

# GLOBAL TAX BRIEFING

## Latin America

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### LATIN AMERICA

This month's issue of Global Tax Briefing is written entirely by members of the Latin American Tax and Legal Network (LATAxNET). LATAxNET, headed up by Miguel Valdés, of Valdés, Machado & Associates, LLC., is a network of top tax and legal specialists all over Latin America, Puerto Rico, the Caribbean and the United States. See back cover for more information about LATAxNET.

## Federal Tax Court Rules on Transfer Pricing and Interprets “Taxable Events” in Argentina

*by Juan Manuel Soria Acuña and Eduardo Aguilera, Mitrani, Caballero, Rosso Alba, Franciá, Ojam & Ruíz Moreno, Buenos Aires, Argentina*

### Tax Law Amendments

The Argentine congressional ordinary sessions for the year 2010 began in March. In one of the first sessions, the Senate passed an amendment to the Financial Transaction Tax co-participation system, altering the ratio of the tax resources that are distributed among the states. If the bill is confirmed by the other chamber of Congress, the Federal government would receive 35% of the collected resources, and the states would receive 50% (the social security system would keep its 15% quota). The administration has warned that if opposition parties in Congress insist on amending the ratios, it will veto the law or even send a bill to eliminate the original tax. The matter is yet to be decided by the House of Representatives.

The proposed amendments to the Income Tax Law are basically aimed at reducing the tax burden on small taxpayers, both corporate and individuals. The latter would benefit from an increase on the minimum exempt income and on the deductions allowed by law. To compensate for this decrease, the draft legislation proposes a withholding on dividends paid to high-income taxpayers and a 5-percent increase in the rate.

The proposed legislation amending the Criminal Tax Law proposes a general increase in the amounts of the minimum threshold that must be met to charge taxpayers with a crime. For example, to charge a taxpayer with simple evasion, the minimum threshold amount was 100,000 Argentine Pesos. The amendment proposes an increase to 1 million Argentine Pesos. Furthermore, the proposed legislation modifies the current system of determining evasion from a scaled system of established amounts determining whether the evasion is simple or aggravated, to a system that looks to the use of forged invoices, the interposition of false taxpayers,

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or the fraudulent use of fiscal benefits to aggravate the punishment and not merely the fiscal amount of the evasion.

The division between the political forces and the lack of a clear majority add uncertainty to the future of all the described amendments, and whether they will be passed this year.

### First Federal Tax Court Ruling on Transfer Pricing Pursuant to New Legislation

On February 26, Division D of the Federal Tax Court decided *Aventis Pharma S.A.*, the first case decided under the reformed transfer pricing legislation effective since 2000. Criticizing the new system and lack of case law and scholarly opinions, the Tax Court rejected the adjustment ordered by the Argentine Revenue Service (“ARS”) and confirmed the transfer pricing report presented by the pharmaceutical company for the 2000 fiscal year period.

The ARS objected to some of the information included in that report, as well as one of the chosen comparable companies, and therefore ordered an adjustment in the transfer prices of the export operations. The adjustment was based on three arguments. First, the ARS contended that the credit notes registered in the financial statement as extraordinary cost, were not actually extraordinary as they were part of the contract between the taxpayer and its clients. Consequently, the transfer pricing report should have considered these losses in the income ratio that was compared to that of non affiliated comparable companies. Second, according to the ARS, *Aventis Pharma S.A.* was classifying the “Subsidy for Research and Development” it received from foreign affiliated companies as a reimbursement of an operating cost to increase the ratio of its operating income. However, the fiscal authorities concluded that there was no proof substantiating the classification of income as a reimbursement for an operating cost. The balance sheet presented by the taxpayer had first classified the subsidy as “Other Income” and not as operating income or less operating cost. The change in the classification was unjustified, according to the fiscal authority, and was disguising and income that had no relation with and operating cost. Third, the ARS objected to the inclusion of *Bently Pharmaceutical Inc.* as a comparable company based on the differences in the business activities carried on and its constant losses. Furthermore, the ARS pointed out that OECD guidelines were not Argentine law and thus they cannot be applied to justify the inclusion of *Bently Pharmaceutical* as a comparable. It quoted a ruling of the same Division of the Federal Tax Court in the *Aerolineas Argentinas* case where it was said that as Argentina is not a member of the OECD and has its own tax rules and concepts, the OECD guidelines were not applicable.

The Federal Tax Court began the decision by acknowledging that the recent and complex transfer pricing rules, its constant amendments and the lack

of advance pricing agreements (“APA”) between the ARS and taxpayers (that would allow companies to have objective criteria to settle their relationships with other affiliated companies and prevent future adjustments and litigation) cause a confusing situation for taxpayers. Furthermore, the lack of case law and scholarly opinions extend the confusion to tax courts. That is the case for the fiscal period under discussion (year 2000) when the rules were even more recent and there were three different transfer pricing rules along the same year regulating reports presented by taxpayers: General Resolution 567/99, 702/99 and 1122/01.

Going to the arguments of the fiscal authority and the taxpayers regarding the first objection raised by the ARS to the transfer pricing report, the Federal Tax Court agreed that the notes of credit were extraordinary discounts on the wholesale price. The special circumstances of the market, the court said, show that the existence and the amount of the notes of credit depend on variable events that cannot be predicted by pharmaceutical companies. The transfer pricing report need not to probe that other comparable companies were also suffering a decrease in the wholesale price due to the notes of credits. It was an irrefutable fact.

Regarding the research and development (R&D) reimbursement, the court held that regardless of the method followed by Aventis Pharma to register the reimbursement on its balance sheets, the reimbursement was clearly an operating income that can be net to any operating cost unless clear proof shows that such a cost did not in fact exist. In other words, the ARS could not produce any proof indicating that the reimbursement was not an operating income expense nor that the company did not have expenses related to research and development that were being reimbursed.

Regarding the inclusion of Bentley Pharmaceutical Inc., the court summarily rejected the ARS’s arguments, describing them as merely rhetorical and completely unsubstantiated by a serious investigation of the facts. The different business activities that

according to the ARS the comparable company carried on were actually activities of its subsidiaries.

More importantly, the court said that General Resolution 702 was applicable to the fiscal period in question, allowing companies to include in the transfer pricing reports comparable operations and companies with an indication of the adjustments needed to eliminate the difference with those companies and operations. The precedent *Aerolíneas Argentinas* was not applicable to the case as the OECD Guidelines are a helpful tool to complete the General Resolution 702. Consequently, its inclusion in the transfer pricing report by the taxpayer was correct. Such case law would only support an objection to the use of the Guidelines when they differ from local regulations.

This precedent should be taken into account in future actions to support two arguments usually used by taxpayers: the Argentine transfer pricing system should be carefully applied by the ARS to its first fiscal periods because of the uncertainty it generated; the OECD guidelines are welcomed by courts when they complete the local regulations, despite what was concluded by many from *Aerolíneas Argentinas*.

### Interpretation of Taxable Events for Financial Transaction Tax

The Financial Transaction Tax (“FTT”) was created by Law 25.413 in March 2001 and amended by Law 25.453 in July 2001. An FTT taxable event was comprised of the following transactions: 1.) debits and credits in banking accounts opened with Argentine financial institutions where the taxpayer is the owner of the account, and the relevant tax is collected by the financial institution; 2.) select transactions made before Argentine financial institutions—other than those channeled through banking accounts—that were listed in Section 3 of FTT implementing the decree as amended by Decree 966/01 (e.g. deposits of checks in savings accounts, wire transfers, payments on behalf of third parties, etc.). Here, the taxpayer orders the payment to the bank, or its beneficiary, as the case may be and the financial institution collects the tax;

and 3.) any other transfers of funds—owned by the transferor or by a third party—even in cash. According to the implementing rules, this “catch-all provision” only applies when the transfers *imply an organized system of payments which is intended to substitute the use of banking accounts*, avoiding therefore, payment of the relevant tax. The taxpayer orders the transfer of his own funds and is, therefore, also liable for collecting and depositing the tax with the Argentine IRS. In the case of transfers made on behalf of a third party, the agent is liable for the collection of the tax.

In *La Angostura S.R.L.*, decided by the Federal Tax Court on February 12, 2010, a taxpayer whose main commercial activity was the retail of gas used to pay its providers with money deposits on their checking accounts, and with third party checks. The ARS argued that the conduct of the taxpayer, that is to say, the constant deposits of money in checking accounts, constitutes an organized system of paying meant to replace the more common use of checks. Thus, every single money deposit was taxed with the FTT.

The taxpayer argued that it did not systematically pay its providers with monetary deposits and did not intend to replace the use of checks. On the contrary—the taxpayer contended—it was forced to pay for the gas with money and third party checks by its clients.

The Federal Tax Court analyzed the words “organized system” as used in General Resolution 1135, and concluded that there is no legal definition. The common use of the words point out to a group of acts or things that share a unique objective. In the case of the FTT, that unique objective must be to replace the use of checks.

According to the ruling, it cannot be concluded that *La Angostura S.R.L.* maintained an organized system of payment with the intent of replacing payment by check because monetary deposits were not the sole method of payment and the facts clearly showed that the taxpayer did not choose that payment system. Monetary deposits were the only remaining option left to the taxpayer

considering its size and market. Additionally, as was pointed out in the ruling, the taxpayer has the right to choose the way it pays its bills and, consequently, has no obligation to deposit the money it receives from its clients on its own bank account.

The *La Angostura S.R.L.* decision constitutes a warning against any broad interpretations of the statute and its regulations. The Federal Court did not spare the statute and the regulations from any possible criticism due to their lack of precision as to the taxable event.

### Federal Tax Court Clarifies Timing Requirements

In *Pioneer Natural Resources Arg. S.A.*, dated October 20, 2009, but recently published on March 31, the Argentine Federal Tax Court ruled on cross-border transfers of technology, identifying the necessary time requirements for the registration of contracts and the deductibility of payments in the local taxpayer’s balance sheet for income tax purposes.

The licensing and transfer of technology regime in Argentina is governed by National Transfer of Technology Law N° 22,426 (“TTL”) as amended and by implementing regulations Decree N° 580/81 and Resolution P-328/2005. The latter enacted by the National Institute of Industrial Property (“INPI”)—the organism responsible for applying these regulations. Article 93 of the Income Tax Law established a reduced withholding rate for payments to foreign beneficiaries when they involved the transfer of technology duly registered according to the TTL.

All contracts that comprise the transfer of technology must be submitted before the INPI for registration for informative purposes. Once the instruments are filed, the INPI scrutinizes the fulfillment of the TTL and issues a certificate stating that the services contained in the agreement are consistent with the concept of transfer of technology. The registration is not a simple formal requirement. In fact, it constitutes a condition precedent in order to benefit from reduced withholding and for the deduction of the costs incurred by the local payer for the acquisition of the technology

and, within this scope, the proceeding must take place before the expiration of the original term of the contract. In this context, as stated by Article 9 of the TTL, agreements that are not filed before the INPI are valid and enforceable, but the Argentine taxpayer will not be able to deduct—for income tax purposes—the business expense, and the total amount of the payments will be considered taxable income to the payee and subject to the general 31.5 percent withholding tax rate provided for in the ITL.

Traditionally, the Argentine Revenue Service has expressed that certificates issued by the INPI do not have retroactive effects. This assertion was materialized in External Note (AFIP) N° 1/2002 whereby the Director of the Argentine IRS affirms that the certificates issued by the INPI are effective as of the date of the filing of the registration request.

In *Pioneer Natural Resources Arg. S.A.*, Pioneer subscribed two contracts with the firm Gaffney, Cline & Associates Inc.—a U.S. resident—whereby the latter provided technological services to the prior in 1998 and 1999. The contractual instruments were registered before the INPI for informative purposes, although the proceeding was carried out after the payments for the technological services were sent abroad. Nevertheless, the INPI issued the corresponding certificates, acknowledging that the services were framed under the provisions of the ITL regarding transfer of technology and, hence, allowing the reduced withholding and the expense deduction.

However, the Argentine IRS challenged the deduction of the business expense and assessed the income tax

payable by Pioneer for fiscal years 1998 and 1999, alleging that the untimely registration precluded the deductibility of payments for technical assistance under the dispositions of Article 9 of the TTL.

Courtroom C of the Federal Tax Court revoked the Argentine IRS' assessment. The court concluded that the fact that the INPI issued the certificates for the technological agreements after the payments were sent to the U.S. did not preclude the deduction on Pioneer's balance sheet since through the effective expedition of the certificates the organism acknowledged that the services were framed under the provisions of Article 93 paragraph a) of the ITL, without any objection whatsoever.

Regarding the External Note (AFIP) N° 1/2002 the court considered that it was not legally valid, since the competent authority with respect to the application of the TTL was the INPI and not the Director of the Argentine IRS. Consequently, the norm has been enacted beyond the Director's powers. Therefore, according to the Federal Tax Court, the business expense challenged by the Argentine IRS was effectively deductible in Pioneer's balance sheet for income tax purposes, since the pertinent requirements were met, namely the registration of the instruments was accomplished after the payments were made, but yet they occurred within the fiscal year when the deduction was performed. Accordingly, this situation was framed under the dispositions of Article 93 paragraph a).

This case is relevant because previous case law had decided against the taxpayer's position (Federal Tax Court, Courtroom B, *Deca Piazza S.A.*, 09.06.2002). ♦

## Value Added Tax Exoneration in Venezuela

by Juan Carlos Garantón-Blanco and Nelson E. Borjas Espinoza, Torres, Plaz & Araujo, Caracas, Venezuela

Our report for Venezuela includes the most relevant developments for the last six months (October 2009-March 2010), including (1) new Value Added and Income Tax Exonerations; (2) new calendar

for special taxpayers ("Sujetos Pasivos Especiales") and withholding agents for tax obligations to be complied with during fiscal year 2010; (3) New Anti-Drug Enforcement Contribution Regulations;

and (4) new developments by the Venezuelan Tax Courts with regards to municipal taxes and tax litigation issues.

### Value Added Tax Exoneration

**Value Added Tax exoneration on capital goods imports**—As per Presidential Decree No. 6985, published in the Official Gazette Nro. 39.291 of October 23, 2009, the importation of capital goods, their parts and accessories therein indicated, intended for the execution of industrial development projects in the manufacturing and/or construction industries in accordance with the Nation's Economic and Social Development Plan 2007-2013, "*Plan de Desarrollo Económico y Social de la Nación 2007-2013*", are subject to VAT and tax holidays (exonerations) provided manufacturers in Venezuela cannot produce the same or cannot produce the same in sufficient amounts. The tax holiday is to be in place for three (3) years from its entry into force.

**Value Added Tax exoneration on defined imports of property**—Presidential Decree No. 6994, published in the Official Gazette Nro. 39.298 of November 3, 2009, provides for a holiday on the payment of Value Added Tax (VAT) on the final importation of chattel needed to secure the continuity, reliability, and efficiency of power generation activities carried out by companies (utilities) engaged in such activities and corresponding to the "systems" listed in the Decree, provided that they are not produced in Venezuela or their production is insufficient.

**Value Added Tax exoneration on dredging services**—Pursuant to Presidential Decree No. 6984, published in the Official Gazette of October 21, 2009, dredging services requested by the competent public body for the "Return to Design Depth of the Orinoco River Navigation Channel" ("*Vuelta a Profundidad de Diseño del Canal de Navegación del Río Orinoco*") project are

exonerated from the payment of Value Added Tax. The exoneration will be in force for two (2) years. The request for exoneration shall be submitted to the Ministry of the Popular Power for Public Works and Housing.

**Income tax exoneration on PDVSA bond interest**—As per Presidential Decree No. 7184, published in the Official Gazette Nro. 39.349 of January 19, 2010, interest obtained by the holders, individuals and companies, from PDVSA's Bonds (US\$-denominated) are exonerated from income tax. The exoneration will be in force for five (5) years.

### Special Taxpayers and Withholding Agents Calendar for Meeting Tax Obligations

SENIAT Administrative Ruling N° SNAT/2009/0117, published in Official Gazette of December 04, 2009, provides the following calendars for 2010 compliance.

Taxpayers must file and pay their tax obligations as provided in the calendar according to the last digit of their Tax Identification Number (RIF), as follows:

#### a) Value Added Tax

R.I.F.	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0y5	19	18	17	20	18	17	19	17	20	19	17	16
9y6	20	19	18	21	19	18	20	18	17	20	18	17
7y3	21	24	23	26	20	21	23	19	21	22	19	20
4y8	22	23	19	23	24	22	21	23	22	21	23	21
1y2	25	22	24	22	21	23	22	20	23	25	22	17

#### b) Value Added Tax withholding

b.1) For WHT made between the 1st and 15th (both inclusive) of every month.

R.I.F.	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0y5	19	18	17	20	18	17	19	17	20	19	17	16
9y6	20	19	18	21	19	18	20	18	17	20	18	17
7y3	21	24	23	26	20	21	23	19	21	22	19	20
4y8	22	23	19	23	24	22	21	23	22	21	23	21
1y2	25	22	24	22	21	23	22	20	23	25	22	17

b.2) For WHT made between the 16th and the last day (both inclusive) of every month.

R.I.F.	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0y5	6	2	3	7	4	2	6	3	2	4	3	2
9y6	7	3	2	6	5	3	2	4	3	5	4	3
7y3	8	4	5	8	6	4	8	9	6	8	5	8
4y8	11	5	8	9	7	8	9	6	7	6	8	9
1y2	12	8	4	12	10	9	7	5	8	7	9	7

### c) Income tax withholding

R.I.F.	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0y5	6	2	3	7	4	2	6	3	2	4	3	2
9y6	7	3	2	6	5	3	2	4	3	5	4	3
7y3	8	4	5	8	6	4	8	9	6	8	5	8
4y8	11	5	8	9	7	8	9	6	7	6	8	9
1y2	12	8	4	12	10	9	7	5	8	7	9	7

### d) Income Tax Advance payment (filing and payment for regular and irregular fiscal years)

R.I.F.	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0y5	11	12	10	8	14	9	13	12	8	11	12	8
9y6	13	9	12	14	11	10	8	11	10	13	11	9
7y3	15	8	11	13	12	14	9	13	14	15	10	14
4y8	12	11	9	12	13	11	14	9	13	14	8	13
1y2	14	10	18	9	10	8	15	10	9	18	9	10

### Legal Gaming & Gambling

R.I.F.	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0al9	8	9	9	9	7	9	9	9	9	8	3	3

### Legal Gaming & Gambling withholding

f. 1. For WHT made between the 1st and 15th (both inclusive) of every month.

R.I.F.	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0al9	18	17	16	16	18	16	16	16	16	18	16	16

f.2. For WHT made between the 16th and the last day (both inclusive) of every month.

R.I.F.	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
0al9	5	1	1	5	3	1	1	2	1	1	2	1

### g. Income tax self-assessment and payment for FY 2009

R.I.F.	Opportunity
0,1 y 5	March 31, 2010
2, 3 y 7	April 5, 2010
9 y 6	April 6, 2010
4 y 8	April 7, 2010

### Antidrug Law Contribution Regulations

On December 29, 2009, the National Antidrug Agency (“ONA”) issued two rulings (published in Official Gazette No. 39.336): (1) Norms and Procedures for Registration of Taxpayers and the Collection, Control and Audit of the Contributions (hereinafter “Ruling on Registration”) provided in Articles 96 and 97 of the Organic Law against the Illegal Trafficking and Consumption of Narcotic and Psychotropic Substances (“Antidrug Law”) and (2) Norms for the Filing and Payment of the Contributions Provided in Articles 96 and 97 of the Antidrug Law corresponding to tax years 2006, 2007 and 2008 (hereinafter “Ruling on Filing”).

The technological platform for complying with the contributions set forth in the Antidrug Law is now accessible through the ONA’s website at: [www.ona.gob.ve](http://www.ona.gob.ve).

### Registration before the National Antidrug Fund—

Through the Ruling on Registration, the ONA has appointed the National Antidrug Fund as the entity in charge of collecting and auditing contributions. Taxpayers have to register at the National Antidrug Fund portal (access through [www.ona.gob.ve](http://www.ona.gob.ve)) and provide the information requested therein. Public and private companies employing 50 or more workers are deemed payers of the contribution. The ruling establishes that the number of workers that the taxpayer has employed during the year, regardless of their stability or permanence, is to be taken into account when calculating this number.

**Filing and payment of the contributions**—Contributions arise on a yearly basis and filing and payment to the National Antidrug Fund is to be made within

the first 15 calendar days of every calendar year. Therefore, taxpayers had to file and pay contributions for the 2009 tax year on January 15, 2010. One of the most controversial features of the Ruling on Registration is that it establishes as the basis for computing the contribution the “*net annual profits subject to the calculation of income tax.*” The forms provided by the National Antidrug Fund are to be used for self-assessment and payment of the contributions, fines, late-payment interest and adjustments to self-assessments.

**Audit and Assessment**—The Ruling on Registration establishes an auditing procedure very similar to that provided in the Master Tax Code (“MTC”). It also establishes that the corresponding administrative and jurisdictional appeals can be lodged against the final resolution of the administrative procedure and it remits expressly to the procedural norms of the MTC, indicating that the latter are of additional application. References to the MTC would appear to indicate that the ONA recognizes the tax nature of the contributions.

**Compliance certificate**—The Ruling on Registration establishes that ONA must issue a compliance certificate within 30 business days following the payment of the contributions.

### Municipal Taxes Income Allocation

On January 20, 2010, the Political Administrative Chamber (SPA) of the Supreme Tribunal of Justice (TSJ) issued Decision N° 00057 (case: *CÓSMED-ICA C.A.: vs. Municipio Chacao*), ruling on the tax on industrial, commercial and service activities (“*Impuesto sobre Actividades Económicas*”) income allocation when a taxpayer has an administrative office in one municipality from which it carries its sales activities, and a distribution center in another municipality from which products are dispatched.

In this regard, the TSJ-SPA ruled that taxpayer’s gross income should be allocated to the municipality where the taxpayer’s sale activities are executed, in other words, the same must be attributed to the

establishment located in the municipality from which products commercial operations are developed. Pursuant to the ruling, a simple warehouse (which operates as a distribution center) located in another municipality from which the taxpayer dispatch his manufactured product and issues the corresponding invoices, does not result in sufficient nexus so as to give rise to an attribution center for municipal tax purposes.

### Tax Litigation Issues

On January, 20, 2010, the Political Administrative Chamber Supreme Tribunal of Justice published decision N° 00067, (case: *COLOMBINA DE VENEZUELA S.A.*) ruling on the obligation of the tax courts to issue their decision validating the taxpayer withdrawal of litigation without the necessity of any prior consent or approval from the court representation of the tax authority.

The decision was issued by the TSJ-SPA based on the appeal filed by the judicial representation of *COLOMBINA DE VENEZUELA S.A.*, considering the reluctance of the Instance Tax Court to homologate or validate the taxpayer request for withdrawal under the argumentation that such powers required a formal authorization from the judicial representation of the tax authorities.

In this particular decision, the TSJ-SPA stated the request for withdrawal is a facultative prerogative of the taxpayer, by means of which it may resign from its lawsuit pretension, without need of the consent or approval of the tax authority, corresponding solely to the tax courts to homologate—validate—said withdrawal, without subsequent procedural formality. Validation is limited to (1) verifying the legal “capacity”—standing—of the taxpayer’s attorneys and powers granted to the extend the same may withdraw the case and (2) that withdrawal deals with matters which are not public policy matters according to Article 264 of the Venezuela Code of Civil Procedure, applicable to tax litigation proceedings as per Article 332 of the Master Tax Code.

In any case, the TSJ-SPA expresses that the result would be different when the taxpayer is not withdrawing the

case as a whole but when the same withdraws particular pleas corresponding to the tax proceedings, e.g. such as a plea for evidence discovery, in which case, validity will be

conditional to consent or approval from the tax authorities judicial representation (in accordance with Article 265 of the Venezuelan Code of Civil Procedure). ♦

## Cross Border Services Rendered from Colombia between Related Parties Receive a VAT Exemption

by *María C. Duran, Lewin & Wills Abogados, Bogota, Colombia*

During the past few decades, trade in services has represented one of the most growing sectors in the global economy. Colombia is not a stranger to this development and it is in the process of improving certain aspects of the applicable legal regime. Until recent amendments, the Colombian VAT regime had an important obstacle for service exports between related parties that the Colombian government has eliminated to improve its legal climate and to promote service exportation.

Exports from Colombia are generally VAT exempt. However, tax regulations regarding the export of services establish a series of conditions in order for them to benefit from such exemption.

The General Agreement on Trade in Services (“GATS”) defines trade in services as the supply of a service on: (1) cross border trade; (2) consumption abroad; (3) commercial presence; or (4) presence of an individual abroad. Nonetheless, Colombian tax law establishes that, for VAT purposes, whenever a service is rendered in Colombia to be exclusively used or consumed abroad, pursuant to a written contract between the parties duly registered with the Colombian Ministry of Trade, there will be a services export exempt from VAT. Consequently, tax law only benefits cross-border trade in services. Therefore, an export of services is VAT exempt when it complies with certain conditions regarding the party contracting the service, the territorial aspect of the service, and a formal registry before the Colombian Ministry of Trade. The Colombian government recently introduced certain amendments to these conditions.

According to Colombian tax law, services rendered within Colombian territory are subject to VAT. A service is defined as any activity, operation or task rendered by an individual or entity to another individual or entity, where there is no labor relation present between the parties, and where the party supplying the service receives compensation for it.

In order to determine whether a service is rendered in Colombian territory, Colombian tax law establishes that, in general, a service is considered supplied from the place where the service is rendered; therefore, VAT is applicable in the state where the service originates. However, it is important to highlight that despite being rendered from outside of Colombia, certain services rendered abroad are deemed rendered in Colombia for VAT purposes, and are therefore subject to VAT.

With this in mind, Decree 1805 of 2010 adopted on May 24, 2010, amended and clarified the three necessary conditions to apply a VAT exemption to services exports.

First, until Decree 1805, if the party contracting the service had an economic activity in Colombia, even if it used or consumed the service abroad, the service rendered was subject to VAT. This restriction implied that if a Colombian party rendered services to a related party abroad, the service export could not benefit from the VAT exemption.

As of the adoption of Decree 1805 of 2010 on May 24, 2010, the Colombian government eliminated this

restriction, and established that any service materially rendered from Colombian territory, used and consumed abroad is VAT exempt. Nonetheless, if for any reason, the service is partially or totally used or consumed in Colombia, the service will not benefit from this exemption—regardless of whether the party rendering the service and the party receiving the service are related parties. Consequently, it is not necessary to determine whether or not the parties intervening in the export of services have any economic relationship, as long as the services are exclusively used or consumed abroad.

Second, regarding the territorial aspect of the service, there are two requirements to bear in mind. On one hand, the service must be exclusively used or consumed abroad. Decree 1805 did not change this aspect, as Colombian tax law already considered this requirement. On the other hand, the service must be materially rendered from Colombia. Decree 1805 of 2010 clarified that for VAT exemption to apply, the person supplying the service could not render the service from abroad. Therefore, taking into account that certain services are deemed rendered in Colombia for VAT purposes, even if they are being rendered from outside of Colombia, these services will still be subject to VAT, since in these cases the exporting party travels to the State where the service is used or consumed.

As of the adoption of Decree 1805, 2010, the individual or entity rendering the services from Colombia must register the services export agreements with the Colombian Ministry of Trade, prior to begin supplying the service. This registry is a necessary condition to benefit from the VAT exemption, whenever it complies with the other conditions established by law, and previously discussed.

Consequently, although Colombian export regulation still requires a lot of work to compete with other exporting countries, with these amendments Colombia improves its environment for its exporters and takes one-step forward to become a platform for companies and multinationals desiring to establish in Colombia and render services abroad.

According to Decree 2681 of 1999, the services export agreement had to be registered before the Colombian Ministry of Trade before the contracting party performed the payment for the rendered service. However, in March 2010, the Colombian Tax Court declared the nullity of this disposition and established that the services export agreement could be registered after the payment for the export. ♦

## Revenue-Raising Reform Legislation Passed in Panama

*by Javier Said Acuña and Raúl González Casatti, Rivera Bolívar y Castañedas, Panamá*

In March 2010, the government passed revenue-raising tax reform legislation to meet proposed challenges, such as the construction of the Panama Urban Rail. Among the main tax reforms is a tax increase in the transfer of movable goods and services (ITBMS, a value added tax) and an increase in the goods subject to payment of selective consumption tax (excise taxes). Additionally, companies will pay income tax at a rate of 27.5% (2010) and 25% (2011). Corporations with taxable income

exceeding US\$1.5 million annually will pay the higher amount between:

- Taxable net income calculated by the traditional method, and
- Taxable net income resulting from applying 4.67% to the total taxable income.

The capital gains tax on real estate was also subject to change in the reform legislation. Income from the

occasional sale of real property, shares and other movable goods, is subject to a capital gain tax of 10%. The taxpayer will now be required to pay a sum equivalent to 3% of the higher between the total value of the transfer and the property value, as an advance of the income tax. The taxpayer may choose to pay 3% of the total value of the transaction as the final capital gain tax. If the transaction (sale) of the property is within the ordinary course of business of the taxpayer, the income tax (capital gain tax) is calculated at a flat and final rate of 3.75% on the higher value between the total value of the transaction and the property value.

Another important change, and maybe the one that caused the most controversy, was the transfer of movable goods and service tax (ITBMS), a type of value added tax. The 7% rate is applied on the amount of goods transferred and services performed within Panama, including imported goods. (Effective from July 1, 2010, the transfer tax is 5%).

Another change involves the increase of goods now subject to the selective consumption tax (ISC), an excise tax. The tax is applied on transfers of goods and services performed that are considered luxuries, not essentials. For instance, in addition to the ITBMS, cable television service providers as well as cellular service providers are subject to ISC on the amount of the invoice. Jewelry, weapons, and automobiles are also subject to ISC at a variable rate depending on the value and type of the consumer goods. However, the most import change to ISC is the way cars are taxed. While the import tax was eliminated, the ISC has increased considerably depending on the value of the car, and now all cars pay ISC regardless of value.

The government is working on regulations to develop the themes established by the law. Nevertheless, we believe government revenues will increase significantly. ♦

## Tax Treatment of Stock Sales in Chile

*by Jorge Espinosa Sepulveda, Espinosa y Asociados, Abogados y Consultores, Santiago, Chile*

In Ruling No. 341 of 2010, the Internal Revenue Service (“IRS”) established the tax treatment applicable to the higher value resulting from the sale of stock. Such treatment is dependent upon whether or not the operations involving the acquisition and sale of stock are habitual. The IRS has defined four different situations a taxpayer may find itself in with regard to article 17, No. 8 and article 18 of the income tax law.

**(1) Habitual Engagement in Acquisition and Sale of Stock**—If the taxpayer is habitually engaged in activities involving the acquisition and sale of stock, regardless of the time elapsed from the stock acquisition and sales date, the higher value resulting from such operation (where the higher value is the difference between the stock sales price and the stock acquisition price, readjusted according to the fluctuation of the consumer price index as of the sales date with the gap contemplated by

the law) constitutes income for all tax purposes in Chile. As such, it is subject to the general taxes stipulated in the First Category Tax with a 17% rate, applied on the earned or accrued income and the Global Aggregate Tax or Withholding Tax, as appropriate, when stipulated by the legal provisions that regulate such personal taxes.

**(2) No Habitual Engagement in Acquisition and Sale of Stock**—If the taxpayer is not habitually engaged in such types of activities, and less than one year has elapsed from the stock acquisition and sales date, then the higher value resulting from that operation is subject to the same taxes mentioned in number 1 above.

**(3) Sale to Partnership, Closely Held Stock Company, or Openly Held Stock Company**—If the taxpayer sells the stock to a partnership, closely held stock

company or openly held stock company, where the same is also a partner or shareholder, or to companies where it has an interest, the higher value obtained by the same is subject to the same taxes referred to in number 1 above. It should be noted that in cases where stock is sold to an openly held stock company, if the taxpayer wishes to be under this tax treatment, it must own 10% of stock or more of the acquiring company.

**(4) Not Habitually Engaged and At Least One Year Elapsed from Acquisition and Sales Date**—If the taxpayer is not habitually engaged in such types of activities and one year or over one year has elapsed from the stock acquisition and sales date, then the situation is as follows. Pursuant to paragraph three of No. 8 of article 17 of the appropriate law, the higher value resulting from such operation constitutes income for all tax purposes, being subject to the First Category Tax with a 17% rate only and applied on the income earned or accrued. Notwithstanding the foregoing, if such higher value is obtained by a person that is not obligated to file its effective income under the First Category regime, that person is generally exempt from the referred single tax.

#### Probable Tax Reform

Government authorities are evaluating strategies to rebuild the regions struck by the devastating

earthquake that affected Chile on February 27, 2010. One strategy is a tax reform involving income tax levied on corporations. However, the probable revenue raising outcome would not be too high and other benefits to compensate this raise are under evaluation.

#### Conventions to Avoid Double International Taxation Entered into by Chile

As of December 2009, the Conventions to Avoid Double Taxation that are currently in force are: Argentina, Brazil, Canada, Colombia, South Korea, Croatia, Denmark, Ecuador, Spain, France, Ireland, Malaysia, Mexico, Norway, New Zealand, Paraguay, Peru, Poland, Portugal, United Kingdom, and Sweden.

The following Conventions have been signed but are not yet in force: Australia, Belgium, Russia, Switzerland, Thailand, and the United States. Negotiations with South Africa have concluded.

Chile is negotiating Conventions with the following countries: Austria, China, Cuba, Czech Republic, Finland, Hungary, India, Italy, Kuwait, Netherlands, Uruguay and Venezuela. ♦

## Taxation of Financial Instruments in Mexico

*by Jorge Salles-Berges, Ortiz, Sosa, Ysusi y Cia, S.C. Asesores Fiscales, Distrito Federal, México*

Congress approved the tax reform bill, published in the Official Gazette last December 7, 2009. Most of its provisions became effective as of January 1, 2010.

A new taxation scheme was established to determine accruable interest income for individual taxpayers resident of Mexico, including that accrued by investment funds for their members or shareholders, which will go into effect as of January 1, 2011. Transitory provisions establish that for the 2010 tax year, the

current regime—applicable until the 2009 tax year—will continue to be applied for 2010.

To determine income tax withholding on interest income under the applicable tax regime in force, financial institutions apply the rate established in the Federal Income Act, which is decreased from 0.85% to 0.60% annually, on the amount of principal that generates interest. Such withholding is considered on account of the annual income tax for both individuals and entities.

Under the new tax regime for 2011, the procedure that financial institutions will apply to compute the amount to be withheld is determined by applying the general corporate income tax rate to the real interest accrued, rather than to the amount of principal.

Given the distortions that arise under this new scheme, we believe that it will probably be amended and/or adapted in the subsequent legislative sessions before it goes into effect.

This article discusses about the new interest regime for 2011, applicable for individuals resident in Mexico.

### New Interest Regime Mechanism

The new taxation scheme applicable for 2011 considers a new method for the calculation of the real interest accrued by individuals, which consists of applying a mechanism known as “cash-in cash-out”, while the effects of inflation are recognized through the use of investment units (UDIS).

Real interest will generally, with certain exceptions, be taxable as it accrues, not when it is collected, as is the case under the current tax regime. Commissions collected by financial institutions will be deductible under this procedure.

Payment of income tax will be made by means of withholding applied to the amount of the positive real interest. If a negative real interest is generated, no withholding may be applied and this will generate a tax credit that can be applied in the subsequent 10 fiscal years exclusively against the same type of income, adjusted for inflation.

No transitory regime is established regarding undeducted negative real interest that is generated up to December 31, 2010.

The income tax withholding rate will be the general corporate income tax rate, which for fiscal year 2011 will be 30% of the amount of positive

real interest accrued, and will be applied to the available funds held in the taxpayer’s accounts or financial assets.

In those cases where the interest is paid by persons not engaged in the financial system or refers to interest on credit instruments not listed in the public market, the individual himself will be responsible for paying the tax on a monthly basis.

In this sense, the new law is not clear enough on the applicable category of income under which interests obtained by individuals should be taxable. The relevant chapter regulating interest income and the one applicable to other income include this concept.

As one of the distortions, the relevant chapter on interest establishes that residents in Mexico who make payments for these items must provide the tax authorities with information related to the payments. Furthermore, every month they must notify the persons to whom they pay the interest of the amount of the real interest accrued, even when it is negative, which obligation, is not included in the chapter related to other income.

It is questionable that the person who pays the interest should also be responsible for determining the real interest accrued, because the latter is no longer required to withhold the income tax.

For individuals, any income tax paid on the amount of positive real interest, either by means of withholding or direct payment, will be considered as a final payment; therefore, individuals will no longer have to file an annual tax return for this type of income. Individuals will only be required to report in the annual tax return, the amount of interest obtained in those cases where their total annual income exceeds \$500,000 (which includes exempt income, taxed income and income on which the final tax has been paid).

In the case of corporations, any tax that the financial system withholds to them will continue to be

considered as an advanced payment, which may be credited against their annual tax payable. For this reason, the provisions related to the recognition of this type of income and the corresponding annual adjustment for inflation, are not modified.

### Interest From Abroad

Interest derived from deposits made abroad, or on credits or loans granted to residents abroad, must pay income tax on a monthly basis and will be considered as a final payment. Under the current tax regime tax is paid on an annual basis.

The tax credits derived from the negative real interest accrued and credits or loans which are bad debts may also be applied based on the same rules discussed above.

No specific procedure is established to determine the exchange gain or loss, because such effect will be recognized as part of the new interest mechanism, at the time the opening and closing balances of the accounts or deposits made abroad are converted into Mexican pesos.

Given that the new mechanism for determining the positive real interest accrued includes the exchange gain or loss, cases might arise in which income tax is paid on positive exchange fluctuations in one month, and in the following months a tax credit is generated as a result of negative exchange fluctuations, anticipating tax payments.

### Economic Effects of the New Regime

The relevant economic effects for individuals under the new interest regime will be as follows:

- Interest received from the financial system will be taxable as it is accrued, not when it is effectively received. Consequently, the tax is paid on income that has not yet been received.
- The obligation of filing an annual tax return for obtaining interest income in the case of individuals is eliminated effective 2011; therefore, taxpayers would pay a higher tax than that applicable on his level of income and, as the case may be, after any personal deductions have been taken.
- In certain cases, it will be necessary to sell any investments held in order to be able to cancel or transfer the accounts or investments to another institution in the financial system, which could generate an economic loss for the taxpayer, depending on the market conditions at the time the assets are turned into cash.
- The negative tax credit generated from obtaining real interest can only be applied by the institution from the financial system in which the interest-bearing investments are held. If there are investments in other institutions, the tax credit cannot be applied against the positive real interest accrued in the other institution.
- The possibility of applying the negative real interest from the other income obtained by individuals is eliminated. Under the tax regime in force, the negative real interest can be applied against any other income received, except income from wages and income from business and professional activities.
- No transitory regime is established for unapplied negative real interest generated up to December 31, 2010, thus generating uncertainty about the right to deduct it in subsequent years. ◆

# Judicial Opportunities in Brazilian Payroll Reduction

*by Fabio Medeiros and Patricia Medeiros Barboza, Machado Associados Advogados e Consultores, São Paulo, Brazil*

Payroll tax has traditionally been a focus of litigation in Brazil. However, interest in judicially recovering potential credits in relation to social contribution on payroll has recently skyrocketed in light of the upcoming deadline for companies to claim reimbursement of unduly paid social contributions on payroll as to the last ten years, which shall expire in early June, 2010.

The basic ground for judicial recovery is the allegation that certain amounts received by employees do not meet the definition of compensation for work and, therefore, cannot be part of the calculation basis for social security contributions in view of the concept of social security taxable event outlined by the Brazilian Federal Constitution.

There are, at present, four main discussions based on such grounds with good chances of success for the companies:

**Prior notice**—payment in lieu of work: case law has defined that payment in lieu of work is not subject to social contributions as such payment is an indemnification to the employee in view of the fact that the employee was prevented from working during the prior notice period by the employer's decision (and thus received compensation for such work), which is a right granted by law.

**Illness allowance**—no social security contributions are due on amounts received by employees in the first 15 days of absence due to illness, even if the payment is afforded by the employer, since there is no work in such period.

**Accident allowance**—because accident allowance is paid exclusively by Social Security and is not compensation for work, there are precedents that the amount of the accident allowance is not subject to social contributions.

**Constitutional 1/3 vacation bonus**—Case law has recognized that the amount of the Constitutional 1/3 vacation bonus paid to public servants is not subject to social contributions; private companies are awaiting the Supreme Court's decision as regards such payment to employees of private companies, expecting it to follow the same line of thought of such precedent.

Companies have also been involved in two other discussions, the first related to payments to employees during maternity leave and the second to vacation payments, but with not such favorable results according to case law.

## Accident Prevention Factor "FAP"

Another subject that has been raising a high level of interest is the so-called "FAP" (Fator Acidentário de Prevenção) or Accident Prevention Factor. FAP was created to customize the rates of the so-called "SAT" (Seguro Acidente de Trabalho—Labor Accident Insurance; a kind of social security contribution that varies from 1% to 3% on payroll, depending on the business of the company) on payroll. Such rates can be reduced to half, or increased by 100%, by establishing an individual percentage for each company based on, among other factors, its accident occurrence index.

The application of FAP aims at benefiting companies that present low accident occurrence and accident-related absence rates and encouraging companies with accident occurrence indexes higher than the average of their economic sector to invest in work environment safety. Companies with an increase on SAT rates in view of FAP are judicially discussing its constitutionality, alleging that it is not compatible with the Brazilian Constitution because of its implementation; there are already precedents sustaining such argument.

### Transportation Voucher Paid In Cash

No social security contribution is due on transportation vouchers granted in cash to employees. This was the conclusion of the majority of the Plenary Session of the Federal Supreme Court (“STF”), which on March 10, 2010, judged Extraordinary Appeal (RE) 478.410 filed by the bank, Unibanco. According to the vote of Reporting Judge Eros Grau, when paid “as transportation voucher or in cash” the payment made by Unibanco “does not affect the benefit’s non-salary nature.”

This has been a controversial matter for a long time. On one hand, when establishing the Law that implemented the transportation voucher (Law no. 7,418/1985), article 5 of Decree no. 95,247/1987 addressed an aspect that had not been provided by law when it determined that:

*The employer shall not replace the Transportation Voucher for an advance in cash or any other payment form, except as provided in the sole paragraph of this article [emphasis added].*

On the other hand, Law no. 8,212/1991 says that the “amount received as transportation voucher, according to the legislation on the matter” is not part of the social security contributions’ taxable basis (article 28, paragraph 9, item “f”). In practice, the Brazilian Federal Revenue Service (“RFB”) uses article 5 of Decree no. 95,247/1987 as the *legislation on the matter* to be complied with and has been issuing assessment notices to companies that do not consider the transportation voucher paid in cash as a taxable amount.

The amount in cash paid as transportation voucher *does not qualify as taxable basis for the social security contributions to be paid by the company*, as established in article 195, I, “a” of the Federal Constitution, since it is not compensation for the work performed by its employees. This has actually been one of the arguments used by the company in RE 478.410, even though the vote

of the Reporting Judge has been more based on the concept of “cash” and eventually declared that article 5 of Decree no. 95,247/1987 “is completely incompatible with the tax system of the Constitution of 1988.”

Among the important legal aspects of this precedent, it should be highlighted that the *decision is only valid for the claimant of the judged proceeding*. Accordingly, even though the ruling is favorable to the line of defense adopted by taxpayers, as it eliminates the compensation nature of the transportation voucher paid in cash, the STF decision was not issued through a direct unconstitutionality action; through the so-called “general repercussion” system; nor did it originate a binding precedent, that is to say, the decision is not automatically applicable to other companies.

This STF precedent, however, is a savings opportunity for many companies, because if the transportation voucher benefit is paid in cash, the costs associated with providing such services, for instance the management and control of paper transportation cards or magnetic transportation cards, tend to be eliminated, as the benefit would be paid through payroll and credited to the employees together with their other earnings.

Accordingly, companies interested in making payments of transportation vouchers in cash without including such amounts in the taxable basis of the social contributions (company and employees’ social security contributions and the ones destined to third parties) may file a proceeding aiming at benefiting from this precedent.

A proceeding of this type, for instance, would also aim at eliminating, through a preliminary injunction, the risks of assessment notices by the RFB due to the lack of payments and for the ancillary obligations that would not be met [information on the Unemployment Severance Fund and Social Security Payment Form (GFIP), entries stated on payroll and/or in accounting etc.]. ♦

# Unilateral Determination of Taxes in the Dominican Republic

*By Norman de Castro, Milciades Rodriguez, and Adolfo Toca, Pellerano & Herrera, Dominican Republic*

In March 2010, the tax administration issued General Rule 02-2010, which establishes the applicable procedures for the unilateral determination of taxes and the right to rectify tax returns by the tax administration.

The scope of the General Rule extends to the integral process of unilateral determination of tax by the tax administration, and the right to rectify tax returns filed by the taxpayers when: (1) an omission is identified; (2) an anomaly is detected in the accounting records; (3) an inconsistency is verified in the tax return made; and (4) a discrepancy in the data provided or any other event that, in accordance to the tax code, must be corrected by filing a tax return or rectifying the present tax return. The process ends with the notification of the resolution, which unilaterally determines the tax amount or a request for a rectifying declaration or the issuance of a waiver/release document. This rule does not include the reconsideration process, in the event that the taxpayer disagrees with the results of this phase.

The determination can be made—in accordance with the tax declaration filed by the taxpayers, liable parties or third parties—in the period and conditions established in the regulations. The declarations are considered to be true, notwithstanding the right of the tax administration to verify the accuracy of such declarations or to modify the items that are challenged.

The tax administration may proceed to unilaterally determine, on solid basis, mixed basis or on a presumed basis, the taxes in any of the following situations:

- When the taxpayer or liable party has omitted the filing of the tax declaration;
- When the tax declaration offers doubts related to its sincerity and accuracy; and

- When the tax declaration is not supported by documents, accounting books or other means that the tax rules establishes or is not displayed in such documents.

Where determination of the tax obligation on a “certain basis” is impossible, the tax administration must resort to a determination on a mixed basis, and then on a presumed basis. It will be interpreted that an impossibility exists to know, in a certain and direct manner, the facts established under the law as tax generating activities in the event of partial or total inexistence, or failure to provide the accounting records or documentation related to the operations in accordance with the legal and regulatory provisions, when the accounting is not consistent with the principles and accounting techniques, and when it shows that the accounting records and documentation do not relate to reality. Accounting records or documentation that is illegible or incomprehensible will also be considered as nonexistent.

**Procedure to make an unilateral determination**—The determination documents, whether they are made under certain, presumed or mixed basis, must be appropriately supported. They must clearly state the aspects related to the taxable events and obligations. When taxpayers go before the tax administration, they must receive a subpoena form specifying facts, inconsistencies, failures and omissions that have been identified. The taxpayer must sign the form as receipt.

**Deadline to present a Discharge Letter**—Taxpayers have 15 days after receipt of the subpoena to file written argument and present evidence to sustain their rights for the tax administration to discharge a “failure to comply.” ♦

## Off-Shore Company Reform in Uruguay

*by Guzmán Ramírez, Ferrere, Montevideo, Uruguay*

The 2007 Tax Reform issued a death sentence of the famous SAFIs (offshore investment corporations), who must cease operation as such by December 31, 2010. On February 19, 2010, Decree 94/10 approved certain rules clarifying the way in which SAFIs must adjust to the general tax system. In this regard, the decree provides mandatory closing of the financial statements at that date, and mandatory commencement of monthly advance payments of the Corporate Oversight Tax (ICOSA) in January 2011. Nevertheless, use of ordinary companies and adequate tax planning make it possible to design appropriate structures to ensure a seamless change. The use of SAFIs has been so extensive because they could be used to engage in offshore activities while paying a single tax of 0.3% on the company's taxable net worth. These companies had a very low tax burden. One might ask whether this tax charge was really a sort of tax benefit. The answer is no. While in some

cases using a SAFI can imply a lower tax burden than using an ordinary company, the difference often is not so significant and in some cases is even nonexistent. This is because SAFIs have been used to performing activities outside Uruguay, which in any event are not totally subject to income tax, net worth tax and VAT when they are performed by ordinary companies. How can the same activity be performed in a convenient way? By use of ordinary corporations. Income tax, net worth tax and VAT are levied on income and net worth located in Uruguay. This means that income obtained outside the country and assets located abroad are not subject to these taxes. The above implies that an ordinary corporation having all its assets outside Uruguay and not generating any income whatsoever in the country can operate without paying income tax, net worth tax or VAT. In such cases, by using an ordinary corporation it may even be possible to pay less than by using a SAFI. ♦

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## Tax Reform, New Obligations in El Salvador

*by Antonio Méndez and Patricia Orozco, Romero Pineda & Asociados, San Salvador, El Salvador*

The recent tax reform has been a common ground for speculation and discussions. In theory, the reform is an attempt to fine-tune the capacities of the tax authority to fight tax evasion and elusive behavior for revenue generation without increasing taxes or tariffs, but simply by collecting more of the same taxes. To this effect, the tax authority has been endowed with new capacities, powers, and in fact we have to admit that new taxes were also created. We intend, in this brief review, only to draw attention to some of the aspects of the new tax regulations, which in turn, imply changes to which we must adapt our practices in order to comply with our new tax obligations, and to know the legal limits in the application of the law.

### Tax Code

Reforms were implemented through modifications in a group of related laws. Nevertheless, Decree No. 233 of the Legislative Assembly (published in the Official Gazette on December 21, 2009) is the nucleus of reforms affecting the tax administration by regulating evasive and elusive tax behavior, and responding to taxpayer needs—the need for continuous modernization of the regulations and a reorientation of tax controls.

More relevant aspects of the reform include:

- [1] Obligatory registration of entities such as the Union of Individuals, *De Facto* corporations, and other entities without legal existence.

This substantial change abandons the traditional concept of legal entities arising from a formal and determinate legal event. Under the reform, certain joint actions—the legal existence of which under other areas of law would not be recognized—undertaken by individuals or entities the legal give rise to joint formal and tax obligations before the tax authority. In business planning, it is critical that attorneys review scheme structures to determine the existence of these new, joint tax obligations. Additionally, such companies must appoint at least one individual with enough legal capacity to act on behalf of the business entity and who is physically present in the country.

- [2] The tax authority must be informed of any modifications or terminations of business schemes within ten working days from the implementation date.
- [3] The new regulations implement the control of transfer pricing practices. Transactions between related entities are to be recorded at market prices to avoid artificial transference of costs and consequently, earnings margins (which may diminish the tax base as a whole).

For example, taxpayers that conduct transactions with related entities or entities domiciled in tax havens or low tax jurisdictions are obligated to inform the tax authority of all such transactions in excess of \$571,429.00, within the first three months of every tax year. Even more critically, even when the taxpayers have set prices to their transactions, the tax authority can set different prices for such transactions if it considers that prices set by taxpayers are not according to market price. Such a price set forth by the tax authority shall be used as a base to calculate taxes due.

- [4] Withholdings to non-domiciled entities or individuals shall be as follows: Payments of any kind of income considered as obtained in El Salvador, even prepayments of income, shall

be withheld 20%. Even though this withholding percentage is considered as the definitive payment amount of the tax, it still grants the taxpayer the possibility to file a tax return.

- [5] Taxpayers obligated to withhold amounts on payments shall be jointly and severally liable for the amounts to be withheld in case withholding is not effected.
- [6] Specific withholding rates according to the transaction conducted have been implemented:
- International transport 5%
  - Foreign financial entities 10%
  - Payments to entities located at tax havens 25%
  - Payments to insurers, re-insurers and bond issuers 5%
  - Payments for intangible goods 5%

### Income Tax Law

Decree No. 236 introduced reform to the income tax law. Among other novelties, the following stand out:

1. **Taxable interest**—Individuals with an average bank account balance in excess of \$25,000 are subject to a new tax under Article 4, number 5 on interest paid on loans.
2. **Tax on earnings from securities**—Earnings obtained from securities transactions in the stock market are taxable, and reported on a separate return. A 10 percent tax on income derived from securities transactions was also enacted.
3. **Bank accounts overseas**—Abandoning the general tendency toward territorial taxation of income, bank deposits of Salvadorans overseas will be taxed at 10 percent where the foreign account deposits are not taxed overseas, and the difference between the overseas tax rate and 10 percent where the deposits are taxed overseas. Income obtained from such deposits must be reported.

### Formal Obligations

The tax authority published a chart summarizing new taxpayer obligations, transcribed from Spanish below:

## FORMAL OBLIGATIONS OF TAXPAYERS

TAXPAYER OBLIGEE	OBLIGATION TO COMPLY WITH	FORM	DATE OF FILING	DEADLINE FOR FILING
Individuals, legal entities, inheritances, trusts or any other business scheme legal entity which request registration for the first time.	<p>Shall pay a special tax for first time registration of moveable goods in El Salvador's territory.</p> <p>The taxable event of this tax is Registration for the first time of:</p> <ol style="list-style-type: none"> <li>Automobiles at the public registry of motor vehicles.</li> <li>Boats and naval ships at the Registry of the Sea and Port Authority.</li> <li>Airplanes at the Aviation Authority's Registrar Office. Exemption for commercial airlines.</li> </ol>	F10v1 "Filing for the payment of special tax to first time registration"	Tax shall be paid only one time in the amount determined by the law. The tax shall be due when the request for registration for the first time of the goods is filed at the public registrar offices.	Within five working days following the filing of the definitive import request. Within 5 working days of acquisition of the good in the country. Within five working days from the date of acquisition of the good in the country, under any kind of title which is described in the public deed document. Within five working days from the end of the term of permanence, navigation and operation for goods with foreign registration referred to in article 3 of the Law for taxation for first time registration.
Judges of the Republic.	Report information of attorneys which are parties in Court Proceedings as attorneys for the defendants or plaintiffs.	F-981v1 "Judges Reports of Court Proceedings".		15 days after the attorney has filed for accreditation in the proceeding.
IVA Taxpayers	Report the correlative numbers of their printed extant documents at the moment of entrance into force of the Tax Reform Bill.	F-921v2 "Report on Existence of Printed IVA Documents.		"29 of January 2010.
Producer or importer of alcoholic beverages.	Report on detailed physical inventory of alcoholic beverages owned at the entrance into force of the legal reforms to the Law which regulates the Commercialization and Production of Alcoholic Beverages and Alcohol.	F-952v1 "Report on Physical Inventory of Alcoholic Beverages."		29 of January 2010.
Producer or importer of soft drinks, isotonic beverages, juices, and concentrated powder for soft drinks.	Report on the inventory of goods to be taxed owned at the entrance into force of the legal reforms.	F-954v1 "Report on Physical Inventory of soft drinks, isotonic beverages, juices, and concentrated powder for soft drinks."		29 of January 2010.
Producer of alcoholic beverages, makers of tobacco products. Fabricant of soft drinks, isotonic beverages, juices, and concentrated powder for soft drinks.	File a report indicating the suggested sale prices to the public and end consumer of their products.	F-948v2 "List of suggested sale prices to the public and end consumer of alcoholic beverages, makers of tobacco products. Fabricant of soft drinks, isotonic beverages, juices, and concentrated powder for soft drinks.		February 1 <sup>st</sup> 2010 for the first time, and January of each year afterwards. Also filing shall be made within a term of 10 working days from the date a change in prices is effected.

# Amendments to Luxury Home Tax and Free Trade Zone in Costa Rica

by Gabriela Barrantes, Facio & Cañas Abogados, San José, Costa Rica

## Luxury Home Tax

The Costa Rican tax administration released Resolution No. 310-2010, pertaining to the Luxury Home Tax that came into effect on October 1, 2009. The resolution establishes that hotels and villas are subject to luxury tax and must, therefore, be included in the list of those liable to pay the tax. In this regard, ownership of property, title, or a right of use or enjoyment of property for residential use located in Costa Rica is a taxable event. The property must be used in a regular, occasional, or recreation way. Consequently, hotels or villas made up of permanent buildings and facilities whose value exceeds ₡100,000,000 (one hundred million colones) are required to pay the Luxury Home Tax.

## Free Trade Zones Regime Law

The amendment to the Free Trade Zones Regime law came into effect on January 22, 2010. This regime facilitates the operation of national and foreign companies that desire to invest in Costa Rica and comply with certain legal requirements. The reform includes many innovations, incentives, and a new classification of companies protected by the regime. It seeks to comply with the World Trade Organization rules of elimination of subsidies. The law grants a number of exemptions, including an exemption from the payment of all taxes on imports and domestic tax when certain materials are destined for recycling or reuse. However, certain industries may not take advantage of the free trade zone. The law excludes mining and weapons companies, and companies dedicated to hydrocarbon exploration or extraction, and electricity generation. ♦

# Bolivian Administrative Resolutions Issued

by Ramiro Guevara, Guevara & Gutiérrez S.C. Servicios Legales, La Paz, Bolivia

Three Administrative Resolutions of note were issued in the first quarter pertaining to, in part, the Financial Transactions Tax and virtual office procedures.

**Administrative Resolution N° 10.0003.10**—(Regulation on the Financial Transactions Tax (“ITF”), dated March 19, 2010, stipulates the requisites, conditions and procedures that must be carried out by the Internal Revenue Service, taxpayers and withholding agents regarding the Financial Transactions Tax, in order to make the payment, collection, supervision, charge and obtain exemptions on the tax.

**Administrative Resolution N° 10.0004.10**—dated March 26, 2010, this Resolution regulates the procedure for presenting sworn statements (tax forms) without

data, by means of the service set forth in the web site denominated “Virtual Office” or alternatively, by means of the SMS system. This Resolution also stipulates the implementation of the Virtual Office for taxpayers and/or responsible third parties. The use of this Virtual Office is mandatory for every taxpayer and/or responsible third party in the General Regime (categorized as Newton users) or those who do and must therefore present original sworn statements without data by using the SMS system through cell phones with respect to the Added Value Tax and/or the Transactions Tax, with the exception of the Newton users.

**Administrative Resolution N° 10.0005.10**—dated March 30, 2010, modifies the Seventh Final Disposition of the Resolution from the Board of

Directors N° 10-0003-10, dated March 19, 2010 in accordance with the following text: Seventh.- The Resolution from the Board of Directors N° 10.0003.10, dated March 19, 2010, shall be in force starting June 1, 2010, from which date on

the Resolutions from the Board of Directors N° 10.0020.06, dated July 27, 2006, N° 10.0021.06, dated July 28, 2006, N° 10.0026.06, dated September 4, 2006 and N° 10.0009.08, dated March 11, 2008, shall no longer be valid. ♦

## New At Source Withholding Tax Rates in Ecuador

by César R. Holguin, LawNetworker S.A. Asesores Legales, Guayaquil, Ecuador

The IRS issued Resolution N° NAC-DGERCGC 10-00147 (published in Official Gazette N° 196, dated May 19, 2010) modifying at source withholding tax rates, which will become effective on June 1, 2010.

Payments made on account of fees, commissions, and other payments made to nationals or foreign individuals residing in Ecuador for more than six months are now subject to 8 percent withholding. Such persons must provide services where the intellectual factor prevails over the manpower (labor), provided such services are not related or associated with a professional college degree obtained by the service provider. If such services are related or associated with a professional college degree obtained by the service provider, a 10 percent withholding tax will be imposed. Again, this applies to foreign and domestic individuals residing in Ecuador for more than six months.

These amendments seek to define the withholding tax percentages for providing services in connection with VAT withholding of 70% and 100%. Where the services are not related to a professional college degree, the VAT withholding tax shall be 70% and 30% will be paid to the service provider. Where the services are related, the VAT withholding tax will be 100%. In all cases, VAT withheld must be paid to the IRS.

The new withholding tax rates are as follows:

### 1% Withholding Tax:

- Interest and commissions arising out of credit operations between financial institutions;
- Private passenger transportation services, and pub-

- lic or private cargo transportation services; and
- Electric energy

### 2% Withholding Tax:

- Purchase of corporate movable goods, except fuel;
- Real estate construction and other similar activities;
- Services paid to individuals, in which the manpower (labor) prevails over the intellectual factor;
- Payments made by credit card issuers to their affiliated establishments;
- Income on account of interest, discounts, and other financial yields. Occasional capital gains for the sale of stock, shares and other rights in corporations are not subject to any withholding tax;
- Interest paid by entities to the public sector;
- Payments and credits to insurance and reinsurance companies legally established in Ecuador;
- Payments and credits to merchant lease companies (legally established in Ecuador) on lease quotas;
- Communication and advertising services.

### 8% Withholding Tax:

- Fees, royalties, copyrights, or any other payment or credit made to individuals resident in Ecuador related to the exploitation of intellectual property;
- Notaries, real estate and commercial registers;
- Real estate leases;
- Sportsmen, trainers, referees, and members of the technical team;
- Foreign and national performers, artists, and teachers who have resided in Ecuador for more than six months. ♦

## Employers Eligible for Social Security Tax Exemption in Puerto Rico

by Nikos Buxeda, Esq., Adsuar Muniz Goyco Seda & Perez-Ochoa, P.S.C., San Juan, Puerto Rico

The Hiring Incentives to Restore Employment Act of March 18, 2010 (“HIRE Act”) provides tax incentives to Puerto Rico employers that hire certain unemployed persons within certain time periods. The

tax benefits provided by the HIRE Act include:

- Employers exempt from 6.2% social security tax on the salary paid to each qualified employee for services rendered between March 19 and December 31, 2010; and
- A cash payment of a maximum of \$1,000 for each qualified employee, hired during a certain time period, who continues to be employed by the employer during at least 52 consecutive weeks. The cash payment is the lesser of \$1,000 or the 6.2% social security tax on the salary of the qualified employee during the 52 week period.

To qualify for the 6.2% social security tax exemption, the employee must meet the following requirements:

1. Commence his or her employment after February 3, 2010 and before January 1, 2011;
2. Certify under penalty of perjury that he or she had not been employed for more than 40 hours during the 60 days prior to the commencement of employment;
3. The employee may not be employed to substitute a former employee, unless the former employee was dismissed with cause or terminated his or her employment voluntarily; and
4. The employee may not have certain family and other relationships with the employer or, in the case of corporate employers, with a shareholder of the corporation that directly or indirectly (pursuant to certain attribution rules) owns more than 50% of the issued and outstanding shares of the corporation.

To qualify for the cash payment, the employee must have been employed any day of any taxable year of the employer ending after March 18, 2010, and be employed during at least 52 consecutive weeks. Additionally, the aggregate salary paid to the employee during the second 26 week period of employment must be at least equal to 80% of the aggregate salary paid during the first 26 weeks of employment. The cash payment is a one time benefit and may be claimed with respect to each qualified employee when the 52 consecutive week requirement is met for the first time. The payment will be made by the Secretary of the Treasury of Puerto Rico, out of funds that will be provided by the United States Treasury, so long as the Secretary of the Treasury of the United States approves a plan submitted by the Secretary of the Treasury of Puerto Rico for the expedited payment of the cash payment to the Puerto Rico employers. ◆



## ABOUT US

We are a network of advisors composed of Latin American, Caribbean, U.S. and Canadian professional firms. The network was formed with the goal of offering the highest level advisory services in participating countries, with special emphasis on keeping our clients up to date on the latest developments.

Our organizational structure allows us to share experiences and professional know-how, always keeping in mind the perspective and reality of each individual country. Our experience with laws and tax cases at the Hemispheric level, along with constant information

sharing regarding the latest tax trends, ensure that our clients are well informed and prepared to deal with their tax issues.

## OUR MISSION

The Network's objective is to contribute to the investigation and analysis of tax policies and strategies, and share such information in both the public and private spheres. We will always seek to propose solutions that will improve the position of the business communities in Latin America, the Caribbean, the United States and Canada.

## OUR VISION

We will continue to establish ourselves on a regional basis as the premier professional tax and legal organization, working in accordance with the highest standards of quality, integrity, and corporate efficiency.

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