them’16.

Methods for Calculating Transfer Prices according to the OCDE, U.S., and Brazil

The uncontrolled comparable price compares the price of goods or services for operations between related people or parties with the same goods or services that have been identified with similar characteristics, and the circumstances in a transaction between unrelated parties. Any corrections in the price can be made if the characteristics or the circumstances are different, using the comparable price as the baseline. The method has some variations, specifically, an uncontrolled comparable transaction (TCC) and, in the case of immaterial intangible services, or the term uncontrolled comparable price for services (CCC) that is used.

The resale price method can be used when a product has be bought from a related party and then re-sold to an independent company in the medium. The resale price is reduced by an appropriate gross margin that represents the amount from which the re-seller can expect to cover his sales costs and other operational expenses, and corrections are made to the concrete operations that are carried out. What is left after subtracting the gross margin can be considered the market price after making adjustments for other costs associated to the purchase of the product.

The increased cost method, a cost that is incurred by the supplier of the goods or services in a transaction between related parties provided by the purchaser with related parties. An adequate margin of profit is added to this cost for a margin of profit in the light of the functions that he carries out, the market conditions, circumstances, etc. After these costs are added, the price can be considered the market price. In each case the margin is determined taking into

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14 See OCDE 2006 and OECD 2011
15 Tax Justice Network 2005
16 Ibid.
This act will have important implications for the tax systems of the different countries in which the entities that form part of transnational corporations operate. This derives from the fact that by these deviations earnings can be transferred to one or another company in the connected group [that are] situated in different tax jurisdictions.

However, the predominance of transactions within the networks formed by Transnational Corporations in international swaps, and the use of transfer prices to assess said transactions, is only one condition to be able to use them for tax avoidance and/or evasion.

The flow of resources that will affect profits in one way or another can be grouped as follows:

- Payment of interest for inter-company loans.
- Purchase of raw materials, materials and components,
- Purchase of services,
- Payments of rights or royalties,
- Quotas for licenses on patents, software, brands and other similar concepts,
- Administrative quotas for counseling, technical assistance,
- General compensation for expenses incurred by the parent company in operations related to its subsidiaries and affiliates.

Transfer prices become one more mechanism that generates the possibility for transnational corporations to ‘direct’ or deviate tax bases from one tax jurisdiction to another.
In order for transfer prices to be able to be used to affect tax collection, differential tax rates must exist in the different geographic zones in which the companies that form part of a business group operate. This fact would create the incentive for the parent company to want to transfer funds and income from those units in the group that are located in countries with high tax rates to countries with low rates in order to minimize the flow destined to paying taxes on benefits and income.

Thus, through manipulating transfer prices, Transnational Corporations can reduce their global tax charges and obtain greater tax earnings than two or more unrelated companies.

I. TRANSFER PRICING IN NICARAGUA

2004:
As early as 2004 the Republic of Nicaragua’s General Income Department (DGI – acronym in Spanish) requested help from the U.S. Department of Treasury to study the effect transfer price practices had on Nicaragua and thus determine the tax gap that is caused by the application of these practices – understood as the difference between the actual tax collection over the effective income and what would be obtained if said practices did not exist – and to contribute towards developing regulations that would allow the authorities to face them.

Comparing the ruling legislation in other countries, the most used characteristics and criteria for comparisons, a synoptic chart was prepared of the proposed Tax System Law. The law considers capital participation (without any limitation of fixed percentages), management control and strategic alliances, family members and permanent establishments. The methods that are used to determine a transfer price would be based on the profits, similar to OCDE’s last two methods. To determine the best method, six criteria were established based on the economic circumstances and relative homogeneity of the products on the market. There are no simplified ‘safe port’ or ‘advanced price agreement’ methods in the 2004 law. The Executive Branch presented this proposal to the National Assembly as a bill for its discussion and approval, but for reasons unknown to the people, it was shelved.

2007:
The topic returned to the public arena in 2007 when on the Central American regional level (Salvador, Guatemala, Honduras, and Panama) and the Dominican Republic, the respective Treasury Ministers jointly approved a transfer price model. Economists considered that this was a good regional effort to advance towards a regional tax framework using OCDE’s model on transfer prices.

Regarding the transfer methods, as the main methods the model considered price setting methods, ‘comparable, not controlled by the price’, ‘total cost’, and ‘resale price’. The document also considers ‘advance price agreements’ as a possible simplified method based on an independent unrelated to the price, which the taxpayer must demonstrate.

Moreover, a technical group that was formed with the objective of preparing a regulatory model for the member countries of the group that considers the simplified ‘safe port’ method and which mentions anti-abuse rules that, nevertheless, should not ‘be used prudently’. So far, in Central America only El Salvador and Panama have laws on transfer prices, in Honduras, Guatemala and Nicaragua they exist as bills that have not been approved.

17 Reference on ‘Transfer Prices in Nicaragua and its Development’ Adolfo Acedo-Strategic Studies Institute for Public Policies (IEEPP) Managua Nicaragua. (out soon)
THE 2009 BILL ON TAX COORDINATION AND TRANSFER PRICES

In October 2009 the Nicaraguan Government presented the Bill on the Tax Coordination Law, which was prepared with technical assistance from the Inter-American Development Bank (IDB), to the National Assembly. This represented a complete modification of the current legislation. However, this bill would shortly be abandoned by the Executive Branch itself and, in December 2009, reforms to the existing legislation were approved based on an agreement with the most important business groups in the country.

This bill proposes 5 methods for calculating transfer prices according to the OCDE’s guide. The arm’s length principle is reaffirmed, but it does not clearly define what would be considered as a related party, which leaves an ambiguous law regarding those cases in which it would be applicable. With respect to tax havens, the law says that taxpayers must present additional proof of the underlying reasons for the transactions, but it does not make any effort to establish a list of tax havens or preferential tax systems. The bill does not have any option of a ‘better method’. It does not foresee any sanctions for bad conduct.

Afterwards, the Executive Branch abandoned driving this project, with Nicaragua now finding itself without a legal tax framework to regulate transfer prices.

II. THE CASE OF ECUADOR: THE WORST PARADOX

Ecuador has been intensively exploiting oil for 39 years. Throughout this period it is ironic that civil society, the media, and the State entities that govern the extraction and tax policies have not asked about a fundamental fact of the extraction process: What conflicts of interests exist in the process of setting the price for a barrel of crude?

Society has not understood this fact and has made it invisible, the result is the lack of capacity to determine whether the price per barrel of extracted oil or whether the values at which they acquire oil-by-products on the international market, are fair. The ‘fair price’ principle that was studied in the United States since 1918, was only considered in Latin America as a way for tax justice since the decade of the nineties.

The fair price is directly related to the concept of ‘transfer prices’. It is related to studies that were carried out in all the production areas to determine how affiliates of related companies are located in different countries that belong to the same international corporation transfer goods and services amongst themselves and how they determine the end price of the product. An oil company taxes itself a certain amount on profits and royalties and, if the company manipulates any aspect of its products or trade services, it can result in fewer benefits declared in the tea producing country.

The study of the transfer prices seeks to set mechanisms that will permit controlling commercial transactions between related parties. The way in which the transfer price rules were introduced in Ecuador was through regulatory provisions and the general norms issued by the Internal Revenue Service (SRI – acronym in Spanish) by Executive Decree No. 243018, and not by law19. This was agreed in 2007 in the Reform Law for Tax Equity, which went into effect in 2008. There was a legal provision so that the arm’s length principle established in the Ecuadorian legislation established what a related party is20. The Internal Tax System Law (RTI – acronym in Spanish), was published in the Official Bulletin on December 23, 2009 together with the Reform Law for Tax Equity, which establish the legal framework by criteria, such as 50% of the volume of transactions with the same company.
In the following example on the sale of LPG I want to remind you of the principle of ‘connected companies’ or ‘related parties’. These are those entities (companies, trustees, or any natural or legal person) who have a business relationship either in the capital, the administration or Government control over a company. Clause 4.3.14 of the contract details the concept of related companies:

‘Parent company: This is the company or entity that directly controls the affiliate or subsidiary; Affiliate: A company or entity that is directly controlled by its Parent Company; and Subsidiary is a company or entity that is directly controlled by the affiliate and indirectly by the Parent Company. This definition does not limit in any way the application of the tax legislation with respect to related parties and transfer prices.’

Point 4.3.26 of the contract on ‘Contractor costs and expenses’ establishes:

‘of the non-capitalized, reasonable and necessary costs directly incurred by the contractor or indirectly through its related companies, inside or outside of Ecuador, during the production phase, including those indicated in his annual programs and budgets, and accounted in accordance to the accounting regulations, and it will include the operational transportation costs through secondary pipelines and those made for the training and technical administrative programs that the contractor carries out during the production phase’.

But in Ecuador these oil price studies do not exist in the extraction sector despite the fact that oil production is of great importance: the current crude oil reserves are 3,407 million barrels and, of that volume, private companies will be responsible for extracting 1,203 million according to information from the Ministry of Non-renewable Natural Resources. Within this context society does not know how the internal production costs were established in the previous oil concession contracts.

Nor do we know the actual production, investment and sale conditions and values. For the government to efficiently regulate the oil sector, and for civil society and the media to be able to play an independent role, it is absolutely necessary to know how oil prices are formed, and the prices that are charged within the companies for the transfer prices within the same multi-national group. The big problem in applying the price transfer legislation in Ecuador is precisely this lack of something to compare with. The government needs this information to be able to make comparisons with other producers to determine whether a transfer price was actually a market price.

How can this objective be achieved when most of the oil companies have affiliates incorporated in tax havens, where they can easily hide or manage their costs to their convenience? As examples, the company Canada Grande Limited, operator of Block 1, one of the smallest in the country, has its residence in the British Virgin Islands; the company CNPC International (Amazon) Ltd., affiliate of the Chinese corporation CNPC, currently the most powerful and influential in charge of oil blocks – is also incorporated in the Islands.

In the Virgin Islands there is no need to declare who the real owners are of a company that is incorporated there; no company taxes are paid on the benefits it records, and no effective tax information shared with other countries and jurisdictions. Therefore, it is a secret jurisdiction.

The government entity that must drive these studies is the Internal Revenue Service (IRS) that carried out the first transfer price study in 2010 and (which) is related to the banana

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21 Esrobross External Auditors, Transfer Price Practice, Ecuador
22 The underlining is ours
23 See Romero and Ruiz 2010 and Richard Murphy 2011
24 Tax Justice Network 2011
sector. It is preparing a new study in the pharmaceutical area, but it has no plan, date, clarity and political intention to start this kind of process in the non-renewable resources area.

But not everything starts from zero; in Ecuador the new oil contracts signed towards the end of 2010 already establish responsibilities. These have made important advances because for the first time they talk about submitting them to the Ecuadorian legislation regarding transfer prices.

We can explain this through the following example. On November 23, 2010 the Ecuadorian State, through the Secretariat of Hydrocarbons, signed a modification contract to the service provision contract to explore and exploit hydrocarbons in Block 16 in the Amazon region with Repsol YPF Ecuador, Overseas Petroleum and Investment Corporation; Amodaimi Oil Company Ltd and CRS Resources (Ecuador) LCD.

In the contract it also clearly indicates that Repsol YPF Ecuador S.A is a company that is organized and incorporated in accordance with the laws of the Kingdom of Spain, with its main headquarters in Spain; Overseas Petroleum and Investment Corporation, incorporated in Panama, has its main headquarters in Panama; Amodaimi Oil Company Ltd, incorporated with the laws of Bermuda, has its main headquarters in Bermuda; and, CRS Resources (Ecuador) LCD, a company that is organized and incorporated in accordance with the Great Cayman Islands, with its main headquarters in the Great Cayman Islands.

On January 16, 2006, in Official Register 188, the SRI incorporated the first framework of the transfer price study applicable to trans-national companies into its tax regulations, called the 'Annex to the Complete Report on Transfer Prices'. Taxpayers whose overseas related companies have operations as parties above 3,000,000 U.S. dollars must present a 'Transfer Price Report' or those that have over 50% of its taxpayers with total incomes deriving from said transactions. The Complete Report must contain the following information:

• analysis of the industry;
• analysis of the activities and functions carried out;
• risks assumed by and assets the taxpayer uses in carrying out these functions;
• identification of the related parties, which indicates an economic situation of slavery and the shareholders’ structure;
• detail and amount of the operations carried out with connected parties;
• method used, indicating the reasons why the method was chosen;
• details on the selected comparables;
• elements, quantification and methodology used to apply any adjustments to the comparables;

The norms require that a report and its annexes be presented independently. Moreover, the company must indicate the method that the taxpayer used to in order to apply the transfer prices in accordance with the arm’s length principle.

In accordance to the Regulations for the application of the Tax system Law, as of the 2006 tax period the taxpayer must present the annex with the Transfer Prices within 5 days after the date of the presentation of his Tax Return.

It is requested that he detail the country of his tax residence, the company’s residence with which the commercial relationship is established in his tax residence country. The tax

25 Colombia also has this annual transfer price annex for large companies, see Barbosa Maríño 2006
26 González-Bendíkson and Toro 2009
registration or identification number that is used in his tax residence country is requested. The Difference from previous tax periods, which is the total of the difference to be adjusted in the operations with related companies accumulated in previous tax periods.

Companies are also required to explain the business relationship, the reasons why the informing taxpayer considers an overseas subject as a related party; the operations that were carried out and whether these were declared as transactions of goods or services. They must also explain the Arm’s Length Principle, understood to be a fair price, which was applied by the corporation.

However, none of this information – which is a legal obligation for companies – has been analyzed by the IRS. In turn, the companies understand that this is internal information that no one has the right to have access to. One of the objectives of this essay was to ask the IRS Director for an explanation of how this legislation will be applied to the oil sector in the future. The request for an interview was never answered.

It is not a simple topic. In the current foreign crude oil, gas, and oil by-products trade system (approximately 10 billion dollars a year) they have sought to anchor the prices to those that are established in the international market, but they put aside precisely those related values that are known as differentials or penalties and about which it is unknown whether they represent the market’s reality. The only thing that the State does in the internal and external LPG (Liquid Petroleum Gas) commercialization chain is to pay costs. The rest of the activities, from the imports to dispatching it in cylinders, are done by powerful multinational companies like Trafigura, Agip, Duragas, Repsol.

In 2007 the state-owned oil company, Petroecuador, signed an agreement with the Ecuadorian military company Flopec for the latter to provide it with Gas through the Multinational, Trafigura. Between November 2009 and April 2011 the Ecuadorian public company, Flopec, signed a gas supply contract with Trafigura for the sum of USD 1.540 billion, according to reports from Petroecuador.

How does the business work? Each ton of gas has a penalty or differential that is added to the established international price. According to the information from the contracts between Flopec and Trafigura (i.e., the related parties), in June 2009 the differential was USD 73 for each metric ton of gas. Currently, (2011) that differential surpasses USD 200 per metric ton.

Trafigura delivered 70% propane and 30% butane in a gas ship anchored in the Gulf of Guayaquil. This Storage system on high seas is administered by a company called Depogas (with special powers from Trafigura, therefore, it is related to it) which is classified as private commercial storage. There the two products are mixed and then transported by small unloading boats to a terminal on firm land to be sent to the provinces through multi-purpose pipelines or in bulk.

The operational cost for storage is 12.90 for every metric ton (MT); the operational costs of the unloading boats is 12.15 MT; the financial costs add up to 9.85 MT; the profit is 4.54 MT. The total is 39.44 MT. This means that there is a cost of USD 39.44 per MT which, multiplied by 1,560,000 MT from the last direct contract with Trafigura, meant a total cost of an additional 61.5 million dollars.

Under what parameters do they establish that the agreed upon values compare to international values?

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27 Attached Technical Sheet on Transfer Prices
28 ibídem
29 Villavicencio 2011
30 Villavicencio Fernando ‘Trasfigura’s Robberies 2011’
In April 2011 Petroecuador, once again in charge of the business, called an international bid only for state companies to provide gas in which the winners are two companies that do not produce gas for export: ANCAP of Uruguay and PMI of Mexico, with a differential that has never been seen over the past decades, USD 220 MT to the floating boat, and an additional USD 40 MT for storage and transportation costs on unloading boats, this item is in Flopec’s favor. Now it is known that Trafigura operates through Ancap.\(^ {31}\)

III. BOLIVIA AND THE LEGAL WEAKNESSES TO CONTROL ILLICIT CAPITAL FLOWS

Bolivia has been going through a process of change on the social and economic levels since 2006. It is well known in the industry that one of the first changes that was felt in the hydrocarbons sector, and more specifically in the natural gas sector, was the nationalization of the oil companies that operated in the country. This change, which some analysts consider more as a repurchase than nationalization, was done very theatrically and, with the army’s help, facilities and fields of various companies that operated in the country were taken over.

The repurchasing process of the hydrocarbon operations in Bolivia was accompanied by a legal structure provided by the new Constitution, which transformed the Republic into a Multi-national State, but which also changed the oil companies into service providers. Aside from the theatrical conditions with which this symbolic takeover was carried out, a new hydrocarbons law was also promised, as well as a strategy for gas extraction and hydrocarbons operations in Bolivia. Therefore, they now operate under the guidelines granted according to their contracts with state-owned Yacimientos Petrolíferos Fiscales Bolivianos (YPFB).

Meanwhile, new laws have been promised to govern and set the norms for the sector. Each year the government promises to finish the new Hydrocarbons Law. However, the legal gap continues. Several drafts have been prepared and presented before commissions of private companies and they have even used the counseling [services] of the Norwegian cooperation. The most recent draft is being reviewed by teams of lawyers from the oil companies that operate in the country, which creates political problems and causes a risk of conflicts of interests.

So much so, that Ministers of Hydrocarbons and Presidents of YPFB come and go in interim positions because they do not meet the selection requirements for the position. The legislation that is still in force has the requirement of several years of experience in the area, as well as having specialized academic diplomas. This situation is added to the restrictions on minimum permissible salaries in state institutions, which must not surpass the salary of the President of the Multi-national State. The restriction on the salaries of YPFB employees was recently lifted and almost 50 employees have been hired at salaries greater than that of the President, which is approximately 2,000 U.S. dollars a month.

Jurisdictional problems have emerged within the existing regulating structures. This has taken the power from the regulating agency, which does not define whether it is an autonomous institution or whether it responds to the Ministry of Hydrocarbons or if it responds to YPFB. Moreover, it presents a special problem for the Bolivian authorities to find the ways by which unscrupulous companies could, if they want to, evade taxes or defraud the State with the transfer price system.

The topic of transfer prices is currently treated by a commission of lawyers from YPFB who check the expenditures of the companies, now service providers, to

\(^ {31}\) Ibídem.
authorize investments or not. Here a balance must be maintained between the strict controls and the political requirements and pressures generated by an energy crisis that occurred during 2010. There is political pressure to increase the levels of investment of the private companies, so they tend to relax the controls over these companies’ expenditures.

IV. TRANSFER PRICES IN BOLIVIA

The general balance of the actions of the extractive industry (EI) in Bolivia is enormously negative. Although most of the weight is on the mining side, the oil sector carries a heavy historical load, not only from its exploitation of Bolivian hydrocarbons resources, but also from the loss of thousands of lives blinded in the Chaco War, a fratricide battle that was caused and encouraged by foreign oil interests.

The exploitation of hydrocarbons in charge of foreign capitals was and continues to be enormously beneficial for them as: risks in investments, having adequate technology and personnel for the business, and other arguments, such as having the necessary capital, cynically and corruptly imposing unfair conditions on the current government, thus taking the biggest piece of the cake.

This deceitful practice not only corrupts the public administrative and political apparatus, but it also – and above all – destroys the possibility of creating better opportunities of life for the large traditional populations. In Bolivia, this situation is unsustainable. Far into the 21st century, it is inadmissible that a country so rich in strategic natural resources should – paradoxically – have immensely poor inhabitants.

So, the question arising from this situation is: how do the multinational companies manage to keep the exploitation of strategic natural resources unscathed in Bolivia?

The main objective of this article is to make a theoretical and legal approach on the problem related to the extractive industries, providing civil society with the instruments that will allow it to understand the practices of the Multinational Companies (MNC) that are in the country.

BOLIVIAN NORMS REGARDING TRANSFER PRICES

Reviewing Bolivia’s legal economy regarding the topic in question, it can be affirmed that it is too weak to be able to – effectively – control the MNC’s activity. Let us look at what this weakens in the norms consists of.

State Constitution (CPE – acronym in Spanish)

In February 2009, Bolivia approved a new constitutional text which incorporates an entire chapter regarding hydrocarbons. Although the CPE does not specifically mention the norms and regulations for transfer prices, the following provisions are observed:

Article 362.

I. YPFB is authorized to sign contracts under a service provider system with Bolivian or foreign public, mixed or private companies for said companies, in its name and representation, to carry out certain activities in the productive chain in exchange for a salary or payment for their services. In no case can signing these contracts mean any loss for YPFB or the State (Bolivian National Congress: 2009, page 87). The underlining is ours.
Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) is the operational institution that must carry out what is enunciated in the CPE. To date it is not known whether YPFB has developed the necessary institutional capacity to allow it to fulfill this constitutional mandate.

Further down it reads:

**Article 366.**

All foreign companies that carry out activities in the hydrocarbons productive chain in the name and representation of the State will be submitted to the sovereignty of the State and they will depend upon the State’s laws and authorities. In no case will any foreign court or tribunal be recognized nor can they invoke any exceptional situation of international arbitration, nor resort to diplomatic claims. (Bolivian National Congress: 2009, page 88)

YPFB’s characteristic rachitis definitely makes the purpose of the preceding text unviable.

**Law No. 843 (Tax Reform)**

In a still incipient and even timid manner, in this law we can find the first progress of the State in trying to regulate the MNC’s activities through the Transfer Prices. Two articles stand out:

**Article 37**

All companies, both public and private, are subject taxes, including: stock companies, mixed stock companies, limited partnerships with shares and simple partnerships, corporate societies, limited liability companies, collective societies, companies irregular or de facto, individual companies, subject to regulations, branches, agencies or the permanent establishment of companies that are incorporated or reside overseas, and any other kind of companies. This list is expository and not limiting. (Bolivian National Congress: 2004)

The article refers to the scope of the tax on company profits as the State’s faculty and capacity to tax the benefits from economic activities. The MNC’s tax planning will seek – at all costs – to maximize their benefits; this implies that YPFB must develop and strengthen its supervisory capacities.

Further down it states:

**BRANCHES AND ESTABLISHMENTS OF FOREIGN COMPANIES OPERATIONS BETWEEN CONNECTED COMPANIES**

**Article 45**

Branches and other establishments of foreign companies, people or entities must keep their accounting records separate from their parent companies and other overseas branches or establishments, so that the financial statements of their management permit determining the tax results from Bolivian sources.

Legal acts that are celebrated between a local company with foreign capital and a physical or legal person residing overseas who directly or indirectly controls it will be considered, to all effects, as having been celebrated between independent parties when the agreed-upon conditions adapt to the normal market practices between independent entities.
When the requirements foreseen in the previous paragraph are not met to consider that the respective operations were celebrated between independent parties, any amounts surpassing the normal market values between independent entities will not be admitted as deductibles to the ends of this tax. To the effects of this article, a local company with foreign capital will be understood as one in which more than 50% (fifty per cent) of the capital and/or the decision-making power directly or indirectly corresponds to natural or legal persons residing or incorporated overseas.

In this article the MNC’s are obligated to keep differentiated, separate accounting, as well as imposing the arm’s length principal as the guiding principle for transactions between related companies. Finally, it defines and differentiates local, from foreign, companies, whether they are affiliates, subsidiaries or parent. In sum, the Bolivian norm must be much more specific and must be accompanied by the development of strong, effective capacities in YPFB.

Bolivia’s ex-Superintendent of Hydrocarbons (Victor Hugo Sainz) presented a document entitled: ‘BOLIVIAN REQUEST FOR A COOPERATION PROGRAM IN THE NORWEGIAN – BOLIVIAN OIL SECTOR’ to the Norwegian cooperation that contemplated a two-phase cooperation program that included six areas: I. Evaluation of the Legal Regulatory Framework and the Hydrocarbons Law, II. Inventory of the Hydrocarbon Resources, III. Administration Program for the Hydrocarbon Resources, IV. Oil Income Taxes and Administration, V. Environmental Protection Program, VI. Transparency and Anti-corruption Program.

According to the ‘Energy Platform’ website, on Monday, July 25, 2011 ‘the Minister of Hydrocarbons and Energy, Jose Luis Gutierrez, signed an ‘Inter-institutional Framework Agreement of Cooperation in the Energy Sector’ with Trond Heyerdahl, Counselor and Mission Head of the Norwegian Diplomatic Section’ that includes ‘three scopes of technical assistance, on hydrocarbon and energy matters, another scope is technical assistance, but from the institutional point of view, technical assistance to strengthen the different institutions. Two things stand out in this agreement: that Bolivia is the only country in the American Hemisphere that is receiving this kind of cooperation and the document has not been made public to date.

THE MNCs CONTROL THE OIL BUSINESS IN BOLIVIA

On May 1, 2006, with the promulgation of Supreme Decree No. 28701, the rules of the oil business game were apparently modified in favor of the Bolivian State, forcing the MNCs to pay more taxes and strengthening YPFB’s share participation in different foreign companies. However, ‘when YPFB was ordered to return to hydrocarbon activities in precarious conditions and submitted to the open competition with transnational companies – this allowed for the reserves and extraction – which is what gives them an economic value – to continue in their hands, and it was their income that was supposed to be affected’.

Despite the ‘nationalization’ measures taken by Evo Morales’ Government, it can be said that in the case of the hydrocarbons reserves ‘the presence of the transnational companies is prevalent’, contravening the spirit and what is established in the 2009 CPE and Hydrocarbons Law No. 3058. It can objectively be observed that in 2005 companies such as Petrobras, Repsol, and Total E&P controlled 83.4% of the natural gas and oil reserves, expressed in energy terms; in 2009 this participation increased, reaching 85.2% of the total reserves. On the other hand, in 2005 YPFB’s control over the reserves, through its subsidiaries Andina and Chaco, was only 12% and in 2009 it went down to 11 %.

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32 Carlos, Espada et al 2011
33 Ibidem, page 52.
The situation is much more beneficial for the MNCs when you consider that in the official statistics for the 2010 hydrocarbons production, for example, you see that Petrobras Bolivia controls 60.48% and Petrobras Energia 2.63%. Both add up to almost two-thirds of the total, a reality that gives them a monopoly in hydrocarbons production in Bolivia. In any case, the MNCs control 80% of the hydrocarbons production.

To crown this, the out-and-out defense –by President Evo Morales himself – of the provisions in Supreme Decree No. 748 dated December 2010 is still present, which sought – above all – to favor Direct Foreign Investments (DFI).

In order to attract investments to develop the oil and natural gas riches and increase the search for reserves, the new hydrocarbons law must establish mechanisms that encourage the interest of foreign capital. The adaptation of the tax system is one of the approaches in which the President of the Bolivian Chamber of Hydrocarbons and Energy (CBHE – acronym in Spanish), Carlos Delius, and the ex-Minister of the area, Fernando Vincenti, coincide:

'Tax flexibility is for future contracts, because those that are in force are already functioning with the conditions that were imposed in May 2006.'

This deteriorates the popular economy, an enormously significant act that contradicts the political project to recover the natural resources [and] which was literally stated in Supreme Decree No. 28701. In accordance with news from the Energy Platform:

'For the (ex) Minister of the nationalization, Andres Soliz Rada, the supreme decree set the bases for the nationalization, but it was abandoned by the Government, who did not fulfill the stipulations of the norm when it signed oil contracts with these same transnational companies without first waiting for the results of the oil audits his office carried out and which revealed accounting frauds and noncompliance with investment commitments, among other irregularities.'

The Contract to Reduce the Unpredictability of Prices (CRVP – acronym in Spanish) that was celebrated between Repsol (Andina) and Petrobras as one case of the application of the Transfer Prices

The oil business in Bolivia is a 'State secret'. To gain access to the oil contracts is a 'mission impossible' because there is no culture of transparency in this IE. To objectify tax avoidance and evasion, we resort to the Article on 'Oil Delinquency' written by Andres Soliz Rada, ex-Minister of Hydrocarbons of Evo Morales' government. In the same we read:

'Camacho Cuellar also made the accusation that Repsol and Petrobras swindled YPFB out of 300 million dollars when they agreed upon the purchase-sale price for gas to Brazil, at lower prices than the ones agreed upon between Bolivia and its neighbor by means of a hedging contract (to prevent an alleged unpredictability of prices). The country's defender himself revealed the contraband of crude oil, as well as the tax evasions of the Spanish company, crimes for which its manager in Bolivia, Julio Gabito, was arrested in Santa Cruz. The Public Ministry was pressured by the government to file all the lawsuits against the companies, instead of using the results to get better contracts than those that were signed last May. Andina's Board of Directors, formed by five delegates from Repsol and two from YPFB, forbade Camacho Cuellar to record their official meetings, to then order him to sign distorted Minutes.'

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35 Popularly known as the ‘gasoline price hike’. The paradox of this ‘price leveling’ is that ‘if the gas price hike had occurred, the population would have ‘subsidized’ an increase in the profits of the private oil companies that operate in Bolivia because, besides having other benefits, their income would increase up to 400%’. See Plataformamaenergetica.org, 01-09-2011
36 See Energy Platform, August 29, 2011
37 See Energy Platform, May 4, 2011
To September 1, 2011 none of the public institutions of the Bolivian State have taken any concrete actions against this larceny, much less sanctioned the authors.

The same ex official, in another article entitled ‘The struggle over gas prices’, provides us with more details on the ‘tax conduct’ of the MNCs in Bolivia, which has gone astray. The companies seem to export gas at a price that is much lower that the one that was agreed upon in the GSA.

‘Pluspetrol was sending gas to Argentina at 0.67; Repsol (Andina) was selling gas to Petrobras, behind YPFB’s back, at one dollar (a ‘hedging’ contract). On its part, British Gas exports gas to its affiliate, COMGAS, in San Pablo, also on the fringes of the GSA [...] These contracts were ‘incestuous’ because the gas producing companies in Bolivia bought [gas] on the other side of the border, converted the country into a gas sieve, which began to be sold, through legal and illegal branches, like what happened in Corumba’.

These examples give us a clear idea of what the presence of the MNCs represents in Bolivia. Apparently their marginal ‘tax conduct’ will not be straightened out by their own will. So, the challenge to put the house in order goes back to civil society because the current government has granted many tax advantages to the IED in the hydrocarbons sector and apparently a package of greater ‘incentives’ is coming.

CONCLUSIONS

In the facts it can be verified that the official discourses of ‘recovering our natural resources’ is completely opposite to the reality: the prevalence of the hydrocarbons activity’s monopoly by the MNC’s in Bolivia. Although the Bolivian Government’s tax income has increased considerably since Hydrocarbons Law No. 3058 and Supreme Decree No. 28701, it is observed that YPFB has not developed the institutional capacity to allow it to control the oil business. This means that the MNCs continue to use the corporate strategies defined in their ‘tax planning’ that allows them to continue avoiding and evading their tax responsibilities, a situation that implies the elimination of better opportunities and living conditions for Bolivian society as a whole.

The status of the situation in the hydrocarbons sector repeats itself with the same or greater magnitude in the mining sector, i.e., the current norms are permissive and they even promote the exploitation of the existing ‘strategic resources’ in the Bolivian sub-soil. There is no need to state that the State and civil society do not have the capacity to control and much less know what is extracted, where [the resources] are exploited and where they go, how much is exploited and exported and, above all, how much it is worth. Therefore, it is impossible – objectively – to determine how much the MNC’s must pay to the State and the Bolivian people in concept of what corresponds to them by rights.
RECOMMENDATIONS

The exploitation must end. For this, it is necessary to take concrete actions.

• Generate a current of opinions in the bosom of civil society to design a new judicial economy that takes precautions, protects, and guarantees Bolivians’ rights, favoring them over the MNCs.

• To establish, country by country, the accounts established by the transnational companies in the oil sector in all their operations in each country where they operate to increase the companies’ transparency and facilitate tax inspections. The reports on transfer prices in Ecuador are a step in that direction.

• For an effective, efficient demand to exchange tax information between tax havens and Latin American states, the lists of tax havens, as in the case of Ecuador, form part of this process.

• The above requires permanently training investigators, professionals in different areas, social activists, and people identified with the Bolivian people’s common good so as to learn in depth the MNC’s mechanisms and strategies oriented towards tax avoidance and evasion. This will permit the design and application of sustainable strategies over time that will finish the larceny to which we are subject.

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