

# DOMINICAN REPUBLIC'S TRANSFER PRICING LEGISLATION: HOTEL SECTOR CASE STUDY

**UN Course on Transfer Pricing**

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## Legal Basis

## Background (1992 – 2011)

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- The arm's length principle is recorded in the Dominican legislation since the creation of the Dominican Tax Code in 1992 by Law No. 11-92, Article 281.
- However it is in 2006 that more specific guidelines are established for the transfer pricing treatment (Tax Reform Law No. 495-06).

## Background (1992 – 2011)

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- Elements of the Tax Code that establish the basis for the determinations of transfer pricing:
  - Art. 281 Arm's length principle and Advance Pricing Agreement (APA ).
  - Art. 2 Economic reality of transactions: substance over form.
  - Art. 272 and Art. 4 of the Implementation Regulations, contain the related criteria.
  - Art. 273 on revenue from export and import of goods (pricing).
  - Art. 292 on economic group.
  - Art. 298 y 305 on Permanent Establishments and Payments abroad.
  - Art. 35, 64 – 66. Tax determination procedure.

## Background (1992 – 2011)

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- **All included hotel sector.** Possibility of signing an APA with Tax Administration:
  - ▣ On prices or rates that will be recognized from comparability parameters per zone, cost analysis and impact of other variables.
  - ▣ Unilateral APA and the hotel industry is represented by the Hotels, Bars and Restaurants Association (ASONAHORES) .
  - ▣ Validity period between 18 and 36 months.
  - ▣ These prices or rates shall apply for purposes of determining Value Added Tax (VAT) and Corporate Income Tax (CIT).

## Administrative Resolution (2011)

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- **Tax Administration Agency Resolution No. 04-2011** on transfer pricing. Includes the main elements of the OECD Guidelines:
  1. Definition of related party;
  2. Definition of comparable transactions and the criteria to be considered for the comparability analysis;
  3. Definition of the methods used and priority thereof;
  4. Operations Adjustments;
  5. Specification of the reporting obligation.
- Creation of the **Transfer Pricing Department**. After a process of staff capacity building began in 2009 .

## Transfer Pricing Legislation (2012)

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- In 2012 the Dominican Tax Code (Tax Reform Law No. 253-12) is amended in order to give legal force to the provisions of Rule 04-11 and improving some aspects, including:
  - ▣ Related criteria: related resident (for special regime effects), relating non-resident operations and preferential tax regimes .
  - ▣ Revision of the Permanent Establishment definition.
  - ▣ Cost sharing agreement.
  - ▣ Comparability analysis process.

## Transfer Pricing Legislation (2012)

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- Cont. (2012 Reform):
  - ▣ Documentation.
  - ▣ Inclusion transfer pricing sixth method.
  - ▣ Best method rule.
  - ▣ APA's improvement (procedure, bilateral APA).
  - ▣ Safe Harbour regime.
  - ▣ Possibility of administrative cooperation agreements.

## Audited Taxpayers

Sector	2011	2012	2013	Total
Industries	114	194	538	846
Services	326	573	1,743	2,642
Agriculture	7	11	78	96
<b>Total</b>	<b>447</b>	<b>778</b>	<b>2,359</b>	<b>3,584</b>

Source: DGII

- Taxpayers subject to transfer pricing legislation represent 1.7% of juridical persons registered in DGII.
- 73.7% of the taxpayers subject to transfer pricing legislation are in the service sector, 23.6% in industry and 2.7% in agriculture.
- 63.0% of the service sector's taxpayers belong to business, hotels and telecommunications.

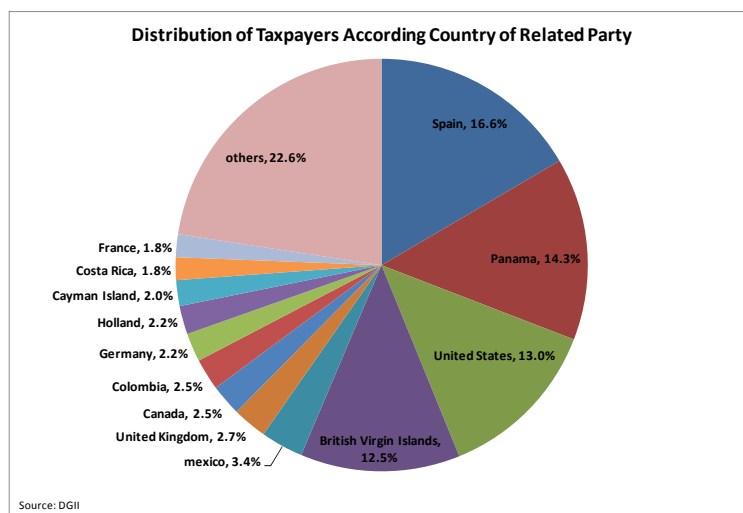
## Audited Taxpayers

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- Transfer pricing transactions are carried out with related parties located in 48 different jurisdictions.
- Of these, 9 are considered by Dominican Rep. as jurisdictions with low taxation.
  - ▣ 32.4% of taxpayers have transactions with these jurisdictions.
- 56.4% of taxpayers have transactions with related parties in Spain (16.6%), Panama (14.3%), USA (13.0%) and British Virgin Islands (12.5%).

## Audited Taxpayers

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# Tax Revenue

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## Tax Revenue per Transfer Pricing Adjustments

2013 - June 2015

Millions RD\$

Year	VAT	CIT	Total	% Total Taxes Tax Administration Agency
2012	1,023.8	189.1	1,212.9	0.49%
2013	941.1	814.8	1,756.0	0.62%
2014	351.8	110.7	462.5	0.15%
2015	486.1	110.9	597.0	0.36%
<b>Total</b>	<b>2,802.8</b>	<b>1,225.6</b>	<b>4,028.4</b>	<b>0.40%</b>

Source: Tax Administration Agency

Note: 2015 figures for the january-june period

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## Hotel Sector Analysis “All Included”

## Economic importance of " All Inclusive" hotels

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- The hotels, bars and restaurants subsector is of great importance in job creation, its contribution to the service sector and the currency generation.

Value Added Hotels, Bars and Restaurants Subsector

Concept	2009	2010	2011	2012	2013	2014
Value Added (Millions RD\$)	132,458.1	143,787.8	160,138.4	173,020.4	187,296.3	207,686.1
% GDP Service sector	12.6%	12.0%	11.7%	11.7%	11.8%	12.0%
% Nominal GDP	7.7%	7.3%	7.2%	7.3%	7.3%	7.5%
Number of employees (persons)	211,771	218,336	223,788	229,572	236,616	256,700
% Employed Population	6.0%	6.0%	5.9%	5.9%	6.0%	6.2%

Source: Calculated with the Dominican Republic's Central Bank figures

Hotels, Bars and Restaurants Subsector Indicators

Concept	2009	2010	2011	2012	2013	2014
Room Availability (Units)	67,575.0	67,095.0	66,069.0	66,044.0	68,542.0	68,840.0
Tourist Arrival (Millions persons)	3.99	4.12	4.31	4.56	4.69	5.14
Hotel Occupancy Rate	66.0%	66.6%	69.3%	70.3%	71.7%	74.8%
Tourism Revenues	4,048.8	4,209.1	4,436.1	4,736.3	5,063.5	5,637.1

Source: Central Bank of the Dominican Republic

## Economic importance of " All Inclusive" hotels

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- "All inclusive" hotels represent 56.8% of sales in the subsector of Hotels, Bars and Restaurants; and 63.4% of the taxes paid by the subsector.

Activity Indicators of "All Inclusive" Hotels

Average 2011-2014

Economic Activity	% Subsector Collection	% DGII Collection	% Subsector sales	% DGII sales declared
<b>Hotels, bars and restaurant subsector</b>	<b>100.0%</b>	<b>4.1%</b>	<b>100.0%</b>	<b>3.4%</b>
Bars and Restaurant	15.0%	0.6%	21.5%	0.7%
Hotels	85.0%	3.5%	78.5%	2.7%
"All inclusive" hotels	63.4%	2.6%	56.8%	1.9%
Other hotels	21.7%	0.9%	21.7%	0.7%

Source: Tax Administration Agency



## Taxation importance of “All Inclusive” hotels

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- Between 2005 and 2015 tax revenues paid by hotels grew 2.4 times, a trend that accelerated since 2011 with the transfer pricing control.

Taxes Paid By Hotels, per Tax type  
Millions RD\$

Tax	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015*
Corporate Income Tax (CIT)	432.2	757.2	682.6	544.2	396.0	703.5	886.3	810.6	1,153.2	1,079.3	1,023.7
Tax on Assets	-	-	54.2	210.2	288.7	254.5	329.0	453.0	329.2	344.6	91.0
Employees Income Tax (withholdings tax)	64.9	97.0	116.2	165.9	177.6	184.5	193.0	218.2	252.6	313.6	243.0
Value Added Tax (VAT)	1,142.5	1,171.2	1,381.5	1,963.7	2,188.9	2,562.7	3,905.7	5,123.5	5,645.7	6,360.7	5,060.0
Property Tax <sup>1/</sup>	226.8	236.0	3.5	-	-	-	-	-	-	-	-
Others	36.0	81.5	62.3	22.7	15.6	78.8	24.8	17.8	19.9	31.7	12.6
<b>Total</b>	<b>1,902.4</b>	<b>2,343.0</b>	<b>2,300.2</b>	<b>2,906.6</b>	<b>3,066.9</b>	<b>3,784.0</b>	<b>5,338.8</b>	<b>6,623.2</b>	<b>7,400.6</b>	<b>8,129.9</b>	<b>6,430.3</b>

Source: Tax Administration Agency

\*January-July 2015.

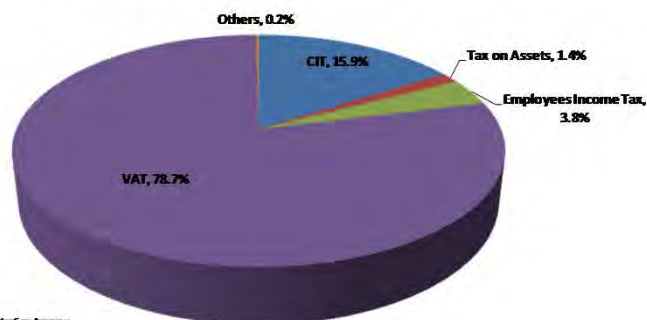
1/Property Tax exemption since 2008

## Taxation importance of “All Inclusive” hotels

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- 94.6% of the taxes paid by hotels correspond to Income Corporate Tax and VAT.

Tax Participation per type, paid by Hotels, Año 2015

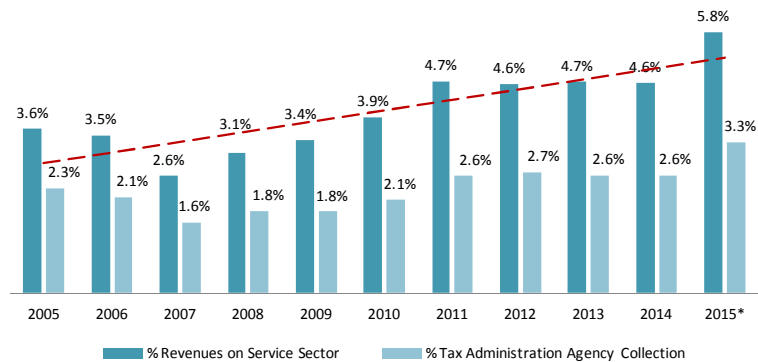


Source: Tax Administration Agency

## Taxation importance of “All Inclusive” hotels

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**Revenue Participation of All Inclusive Hotels**  
percentage; 2005-2015\*



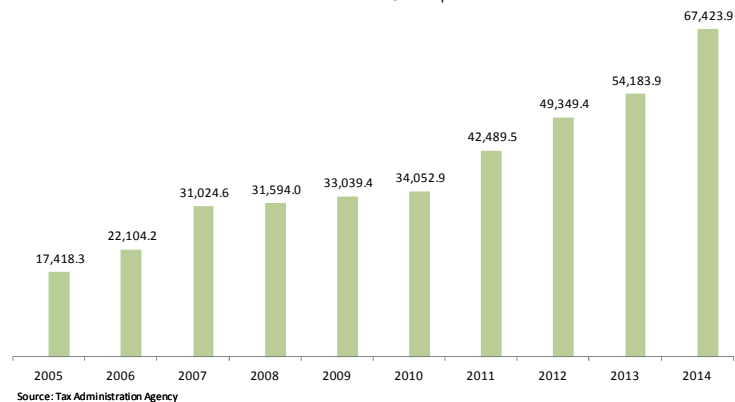
Source: Tax Administration Agency

## Taxation importance of “All Inclusive” hotels

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- Since 2010 gross revenues reported by Hotels to the Tax Administration Agency increase in 98.0%.

**Gross Revenues Reported by Hotels, 2005-2014**  
Million RD\$

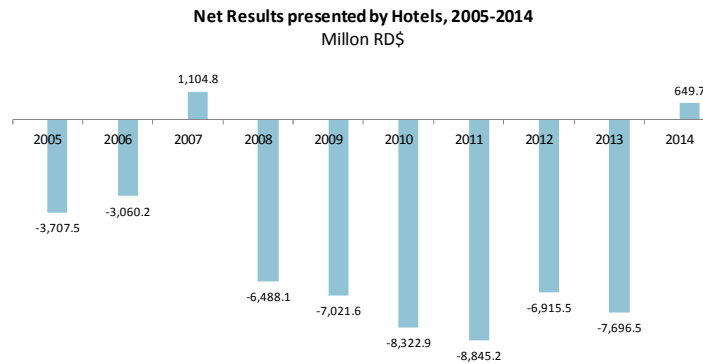


Source: Tax Administration Agency

## Taxation importance of “All Inclusive” hotels

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- The international economic crisis affected tourism, which implied that transfer pricing audits did not report greater net benefits, a trend that was reverted in 2014.



Source: Tax Administration Agency

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## Transfer Pricing Control “All Inclusive” Hotels Sector

## Tax Planning “All Inclusive” Hotels

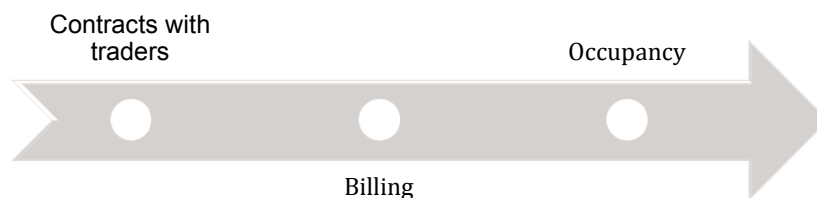
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- Tax Administration Agency started a process to review revenues from “All inclusive” Hotels, due to its non resident related parties which facilitates transfer pricing transactions to relocate tax base, through:
  - ▣ The use of a related party for the marketing of the rooms, located in most cases in countries with low or no taxation.
  - ▣ Ongoing losses and high debt with marketers. For over 10 years, taxpayers in the sector reported losses in their financial statements.
  - ▣ Rates per night per guest reported to Tax Administration Agency were lower than the reported operating costs per guest.
  - ▣ The advertised rates were higher, at more than one hundred percent, than the declared to Tax Administration Agency.

## Audit Process

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In 2009, the Tax Administration Agency conducted an audit process to the Room Sales Operations where they punctually checked :



# Functional Analysis

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## Role

- Providing an All Inclusive service
- Manage or operate the hotel



## Assets

- Properties (buildings , vehicles, furniture, etc. )
- Inventory for the service



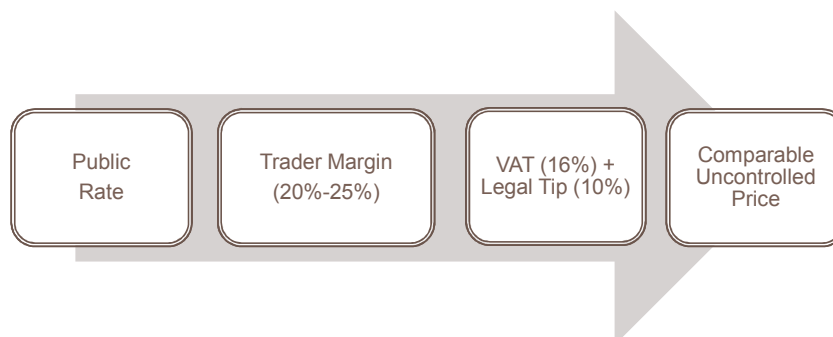
## Risks

- Exchange Rate
- Quality Service
- Market
- Country

# Comparable Uncontrolled Price Determination

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To calculate uncontrolled price that would be used to adjust the reported income, Tax Administration Agency hired market research companies to determine hotel rates in international markets of hotels operating in the Dominican Republic. Allowing to establish a fee per season (high and low) and an average by location and category.



## Comparable Uncontrolled Price Fees

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### Zone

According to geographical location were divided into zones A, B and C



### Category

Five Hotel categories were identified



### Season

High : December - April  
Low: May – November

## Results

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For the fiscal years 2007-2010, 73 audits were conducted .

The sentences of the Judicial System were in favor of Tax Administration.

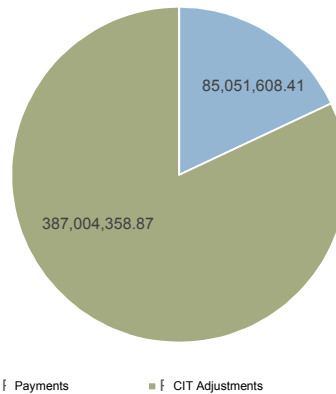
Adjustments of US\$472,055,967.28 millions were determined.

A Framework / Safe Harbours Agreement and APA arises

## Hotels Tax payments for adjustments

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Details of the Payments and CIT Adjustments 2007-2011; Amounts in US \$



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Advanced Pricing Agreements (APA)  
"All Inclusive" Hotels

## APA Features and content

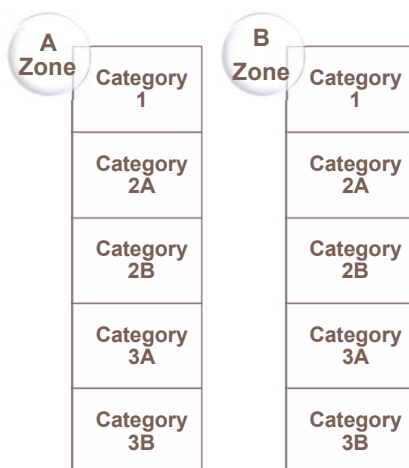
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- Proposed rates depending on the category and geographic location of the taxpayer.
- Rate is determined based on the marginal cost method for the determination of the VAT and a Low effective tax rate for the CIT.
- Submit information for checking compliance with the APA .
- The period of validity is 3 years .

## Features and content of the Framework Agreement

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Different rates apply depending on the category and geographic location of the taxpayer.





## Features and content of the Framework Agreement

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### VAT taxable income

Net margin method on  
Operating Costs and  
Expenses



Gross profit method on  
Costs and Expenses



Fixed Rate per category  
and Zone



Value  
Added  
Tax (VAT)

## Rates establishment for Method based on Costs

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Regardless of the selection of either of the two costs methods, the fee shall be calculated as follows:

- Annual Report

Total costs  
and / or  
expenses  
IT



Occupancy  
Rate



Profit  
margin



Declared  
Rate

- Financial statements
- Annual Tax Return

12.5%

20%

## Rate by Category and Zone

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Different rates depending on the category and geographic location of the taxpayer are established.



Uncontrolled Price Fees

## Methodology for determining the CIT

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- Taxable income for Corporate Income Tax



## Information to be submitted

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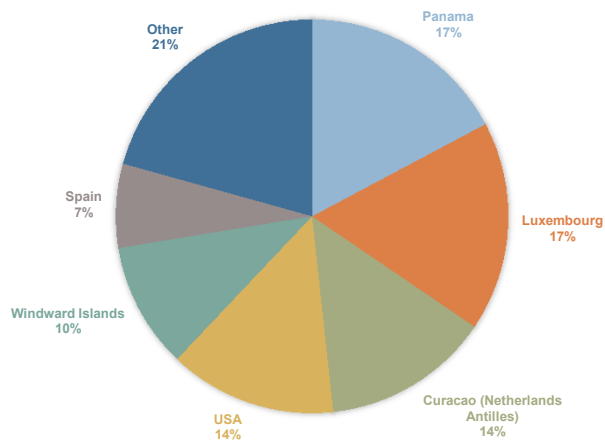
### Annual Report for IT operations

- Operations Description
- Amount and type of rooms
- Total Occupancy per month
- Number of gratuities
- Policy rates and trading contracts
- Income details of related and independent

## APA's by country of residence

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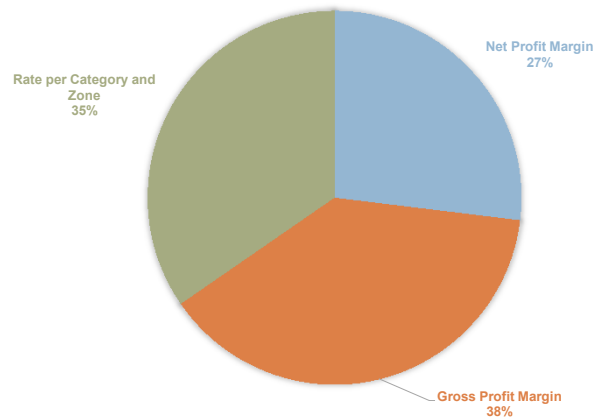
COUNTRY OF RESIDENCE OF FOREIGN RELATED



## APA's by Method

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APA'S BY METHODOLOGY



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Thank you!