

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.

Transfer Pricing Developments in Argentina

by Juan Manuel Soria Acuña and Eduardo Aguilera, Mitrani, Caballero, Rosso Alba, Francia, Ojam & Ruiz Moreno, Buenos Aires, Argentina

As we reach the final quarter of the year, the National Tax Court is deciding more transfer pricing cases for the 1998 and 1999 fiscal periods, thus clearing many of the uncertainties contained in the statutes. In *Nobleza Piccardo S.A. C.I. y F. c/ AFIP-DGI*, the National Tax Court seems to rank the Comparable Uncontrolled Price Method as a priority method for

[T]he National Tax Court seems to rank the Comparable Uncontrolled Price Method as a priority method for transfer pricing adjustments.

transfer pricing adjustments. In *Volkswagen Argentina S.A. c/ AFIP-DGI*, the National Tax Court required effort from both the taxpayers and the fiscal authority when justifying or questioning transfer pricing reports or adjustments.

In a different issue, the Federal Court of Appeals confirmed the traditional standard regarding the deductibility principle for companies.

Transfer Pricing Method Hierarchy Established by Federal Tax Court

In *Nobleza Piccardo S.A. C.I. y F. c/ AFIP-DGI* (July 15, 2010), Courtroom "B" of the National Tax Court had to decide the applicable transfer pricing method for export operations from an Argentine cigarette manufacturer (*Nobleza Piccardo*) to its affiliate distributor in Chile (British American Tobacco or "BAT"). The latter owns 70% of the shares of the first.

The assessment issued by the Argentine Revenue Service (ARS), questioning the value of the export operations in 1999 and 2000, was based

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mainly on the fact that the prices at which BAT distributed cigarettes in Chile and the prices at which *Nobleza Piccardo* distributed cigarettes in Argentina were similar as to each other but significantly higher than the price of the transactions between *Nobleza Piccardo* and BAT, violating the arm's length principle. Furthermore, the Customs Service of Chile had informed the ARS that the ultimate buyer of the exported goods had valued the imported goods at a price that exceeded the \$12.5 million whereas *Nobleza Piccardo* reported a value of \$7.5 million. The ARS concluded that the difference of \$5 million was Argentine source income unduly assigned to the trader located in Chile.

In its annual transfer pricing report the taxpayer had applied the Transactional Net Margin Method, while (according to the ARS) it should have applied the Comparable Uncontrolled Price Method for 1999 and the Cost Plus Method for 2000.

The National Tax Court rejected the adjustment for the 2000 fiscal period based on the same arguments that led it to confirm the first one: The Uncontrolled Price Method should be applied, if possible, by both the taxpayers and the ARS.

The National Tax Court began its ruling by analyzing the proposed adjustment for 1999. By quoting tax scholars' opinions and OECD guidelines regarding different criteria to decide the applicable transfer pricing method for a transaction, it was pointed out that a certain majority seems to support the idea that there is a hierarchy of method to determine the correct price that falls within the arm's length principle. The operation methods (Comparable Uncontrolled Price Method, the Resale Price Method and the Cost Plus Method), should be preferred over the profit methods (include the Profit Split Method and the Transactional Net Margin Method). Specially, the Comparable Uncontrolled Price Method should be the priority method.

The National Tax Court admitted the transfer pricing method used by the ARS but ordered a modification of the adjustment. The Court stated that even if the Uncontrolled Price Method is applicable to the case, the adjustment would imply a profit margin of 116.12% while the average for the industry is 45.2%. Consequently, the adjustment for 1999 has to be adapted to that percentage, of 45.2%.

Regarding 2000, the ARS had argued that the Uncontrolled Price Method was not applicable due to the lack of comparables for that fiscal period. The ARS pretended to use the Cost Plus Method.

The National Tax Court rejected the adjustment for the 2000 fiscal period based on the same arguments that led it to confirm the first one: The Uncontrolled Price Method should be applied, if possible, by both the taxpayers and the ARS. The need to apply a different method should be sufficiently argued and proven by the ARS.

Transfer Pricing Adjustments for the Automobile Industry Decided

On July 12, 2010, Chamber “D” of the National Tax Court ruled on *Volkswagen Argentina S.A. c/ AFIP-DGI*, which involved transfer pricing adjustments proposed by the ARS for the 1999 fiscal period. This is the second case involving VW and transfer pricing regulations as an adjustment for the 1998 fiscal period was previously analyzed by this Court.

[U]nlike individuals, companies are allowed to deduct any cost connected to the source of income.

The Court pointed out that 1999 was a very particular year for the automobile industry. A negative economic scenario produced a series of unwanted effects such as massive lay offs, default of debtors and excess productive capacity. Taking into account that VW had chosen foreign companies as comparables for its annual transfer pricing reports, an adjustment had to be made in order to adapt the financial statements of those foreign companies—doing business in countries with a different economic situation—with the crisis situations going on in Argentina. The selected transfer pricing method was the Transactional Net Margin Method.

The ARS accepted the selected method but objected to the partial adaptation carried on by the taxpayer. According to the fiscal authority, VW should have proven that the financial results of the comparables had not been affected by lay offs, default of debtors and idle capacity before adjusting the VW transfer pricing report. In other words, the ARS had no

means to find out if the comparables were isolated of the negative effects that VW claimed to justify the adaptations of the financial results.

The National Tax Court began its decision by recognizing the difficulty for taxpayers and Courts to interpret and comprehend transfer pricing regulations for 1999. That is because it was the first fiscal period with such regulations, which means no precedents to clear out difficulties in the interpretations.

Going to the core of the case, the National Tax Court criticized the proceeding followed by the ARS to question the transfer pricing report filed by VW. The fiscal authority did not explain nor present any evidence to show that the use of the foreign comparables did not require an adjustment based on the special economic situation of Argentina. To disqualify the adjustment made by VW, the ARS should have shown that the comparables were going through a similar financial situation, suffering from the same effects of the economic crisis (recession) of Argentina.

However, the transfer pricing report had also failed to justify the selections of the adjustment criteria, the Court said. The lack of consistency of the transfer pricing report was equal to the lack of consistency of the fiscal assessment. Taking the latter into consideration, the difficulty for taxpayers to apply transfer pricing regulations for 1999 and the fact that the self assessment principle is the rule for the Income Tax in Argentina, the Court decided to reject the transfer pricing adjustment proposed by the ARS. The trial costs were, nonetheless, split between the parties due to the characteristics of the issues under discussion and the fact that neither party proved its case.

Deductibility Rule Confirmed by Federal Court of Appeals

In *Swift Armour S.A. Arg.*, decided by Chamber I of the Federal Court of Appeals on May 6, 2010,

and published in September 2010, the taxpayer had borrowed money in order to cancel its debt with its own shareholders due to a reduction of capital. It then sought to deduct the interest paid from income tax.

The ARS had questioned the deductibility of the interest as it cannot be qualified as cost to obtain or maintain the source of income of the company.

The National Tax Court had rejected the assessment and the Federal Court of Appeals confirmed this ruling. In the opinion of the Court, unlike individuals, companies are allowed to deduct any cost connected to the source of income and in order to question the deductions the ARS has to show that they are absolutely unconnected to the source of income. In this case, the fiscal authority failed to prove the lack of connections as the modification of the company's structure is in a way linked to the source of income. ♦

Bolivian Tax Update

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Changes in the Tax and Customs Laws Regarding Tax Crimes

Law No. 037, dated August 10, 2010, modifies the Tax Code as well as the General Customs Law, in relation to the criminal regime and its procedures, as well as the sanctions to customs crimes. The imprisonment term for customs and tax crimes set forth in the Tax and Customs codes was increased to up to ten years (the maximum term was six years). Also, the law establishes that customs authorities will now have the power to automatically confiscate any means or goods used in the customs crimes, such as real estate, vehicles, aircrafts, boats, etc. The harsher penalties set forth in the law were issued in order to prevent and attempt to halt the ongoing customs fraud and contraband in the country that, according to the government's figures, are 1.5 million dollars each year. The law was sanctioned despite intense opposition led by minor importers who even burned customs deposits in the city of Oruro as they understood that the law would allow customs authorities to confiscate their shops. The law, however, is intended to seek to punish major importers that fail to comply with customs obligations when importing their goods.

Judiciary Council as Information Agent for Tax Purposes

Administrative Resolution N° 10.0014.10, issued by the Board of Directors, dated July 2, 2010, appoints

the Judiciary Council as a new Information Agent, and specifies its nature and the form in which it must prepare and present the information required by the Tax Administration. The resolution intends to scrutinize and more strictly assess income generated by public notaries in the country as the Judiciary Council receives annual information regarding public notary's operations at a national level.

New Adjustments to the Billing System

Administrative Resolution N° 10.0019.10, issued by the Board of Directors, dated September 7, 2010, modifies Administrative Resolution No. 10.0016.07, issued by the Board of Directors. The following articles are modified by this Administrative Resolution: second paragraph of paragraph VII of article 6, which was included in this Resolution by paragraph II of article 2 of Administrative Resolution N° 10.0032.07, issued by the Board of Directors, dated October 31, 2007, which was modified by paragraph IV of article 15 of Administrative Resolution N° 10.0022.08, issued by the Board of Directors, dated June 29, 2008; article 9, by adding a second paragraph; clause No. 4, of paragraph I of article 10, by adding paragraph h); substitution of paragraph e) of numeral 4 of paragraph I of article 10, which was modified by paragraph X of article 1 of Administrative Resolution N° 10.0032.07; and the substitution of paragraph I of article 13. The

new billing system incorporated in 2007 was issued in order to control and assess the payment of the Value Added Tax, considered in the resolution as “*one of the pillars of the National Tax System...*” Consequently, the new billing system (and further amendments such as this last one), by specifying regulations aimed to formalize the issuance of VAT invoices in the market and in the everyday regular commerce, attempt to ease, encourage and regulate the issuance of invoices.

On the Treatment of the Unified Agricultural Regime

Administrative Resolution N° 10.0020.10, issued by the Board of Directors, dated September 24, 2010, updates the value of the fixed payment per hectare of the Unified Agricultural Regime (RAU), specified in Annex II of Supreme Decree 24463, dated December

The Tax Administration has already specified through press releases that taxpayers (in the cattle and farming activities) have been abusing the RAU regime.

27, 1996, which was substituted by Supreme Decree 24988, dated March 19, 1998, according to the annex that forms a part of this Resolution.

The RAU regime has been created by Supreme Decree N° 22148, later amended by Supreme Decree N° 24463, in order to regulate an informal sector in the economy dedicated to low scale economic activities carried out by small farmers. In that regard, RAU taxpayers’ obligations are directly linked with the size of the land they develop and/or exploit and although the RAU doesn’t tax the land as such, it taxes an estimate of the commercialized production of the RAU taxpayer. Consequently, the existence of the RAU regime is subject to: i) the size of the land; ii) the activities being exploited (if they render services or in any way carry out an industrial development, they are excluded from the regime); and iii) the RAU taxpayer’s characterization as an enterprise.

The Tax Administration has already specified through press releases that taxpayers (in the cattle and farming activities) have been abusing the RAU regime as they don’t appear to be low income taxpayers (based on the amount of their production and sales) and that larger entities and companies have been taking advantage of this regime in order to lower their tax burdens.

In light of the previous, apparently new assessment plans are to be incorporated by the government in order to review the existing RAU taxpayers. ♦

Transfer Pricing Developments in Brazil

by Cristiane Magalhães, Daniel Orsini, Luís Rogério Farinelli, Tatiana Villani and Stephanie Makin, Machado Associados Advogados e Consultores, São Paulo, Brazil

Innovative Case Law On Transfer Pricing: Illegality Of Normative Instruction No. 243

Contributed by Cristiane Magalhães and Daniel Orsini

A recent decision from the Federal Regional Court of Appeals – 3rd region in São Paulo (“TRF3”) may become an important precedent for transfer pricing issues

in Brazil. By a majority decision, the court found that Normative Instruction No. 243 (“IN 243”), of 2002, had overstepped its regulatory competence when it established how to calculate the 60% profit margin under the Resale Price Less Profit (“PRL 60”) method.

The decision granted the taxpayer the right to calculate the PRL 60 method based on the provisions

of Law No. 9430/96, disregarding the regulations of IN 243.

To better comprehend this decision, one should note that PRL 60 was instituted by Law No. 9959, in 2000, which altered Law No. 9430/96. Since then, the PRL 60 method is the resale method used when the imported items are applied in the production in Brazil.

The text of Law No. 9430/96, as dully altered, already established how the benchmark should be calculated, namely from the resale price of the items, minus (i) the unconditional discounts; (ii) the taxes and contributions levied on sales; (iii) the commissions and brokerage fees; (iv) *the 60% profit margin, calculated on the resale price after the deduction of the values referred to in the previous items and of the aggregate value in the country.*

Despite the fact that this ruling could still be modified by higher courts, the trial on behalf of the taxpayer represents a significant victory.

This wording led to the conclusion that the aggregate value should only be excluded when determining the 60% profit margin. Normative Instruction No. 113, of 2000 (“IN 113”), and the precedent regulation, Normative Instruction No. 32, of 2001 (“IN 32”) further validated this understanding.

IN 243, which revoked IN 32, brought along a new calculation methodology. The new rules, introduced by IN 243, still effective today, set forth that, for the purposes of calculating the benchmark, the final product’s sale price should be considered proportionally to how much the cost of the imported item represents of the total cost of the item sold. The 60% margin is then applied onto this prorated participation and subtracted of this same amount in order to determine the benchmark.

These different methodologies to calculate the benchmark and their practical results can be verified in the following table:

Act	Benchmark Formulae	Benchmark
Law No. 9430/96	$= SP - TDC - 60\% \times (SP - TDC - AV)$	60
IN 243/02	$= (SP - TDC) \times (VI/TC) - 60\% \times (SP - TDC) \times (VI/TC)$	12

SP = Sale Price = 100
TDC = Taxes, Discounts and Commissions = 10
AV = Aggregate Value in the Country = 40
VI = Value of the imported input from the related party = 20
TC = Total Cost = 60

The main issue analyzed by the TRF3’s decision was the difference in the methodologies. The court had to settle if the modifications brought by IN 243 were only a way to interpret the legal provisions or if they illegally altered the law.

The reporting judge voted against the taxpayer, stating that IN 243 acted within its regulatory competence by correcting the misinterpretation caused by previous IN 32 and perfected the transfer

pricing methods in existence. This vote appears to have favored the mathematical side of the methods over their legality.

However, the other judges disagreed with this positioning – correctly, in our view. They decided that IN 243 regulations altered the methodologies, overstepping its regulatory limits, as:

...before [IN 243], the PRL was calculated after the deduction of the profit margin, whose computation took into account the product’s sale price in the national market, differently from what happens today when the foreign merchandise is taken into account proportionally to the total cost of asset. (quote from the majority decision)

Furthermore, it was also stated that Provisional Measure No. 478 (“MP 478”),¹ of 2009, which tried to impose a similar method to the one in IN 243, via an act with force of Law, would have been a viable way to alter the method in Law No. 9430/96, differently from a simple normative instruction that could only regulate it.

Besides, the explanatory statement of MP 478 recognized that several regulations issued by tax authorities were only introduced by normative instructions and not by Law No. 9.430/96, even if the decision at hand did not allude to it. This explanatory statement, without doubt, strengthens the taxpayers’ argument. Given the clear discrepancy existing between IN 243/02 and Law No. 9430/96, the court ruled out the need for production of proof.

Accurately, the court disagreed with the theory that IN 243 would be legal because it “perfected” the PRL 60 method. In our point of view, even if improvements of this magnitude could be carried out, they should never be introduced by acts without force of law under the guise of “interpretation”. If this were allowed, tax authorities would then have a *carte blanche* to “correct” anything they deemed inadequate, which would be incompatible with the tax legality principle.

Despite the fact that this ruling could still be modified by higher courts, the trial on behalf of the taxpayer represents a significant victory. If the interpretation given by the TRF3’s ruling is spread within case law, taxpayers will be able to achieve substantial reductions in transfer pricing adjustments and to recover amounts paid in excess in the previous years.

We must keep in mind that, in principle, the taxpayer’s right to recover these amounts becomes time-barred within five years counted from the payment. Thus, the deadline to demand the restitution of the amounts paid in excess due to the IN 243 methodology of transfer pricing adjustments for year 2005 may be coming to an end, since this payment would have been made in the beginning of 2006 and would become time-barred in the beginning of 2011.

If the taxpayer is interested in recovering such credits, it is advisable to make all the necessary arrangements still in year 2010 to guarantee the right to the restitution of these amounts, which may be significant.

Rate Increase of the IOF-Exchange Due on Some Investments in the Brazilian Financial and Capital Market

Contributed by Luis Rogério Farinelli, Tatiana Villani and Stephanie Makin

Seeking to partially contain the devaluation of the US dollar, the Brazilian government has twice increased the rate of the tax on financial transactions due on exchange operations (IOF-exchange) related to some investments in the Brazilian financial and capital markets, in October 2010.

The two per cent (2%) IOF-exchange rate, which was applied to exchange transactions made by foreign investors that resulted in the inflow of funds for any investments in the Brazilian financial and capital market, was increased to 4% and had its application extended to simultaneous exchange contracts regarding the inflow transactions, by Decree N° 7323. This rate was then further increased, within the same month, to 6% by Decree N° 7330.

Furthermore, Decree N° 7330 extended the applicance of the 6% rate to exchange transactions made by foreign investors for the inflow of funds (including simultaneous exchange contracts) for depositing the collateral margin required by the Brazilian stock or commodities and futures trading markets.

However, some transactions made by foreign investors are still taxed by a IOF-exchange 2% rate, which include (i) the transfer of funds from abroad destined to variable-income investments made through the Brazilian stock exchange or commodities and futures exchange, as per National Monetary Council (CMN) regulations (with the exception for transactions involving fixed-income derivatives) and (ii) the inflow of funds for the acquisition of shares made

through registered public offering or non-registered public offering if dismissed by the Brazilian Securities Exchange Commission (CVM) or the subscription of shares, provided that in both cases (acquisition or subscription) the issuing company is registered to negotiate its shares in the stock market.

No changes were made with regard to exchange transactions for the repatriation of funds invested by foreign investors in the Brazilian capital and financial market, which are still subject to a 0% IOF-exchange rate.

Relevant Administrative Decision Stating That ICMS Tax Incentive Refund Is Not Subject To Income Taxes

Contributed by Luís Rogério Farinelli, Tatiana Villani and Stephanie Makin

In May 2010, a decision from the Superior Chamber of the Administrative Council of Tax Appeals (the highest level of the Brazilian Federal Administrative Tax Courts) recognized the taxpayer's right of excluding the state value-added tax (ICMS) incentive refund from its income tax (IRPJ) and social contribution on net profit (CSLL) taxable basis.

It is important to clarify that, for income tax purposes, the treatment of tax incentive refunds depends on their qualification as "cost subsidy" (which aims at funding the taxpayer's regular activity and current costs) or as "investment subsidy" (granted for the

purpose of encouraging taxpayers to implement or expand economic projects). Under income tax law, "cost subsidy" is subject to IRPJ and CSLL, whilst "investment subsidy" is not.

The tax incentive refund under discussion is granted by the State of Amazonas and it consists in giving back to the taxpayers a partial or full amount of the ICMS paid in some transactions, provided that requirements and conditions set by State Law No. 1939/1989 are met. It is a relevant tax benefit for Brazilian and foreign companies granted not only by the State of Amazonas but also by other States.

Federal tax authorities tend to tax such ICMS refund as several administrative decisions have already stated that such ICMS tax incentive was to be characterized as "cost subsidy."

This recent decision from the Superior Chamber of the Administrative Council of Tax Appeals stating the opposite (qualifying such tax benefit as an "investment subsidy," not subject to IRPJ and CSLL), may eventually lead to a change in the tax authorities understanding on the matter, case in which it could represent a good opportunity for the taxpayer to recover amounts paid in excess in the previous years. However, the issue is still quite controversial. ♦

ENDNOTES

¹ MP 478 was not voted by the National Congress within the legal deadline, consequently losing its validity.

Chilean Tax Update

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Tax Position of Payments Remitted Abroad in Relation to Withholding Tax

On September 24, 2010, the Chilean Internal Revenue Service issued Ruling No. 1705, addressing the taxable event relating to the withholding tax

stated in article 59 No. 3 of the Income Tax Law for remittances of errors and omissions insurance premiums taken by professionals in Chile. According to the IRS, article 59 No. 2 imposes a 35% tax rate on payments for services rendered abroad, like errors and omissions insurance. Nevertheless, article

59 exempts sums paid, amongst others, for insurance and reinsurance that are not subject to article 59, No. 3. In order to be eligible, these operations and the conditions thereof must be reported to the IRS within the term provided by this agency. The IRS may exercise its right to challenge the values assigned to these operations pursuant to article 36 of the Income Tax Law.

Likewise, the IRS informed in Ruling No. 3645 of 2008 that payments to persons neither domiciled nor resident in Chile for errors and omissions insurance premiums that cover third party damages with a company not established in Chile are not subject to the withholding tax set forth in article 59 No. 3 of the Income Tax Law.

Consequently, payments remitted abroad for errors and omissions insurance payments are exempt from withholding tax for they do not constitute the taxable event set forth in article 59 No. 3. Nonetheless, to qualify for this exemption, taxpayers must comply with the requirement stated in article 59 No. 2, that is, to inform the IRS of the operations and conditions considered exempt within the term provided to that end. Otherwise, withholding tax will be imposed on these remittances abroad with a rate of 35%.

Tax Treatment of Future Arbitration Contracts or Sales Forwards in Foreign Currency and Stamp Tax

In Ruling No. 1211 dated July 22, 2010, the Internal Revenue Service addressed the application of the stamp tax to sales forwards in foreign currency and future arbitration contracts.

The future arbitration contract or forward is the instrument by means of which a “seller” commits to give the “purchaser” a certain sum in foreign currency (e.g. Euros) at a specific date. In turn, the purchaser commits to pay the seller as of the agreed upon date a certain sum in a different foreign currency (e.g. US dollars), for which the exchange parity must be agreed upon. Likewise, the parties may agree to compensate these obligations and pay the after foreign exchange

translation resulting difference in local currency under the terms agreed upon.

In turn, the sales forward in foreign currency has a “seller” (e.g. a local bank) that commits to give the “purchaser” (the taxpayer) a certain sum in foreign currency (e.g. Euros) at a specified moment in time. The purchaser also commits to give the seller as of the referred date a certain sum in local currency, for which the exchange parity must be agreed upon. The sales forward also allows for compensation.

In order to determine whether or not the operations included in these contracts are subject to the stamp tax, we must know whether or not they are regarded as cash credit operations. Article 1 of Law No. 3475 of 1980 levies this tax on letters of exchange, orders of payment, promissory notes, simple or documentary loans and any other document even those not issued on hard copy where a cash credit operation is stated. As defined by Law No. 18010, article 1, cash credit operations have one party that gives or undertakes to give a certain sum of money while the other party undertakes to pay it back at a later date.

According to the Internal Revenue Service, the contracts described herein are not comprised in any of the juridical acts stated in Decree Law No. 3475, article 3 nor are they cash credit operations as defined by Law No. 18010 since the obligations stated in both contracts are fulfilled as of the date agreed upon by the parties only as defined in article 1, Law 18010, not triggering the taxable event subject to the stamp tax set forth in Decree Law No. 3475; therefore we may conclude these contracts are not subject to the referred tax.

Tax Treatment of Capital Gains under the Chile–United Kingdom Convention for the Avoidance of Double Taxation (“Convention”)

The Internal Revenue Service, in Ruling No. 1221 dated July 22, 2010, addresses the tax treatment set forth in the income tax law applicable to capital gains taking into consideration the Convention and the sums remitted from Chile to the United Kingdom.

Pursuant to article 10 of the Convention, dividends paid by a company that is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State. However, such dividends may also be taxed in the Contracting State of which the company paying the dividend is a resident and according to the laws of that State, but if the dividends are beneficially owned by a resident of the other Contracting State, the tax so charged shall not exceed 5 per cent of the gross amount of the dividends if the

As provided in the law, these funds and their administrators are regarded as separate entities and operations must be carried out by these Institutions on behalf of funds.

beneficial owner is a company that owns directly or indirectly at least 20 per cent of the voting stock of the company paying the dividends; and 15 per cent of the gross amount of the dividends in all other cases.

Consequently, Chile might only charge 15% of the gross amount of the dividends as provided in letter b) No. 2, article 10 of the Convention. As a result, we need to determine the status of the First Category Tax payable by the company paying the dividend that under the general regulations is a credit against the final taxes considering

- (1) its rate is 17%²;
- (2) the 15% rate stated in letter b), number 2, article 10 of the Convention (assuming the beneficial owner is a natural person located in the United Kingdom);
- (3) the 2% excess that should be refunded.

According to the Internal Revenue Service, the rate referred to above does not apply in Chile as expressly stated in article 10 number 2, as follows:

This paragraph shall not affect the taxation of the company's profits out of which the dividends are

paid. In the case of Chile, this taxation includes the application of the withholding tax.

Thereby, the withholding tax of article 58 number 2 of the Income Tax Law affecting dividends paid by Chilean stock companies to residents of the United Kingdom is not subject to article 10 number 2 of the Convention, then such dividends will be subject to a 35% tax rate with credit rights against the First Category Tax paid by the company paying the dividends.

This is the result of both States having different tax legislations. While the tax affecting companies in the United Kingdom is not related to final taxes, in Chile there is an integrated taxation system.

Nevertheless, both States have similar tax burdens, so this exception and the limit stated in article 10 of the Convention are intended to avoid harming the taxation system in either State

Tax Treatment Applicable to the Higher Value Arising on the Sale of Stocks in Non-Habitual Transactions

The Internal Revenue Service addresses in Ruling No. 1298 dated August 3, 2010, the tax treatment applicable to the higher value arising on the sale of stocks, in the scenario described below: A Group of companies whose parent is located abroad has in Chile an Investment Company (A), a Branch (B), that are the two shareholders of company (C) that in turn has a share interest in a local company. Companies A (with over 50% interest in C) and B are analyzing whether or not to sell, neither directly nor indirectly, their share interest in C to an unrelated third party. Neither the business purpose of the company nor that of the branch include the acquisition of shares of stock. The IRS has established the requirements for these sales to be deemed not habitual and therefore be subject to the First Category Tax as a sole duty.

- (1) As informed by the IRS, Circular No. 158 of 176 applies to company “A” for its share interest in “C” is over 50% and its business purpose does not include the acquisition of shares considering that investments in shares in a stock company 50% or over owned by the investor are regarded as not habitual for they are not intended for speculation purposes but for improving the company’s operations.
- (2) In connection with “B” and considering it owns less than 50% in “C”, the Internal Revenue Service informed that the sale of shares of stock would be regarded as not habitual since the business purpose of C does not include the sales/purchase of stocks, C has not been engaged in this type of activity, and stocks were purchased in order to improve the investments of the Group located abroad; then we may presume this purchase was intended to improve the operations of the company.

The tax treatment applicable to the higher value arising on the sales/ purchase of shares of stock is dependent upon such transactions being regarded as not habitual; as such they will be imposed the First Category Tax as a sole duty and no other tax will levy the profits remitted abroad.

Investment Funds Administered by Mutual Guarantee Stock Companies

The Internal Revenue Service addresses Investment Funds Administered by Mutual Guarantee Stock Companies in Ruling No. 1413 dated August 20, 2010, mostly to determine whether or not Tax IDs are to be granted to these Funds.

In the first place, Law No. 20179, article 1 authorizes the establishment of Mutual Guarantee Stock Companies. These companies are governed by the Corporations Law; their business purpose must exclusively be to provide personal guarantees to their beneficiaries’ creditors for their obligations relating to their business, productive, professional or trading activities. They are also authorized to provide technical, economical,

legal and financial advice to the beneficiaries and administer the funds specified in the law, that is, funds intended to guarantee the obligations guaranteed by Mutual Guarantee Institutions. As provided in the law, these funds and their administrators are regarded as separate entities and operations must be carried out by these Institutions on behalf of funds. These funds are regulated by the regulations applicable to Private Investment Funds, as appropriate.

In consideration of the fact that the Tax ID is intended to identify people and entities of any kind, with or without legal personality, provided they trigger or may trigger and/or withhold taxes for the activities they are engaged in, Funds administered by Mutual Guarantee Stock Companies must have a Tax ID for they are separate entities—other than their administrators—with separate equities whose activities may trigger taxes.

Conventions for the Avoidance of Double Taxation Entered into by Chile

As of September 2010, the Conventions for the Avoidance of Double Taxation in force are: Argentina, Brazil, Belgium, Canada, Colombia, South Korea, Croatia, Denmark, Ecuador, Spain, France, Ireland, Malaysia, Mexico, Norway, New Zealand, Paraguay, Peru, Poland, Portugal, United Kingdom, Sweden, Switzerland and Thailand.

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

Finally these Conventions are in negotiation: Austria, China, Cuba, Finland, Netherlands, Hungary, India, Italy, Kuwait, Czech Republic, Uruguay and Venezuela. ◆

ENDNOTES

- 1 In order to lessen the effects of the earthquake that occurred last February, the authorities implemented a temporary tax reform that changed the First Category Tax rate applicable to corporate incomes as follows: Commercial year 2011 - 20% rate, commercial year 2012 - 18.5% rate, to return in commercial year 2013 to the current 17% rate.

Differential Exchange Rate Taxation in Costa Rica

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

An important discussion has been raised in the past few months between Costa Rican courts and the tax administration about income generated from differential exchange rates. Income from differential exchange rate currency arises when the taxpayer has credits in a foreign currency, such as US dollars. When applied to this case the accrual accounting method and the accounting rule that states that the accounts should be in colones, the taxpayer will record revenue from the total accounts receivable at the exchange rate prevailing at the time of the accrual. However, when the taxpayer receives payments over the period prescribed in a foreign currency that is constantly revaluating, the taxpayer ends up getting more colones than those initially registered. Apparently, it constitutes an asset that is automatically revaluated, adapting to the local currency devaluation, which can be considered as an unrealized capital gain. The discussion is focused in the taxability of such gains from differential exchange.

The criterion maintained by the tax authorities is that when revenues from differential exchange rates are the result of the ordinary course of business or consist of usual (or ordinary) income, such income is taxed by the income tax. Even though Costa Rican income taxation system is based on the productive income criterion, which means that only those gains resulting from the productive factors putted into operation by the taxpayer can be considered as income for tax purposes.

This position of the tax authorities had been objected to by a judgment of a section of the Costa Rican Administrative Court, which considers that the criterion

of the tax authorities is against the law because no law in Costa Rica states that the gains from exchange rate differential are taxable, in place such gains are exempt according to the income tax law.

According to this criterion, any gains from an exchange rate differential are beyond the object of the income tax, regardless the conditions of regularity in which they generated. However, the tax authorities have stated that this judgment is not binding.

The controversy grew with the recent judgment of another section of the Costa Rican Administrative Court, which expresses its disagreement with the criterion that states that gains from exchange rate differential are not a taxable event in the income tax. According to this judgment, the income tax law states that the income tax levies gains in cash or in kind, regularly or occasionally obtained, while coming from Costa Rican source. In accordance, income from exchange rate differential as a profit generating mechanism are included in the law even if it is not expressly indicated in the income tax law because it is not necessary to stipulate in the law all the assumptions of gains and benefits.

Thus, this discussion stays on and it appears that it will be necessary that the First Chamber of the Supreme Court clarify the issue. Meanwhile, there are enough arguments to support the criterion that states that the incomes from differential exchange rate are not taxable. However, adopting this view implies a fiscal contingency because of the position of the tax authorities and a poor support of a section of the Administrative Court. ♦

Bilateral Investment Treaties and Payment Procedures for Dividends and Profits in Ecuador

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

The IRS has issued Resolution No. NAC-DGER-CGC10-00614, published in Official Gazette No. 301 dated Friday, October 15, 2010, outlining the procedure for the payment of dividends and profits distributed by corporations and trusts to resident individuals of Ecuador. The legal background for this resolution is as follows:

- (1) Literal e) of Article 36 of the Internal Revenue System Law (hereinafter the Tax Law), which rules that dividends and profits, as well as revenues obtained by commercial trusts, distributed to resident individuals of Ecuador, will form part of their global income, being entitled, however, to utilize in their annual income tax return, as tax credit, the tax paid by the corporation or trust, corresponding to such dividend, profit or revenue;
- (2) Article 50 of the Tax Law, which establishes that the withholding must be done at the moment of payment or credit into account, whichever occurs first;
- (3) Literal e) of Article 137 of the Regulation to the Tax Law, which rules that corporations/trusts that distribute dividends, profits and revenues to their individual shareholders residents in Ecuador, have the obligation to inform the beneficiaries of such income, in the terms set forth by the IRS, the amount they must declare in their global tax return and the Tax Credit to which they are entitled.

In view of the foregoing, the resolution rules as follows:

- (1) Corporations and trusts that distribute dividends, profits or other benefits on behalf of individuals residents in Ecuador, will insert in

the withholding voucher the amount of income tax paid by the corporation or trust, on account of said dividend, profit or benefit, over which the withholding is being affected.

- (2) If there is a mistake in the information inserted in the withholding voucher referred to in the preceding paragraph, or if this has been omitted, the beneficiary of the dividend, profit or benefit, must request to the corporation or trust a certificate containing the real amount of the income tax paid on account of such dividend, profit or benefit

Denunciation of Bilateral Investment Treaties (BITs)

Currently Ecuador has the following Bilateral Investment Treaties (BITs) in force:

Country	Subscription Date	Enforced in Ecuador
Germany	21 March 1996	12 February 1996
Argentina	18 February 1994	1 December 1995
Bolivia	25 May 1995	15 August 1997
Canada	29 April 1996	6 June 1997
Chile	27 October 1993	2 January 1996
China	21 March 1994	9 July 1997
Costa Rica	6 December 2001	
El Salvador	16 May 1994	14 January 1996
Spain	26 June 1996	18 June 1997
United States	27 August 1993	11 May 1997
Finland	18 April 2001	16 December 2001
France	7 September 1994	10 June 1996
Honduras	26 June 2000	
Nicaragua	2 June 2000	8 September 2002
Paraguay	28 January 1994	18 September 1995
Peru	7 April 1999	10 December 1999
Netherlands		
Sweden	31 May 2001	1 March 2002

Country	Subscription Date	Enforced in Ecuador
Switzerland	2 May 1968	11 November 1969
United Kingdom	10 May 1994	24 August 1995
Dominican Republic	26 June 1998	
Venezuela	18 November 1993	1 February 1995

Denunciation of BITs—The Assembly of Ecuador approved to abrogate the agreements for Reciprocal Protection of Investments with the UK and Northern Ireland and the Investment Protection Treaty with Germany. The legislature approved the termination of the treaty between Ecuador and Germany on the Promotion and Reciprocal Protection of Capital Investments, “because some of its articles” are contrary to constitutional provisions explicitly.” Also, for contradicting the Constitution, the National Assembly approved to denounce the “Convention on the Promotion and Reciprocal Protection of Investments, signed between Ecuador and the United Kingdom of Great Britain and Northern Ireland.

The Commission based its decision on Article 422 of the Constitution, which states that Ecuador may not conclude treaties or international instruments to which the government cedes sovereign jurisdiction at the behest of international arbitration in contract disputes or commercial, between the state and individuals or associations with the exception of international treaties and instruments providing for the settlement of disputes between states and citizens in Latin America by regional arbitrators appointed by courts of the signatory countries. A year ago, the president of Ecuador, Rafael Correa, requested the Assembly the withdrawal or abandonment of thirteen bilateral agreements on mutual protection of investments because, in its discretion, contain clauses contrary to the Constitution and Prejudicial to national interests.

Denunciation and termination of BITs on Hold—On the contrary and stepping backwards,

the President has announced that the Government will not proceed on with the termination approved by the National Assembly until the Production And Investment Code is approved. The Ministry of Investments has assured that all BITs will remain in force even after the denunciation approved by the Assembly. The spoke person informed that the President wants to re-order the investments general frame in accordance with the Constitution of Ecuador, through the Production And Investment Code. This new Law, likely to be approved by the National Assembly in the next days, contains clear rules as to foreign investment is concerned and aims at honoring the foreign investment and private property and allows and encourages the subscription of investment agreements between the Government and private investors. Notwithstanding, she added, the BITs will continue in force, even after the denunciation, at least for a term of ten years, pursuant the clauses contained therein.

The Constitution and BITs—The cornerstone of the problem is the Constitution approved on 2008. It prohibits to celebrate Treaties in which the Ecuadorian Government cedes sovereign jurisdiction on behalf of international arbitration, in contractual controversies or of commercial nature between the Government and individuals or juridical entities. The Constitutional Court of Ecuador also coincided that the Constitution does not accept extra regional arbitration systems, as those included in the BITs. Textual Transcription of the Article of the Constitution:

Article 422.- It will not be permitted to celebrate Treaties or International Commitments in which the Ecuadorian Government resigns its sovereign jurisdiction on behalf of international arbitration in contractual controversies or of commercial nature between the Government and individuals or juridical entities.

The exception to this rule are Treaties and International Commitments that subdue the solution of controversies between States and citizens in Latin America to regional arbitration

organisms or to be resolved by jurisdictional organisms appointed by the signatory member countries. Judges of the States that are part of the controversy cannot intervene in this regional arbitration.

In the case of controversies arising out of the external debt, the Ecuadorian Government will encourage arbitration solutions in terms of the origin of the debt and abiding by the principles of transparency, fairness and international justice. ♦

Constitutional Court Declares Excise Tobacco Tax Base Unconstitutional in Guatemala

by Ana Alfaro, Mayora & Mayora, S.C., Guatemala

Back in March 2009, British American Tobacco (BAT) asked the Guatemalan Constitutional Court to examine whether the second paragraph of Article 27 of the Tobacco Law (TL) was consistent with the general principles of equal protection of the law and the rule of law, but mainly, focusing on what they perceived as a *double taxation case*, which is prohibited by Article 243 of the Constitution.

The TL contained, until today, three tax bases on which the Excise Tobacco Tax of 100% had to be calculated:

- (1) For manufacturers, according to Section 23, the tax base should be the retail price of the product (*ex factory price*), which shall not include the Tobacco Excise Tax. Discounts or commissions granted to retailers should not affect the taxable base.
- (2) For importers, according to the first paragraph of Section 27 and Section 30, the tax base should be calculated on the CIF price of the products, plus the import duties and other related charges.
- (3) Lastly, second paragraph of section 27 of the TL—declared unconstitutional—established a mandatory tax base, which if higher than the mentioned in literals a) and b), should be the applicable one for both, manufacturers and importers. This tax base was “the 46% of the *Suggested retail price of the products* (that must be reported to the Tax Administration under

oath)” on which the tax rate of 100% should be assessed.

The essence of BAT’s argument was that in order to arrive to the suggested retail price of the products the amount of the Excise Tobacco Tax could have not been left out, and that, according to their understanding, constituted double taxation.

Although it had repealed three identical actions in the past, on September 14, the CC declared the unconstitutionality of second paragraph of Section 27 on the grounds of a violation to the principle that mandates that the Guatemalan Tax System should be *just and equitable* (contained in Section 243 of the Constitution of the Republic of Guatemala). The Court states that such paragraph represents a problem of what it has called “*superposition of taxes*,” since the *suggested retail price* does not furnish an undistorted tax base; on the contrary, second paragraph of Section 27 creates a mandatory tax base (if higher than the one established for manufacturers and importers, correspondingly) which is *artificial* due to the fact that, to arrive to such *suggested retail price*, the taxpayer must take into consideration the Excise Tobacco Tax.

With this Ruling, the CC has created jurisprudence in regard to *superposition of taxes in the tax base*. Lastly, the Superintendent of the Tax Administration declared that with this Ruling, the Government would earn US\$16,800,000 less this year. ♦

Mexican Economics Related to the 2011 Federal Income Act

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

The Federal Income Act of 2011 forecasts a total of 3.5 billion pesos in public revenue and economic growth in 2011 between 3.8% and 3.9%, considering a fiscal deficit of 0.5% of the gross domestic product.

According to this Act, the Mexican crude oil mix price is expected to be at US\$65.4 per barrel, which would increase the non-fiscal revenue by 11,900 million pesos during 2011, considering an exchange rate of 12.90 pesos per US dollar.

In addition, tax collection will be increased by 6,500 million pesos, as well as other non-fiscal or oil related revenue will be increased for Mexico by 9,600 million pesos, considering that the value added tax rate will remain at 16%.

It is expected that the Mexican gross revenue will be 2.2 billion pesos, from which 1.4 billion will be tax income.

In connection to the income to be obtained from governmental entities, Pemex will contribute with 386,500 million pesos, the Federal Electricity Commission with 271,642 million pesos, the Mexican Social Security Institute with 11,472 million pesos and the State's Employees Social Security and Social Services Institute with 37,000 million pesos.

It is also considered to collect income tax at an amount of 688,965 million pesos, 60,605 million pesos for flat rate business tax; 555,677 million pesos for value added tax and 69,920 million pesos for excise tax, including the increase of seven pesos per cigarette pack as well as the new 25% excise tax applied to energizing beverages.

The Mexican Congress authorized to the President a total amount of 5,000 million dollars for public leverage from domestic and foreign lenders, including international financial organizations.

In this regard, the Federal Income Act also authorizes the government of the Federal District (Mexico City), to obtain public leverage of 4,000 million pesos for construction of public infrastructure based on the official budget of the Federal District for 2011.

To avoid disproportional increases to gas price to be paid by the final customer, the Mexican President is also authorized to establish such price.

Based on the aforementioned Act, starting 2012, the National Hydrocarbon Commission will receive 0.03% of the rights paid by Pemex, which will allow such commission to receive 250 million pesos during said year. ♦

Panama Adopted Tax Information Exchange Agreement

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

Over the last few years, Panama has expressed its willingness to host the principles of “transparency”

and “Tax Information Exchange” promoted by the Organisation for Economic Co-operation and

Development (OECD). Consequently, Panama signed a letter of intent that ratifies Panama's commitment to reform legislation, seeking an exchange of tax information with those countries with whom Panama has celebrated special agreements and treaties for this purpose.

Panama, looking forward to meeting the requirements of the OECD, took some internal actions. The actions taken by Panama consist in the adoption of new regulations and the approval of Treaties for the Avoidance of International Double Taxation.

By means of Law No. 33 of June 30 of 2010, we added a chapter to the Fiscal Code to adequate the local regulation to the treaties or agreements to avoid double international taxation. Specifically, Chapter IX was added to Title I of Book IV of the Tax Code, entitled "Adjustment Rule to comply with the Treaties to Avoid International Double Taxation."

Law No. 33 seeks to minimize tax evasion by developing principles that govern transfer pricing. The rules governing transfer pricing seek to prevent the manipulation of prices of traded goods and services between related companies or companies that are under common control that seek to increase costs or deductions and bring about a decrease in taxable income.

In addition to the above, Panama has negotiated Treaties to Avoid International Double Taxation with several countries, including the following:

- (1) Mexico
- (2) Spain
- (3) The Netherlands
- (4) Qatar
- (5) South Korea
- (6) Italy
- (7) Portugal
- (8) Singapore
- (9) Belgium
- (10) France
- (11) Barbados

- (12) Luxemburg
- (13) Ireland

Almost all of these negotiations have already concluded; Panama currently has approved and signed nine treaties. The nine treaties signed are with Spain, Portugal, Barbados, Qatar, Singapore, the Netherlands, Luxemburg, South Korea, and Mexico, which has recently ratified the Treaty. According to the OECD, Panama needs to sign at least 12 treaties to be removed from "the grey list."

However, one of the most relevant actions taken by Panama is the signing of an agreement for Tax Cooperation and exchange of information related to taxes with The United States of America on November 30. This particular agreement is very important since our country is a great recipient of foreign direct investment of US Citizens and many of them widely uses our financial center in order arrange business and personal transactions here and overseas.

Scope of the Agreement—In words of the agreement itself:

The competent authorities of the Parties shall provide assistance through exchange of information that may be relevant to the administration and enforcement of the domestic laws of the Parties concerning the taxes covered by this Agreement, including information that may be relevant to the determination, assessment, enforcement or collection of tax with respect to persons subject to such taxes, or to the investigation or prosecution of criminal tax matters.

According to the Agreement, "competent authority" means, for the United States, the Secretary of the Treasury or his delegate, and for Panama, the Ministry of Economy and Finance or its delegate.

Taxes Covered—All imposed United States federal taxes and all Panamanian national taxes are subject to the agreement. Additionally,

The Agreement shall apply also to any identical taxes imposed after the date of signature of the Agreement in addition to or in place of the existing taxes. It also applies to any substantially similar taxes imposed after the date of signature of the Agreement in addition to or in place of the existing taxes if the competent authorities of the Parties so agree. The competent authority of each Party shall notify the other of any substantial changes to the taxation and related information gathering measures covered by this Agreement.

According to the Agreement, the exchange of information may only occur upon request and will be generally exchanged without regard to its use: whether the information is needed for tax purposes or the investigated conduct would constitute a crime under the laws of the requesting party, had such conduct occurred in the territory of the requesting party.

Notwithstanding the above we clarify that the competent authority of the requested Party may decline a request. Article No. 6 of the mentioned agreement determine the possibility of declining a request.

ARTICLE 6 POSSIBILITY OF DECLINING A REQUEST.

1. The competent authority of the requested Party may decline to assist: (a) where the request is not made in conformity with this Agreement; (b) where the requesting Party has not pursued all reasonable means available in its own territory to obtain the information, except where recourse to such means would give rise to disproportionate difficulty; or (c) where the disclosure of the information requested would be contrary to the public policy of the requested Party.

According to Article 6, the request Party cannot ask for information if the Party has not requested before this information directly to the tax payer. The request shall be framed with the greatest degree of specificity. It must clearly specify, (1) the identity of the taxpayer whose tax or criminal liability is at issue;

(2) the reasons for believing that the information requested may be relevant to tax administration and enforcement of the requesting Party, with respect to the person identified; and (3) other issues provided by Article 5.

Panama has a territorial income system, so, it is required to collect taxes on all income produced in the country, regardless of the nationality of the person who generates the income. The Agreement governs these topics, so that the person that pay taxes in Panama can relieve their tax burden due to the possible granting of federal tax credit in the US.

With these actions, and specifically with the signing of the Tax Information Exchange Agreement with the US, Panama is sending a clear message to the international community, ratifying its commitment with the principle of transparency and its willingness to prevent that our financial system will be scam by criminal actions (such as money laundering and tax evasion).

Some of the benefits that we can expect from this agreement are:

- (1) According to the agreement, an automatic exchange of information is not possible. The information must be request and supported in specific issues. This request system will not allow “fishing expeditions.” There is no reason to panic.
- (2) To attract more external investment and foreign capital, especially from the countries where we have celebrated these kinds of agreements and treaties.
- (3) The elimination of financial and legal restrictions that several countries have imposed Panama, since they wrongfully considered Panama as a tax haven.
- (4) The possibility to request the OECD for a review of our international status.
- (5) The possible ratification of a Free Trade Agreement with the US (FTA) (TPC in Spanish abbreviations).

Panama still has to make some additional changes to our internal legal system to comply with the provisions of the signed agreements. However, we feel confident that the path our country has decided to transit is the

adequate in order to potentiate our strategic position, our financial system and our strength as a logistic hub for cargo and passenger in the Americas, and reinvent the way we do business with the world. ♦

Income and Excise Taxes on Foreign Persons in Puerto Rico

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

Act Number 154 of October 25, 2010 (“Act No. 154”), established a new rule (the “10% Threshold Test”) to determine if a foreign corporation, partnership or nonresident alien (the “Foreign Person”) is engaged in trade or business in Puerto Rico and thus subject to Puerto Rican income tax as a resident corporation, partnership or alien under the Puerto Rico Internal Revenue Code of 1994, as amended (the “PR-IRC”). If the 10% Threshold Test is met and a certain \$75 Million Threshold is not exceeded, the Foreign Person is subject to the regular Puerto Rico corporate income tax and dividend withholding or branch profits tax (the “Income and Repatriation Tax”) on a portion of its income (the “Deemed Effectively Connected Income”).

Additionally, if the \$75 Million Threshold is exceeded, and a certain Excise Tax Threshold Test is met, the Foreign Person is not subject to the Income and Repatriation Tax, and is subject instead to a new temporary excise tax (the “Excise Tax”) on the value of certain products and services. Specifically, the Excise Tax is imposed on the value of products and certain manufacturing services acquired by the Foreign Person, which are manufactured or produced in whole or in part, or rendered, in Puerto Rico by a member of the Foreign Person’s controlled group (as defined in Act No. 154) (such products and services, the “Products”).

The Income and Repatriation Tax

The 10% Threshold Test and the \$75 Million Threshold—The Foreign Person is subject to the

Income and Repatriation Tax, only if (i) any of four 10% Threshold Tests is met for the taxable year or any of the three preceding taxable years, and (ii) the Puerto Rico Affiliate’s gross receipts from the sale, exchange or other disposition of Products manufactured or produced (and rendered, in the case of services) by it in Puerto Rico does not exceed \$75 million (the “75 Million Threshold”) for any of the preceding three taxable years.

The 10% Threshold Tests consists of four tests based on

- (1) the gross receipts derived by the member of the Controlled Group that has an office or place of business in Puerto Rico (the “Puerto Rico Affiliate”) from the sale of Products to the Foreign Person;
- (2) the cost of Products purchased by the Foreign Person from the Puerto Rico Affiliate;
- (3) the commissions or other fees earned by the Foreign Person from transactions with respect to Products; and
- (4) the gross receipts of the Puerto Rico Affiliate or Foreign Person from the sum of the foregoing transactions plus the sale of Products by the Puerto Rico Affiliate that are facilitated by the Foreign Person.

Income and Repatriation Tax—If any of the 10% Threshold Tests is met and the \$75 Million Threshold is not exceeded, the Foreign Person will be subject to the PR-IRC’s corporate income tax

of a maximum of 39% (40.95% for taxable years commencing prior to January 1, 2012) on its net taxable income derived from its Deemed Effectively Connected Income and to all of the provisions of the PR-IRC applicable to resident foreign corporations (e.g., alternative minimum tax). Additionally, upon the repatriation of its Deemed Effectively Connected Income, a 10% Puerto Rico withholding tax will be imposed upon the Foreign Persons' stockholders or partners, if applicable, or, alternatively, a 10% branch profits tax will be imposed upon the Foreign Person.

The Deemed Effectively Connected Income—The Deemed Effectively Connected Income is computed by multiplying the Foreign Person's total "gains, profits and income" by a percentage based on the purchases, sales, property and payroll of the taxable year (the "Multifactor Percentage"). Act No. 154 contains special rules with respect to the computation of the purchases, sales, property and payroll factors used to compute the Multifactor Percentage.

If the Foreign Person believes that the Multifactor Percentage does not adequately reflect its income attributable to business or sources in Puerto Rico, it may file a ruling request objecting to the application of the Multifactor Percentage and proposing an alternate method to compute its Deemed Effectively Connected Income. If the Secretary concludes that the Multifactor Percentage is inequitable (as applied to the Foreign Person) and the alternate method results in properly determining the Foreign Person's Deemed Effectively Connected Income, the Foreign Person will be allowed to compute its Deemed Effectively Connected Income pursuant to the alternate method, subject to any modifications made by the Secretary. The Deemed Effectively Connected Income of Foreign Persons that do not file the documentation to support the Multifactor Percentage which will be required by the regulations to be promulgated under Act No. 154, and do not object the Multifactor Percentage, will amount to 50% of the gross income derived from the sale, exchange or other disposition of the Products.

The Anti-Abuse Rule—Act No. 154 bars practically all tax planning techniques to avoid or reduce the Income and Repatriation Tax, by providing that any transaction or series of transactions, one of the principal purposes of which is the avoidance of the Income and Repatriation Tax, will be disregarded for Puerto Rico income tax purposes (the "Anti-Abuse Rule"). Thus, even if there is a legitimate business purpose for a transaction or series of transactions, if one of their principal purposes is to avoid the Income and Repatriation Tax, the transaction will be disregarded for Puerto Rico income tax purposes.

The Excise Tax

The Applicability of the Excise Tax—If the Puerto Rico Affiliate's gross receipts from the sale of Products exceed the \$75 Million Threshold for any of the three preceding taxable years and a certain Excise Tax Threshold Test is met, the Foreign Person is not subject to the Income and Repatriation Tax, and is subject instead to the Excise Tax. Additionally, if the Excise Tax is not applicable for "any reason," the Foreign Person will be subject to the Income and Repatriation Tax. Thus, it seems that the Foreign Person will be subject to the Income and Repatriation Tax if the \$75 Million is exceeded but the Excise Tax Threshold Test is not met, and also upon the phase out of the Excise Tax commencing on January 1, 2017.

The Excise Tax—The Excise Tax is imposed upon the "value" of the Products acquired by the Foreign Person. The term "value" is defined as the "sum of all charges for the Products, included in the bill," so long as a bill is rendered, and as the "fair market value" of the Products if a bill is not rendered. The term "fair market value" is not defined by Act No. 154 or elsewhere in the PR-IRC. Significantly, Act No. 154 is silent with respect to the impact of adjustments made to the "value" (i.e., selling price) of the Products pursuant to section 482 of the United States Internal Revenue Code, as amended.

The Excise Tax is applicable to transactions effected after December 31, 2010 and will amount to 4% from January 1, 2011 until December 31, 2011; 3.75% from January 1, 2012 until December 31,

2012; 2.75% from January 1, 2013 until December 31, 2013; 2.50% from January 1, 2014 until December 31, 2014; 2.25% from January 1, 2015 until December 31, 2015; and 1% from January 1, 2016 until December 31, 2016. The Excise Tax is phased out after December 31, 2016.

The Excise Tax Threshold Tests—The Excise Tax Threshold Tests are the same as the 10% Threshold Tests, except that in determining whether it is met only the three preceding taxable years are taken into account (i.e., current the taxable year is not taken into account).

Payment of the Excise Tax—The member of the controlled group that sells, exchanges or otherwise disposes of Products has the obligation to collect the Excise Tax from the Foreign Person and remit it to the Puerto Rico Treasury. If such member of the controlled group fails to collect the tax, it is liable to the Puerto Rico Treasury for the amount of the Excise Tax that it failed to collect, plus applicable interest and penalties.

The Anti-Abuse Rule—The Anti-Abuse Rule is also applicable to transactions or series of transactions one of the principal purposes of which is the avoidance of the Excise Tax. ♦

Tax Developments in Uruguay

by *Guzmán Ramírez, Ferrere, Montevideo, Uruguay*

Shopping Tourism

Since August 3, 2010, parliament has been studying the possibility of passing a bill that would create a fund to finance tourist projects in the country's border areas. The fund would be financed by 30% of fees paid by tax free shops for bringing merchandise into Uruguay.

Tax free shops are currently showing excellent sales levels, primarily due to the rising presence of Brazilian tourists taking advantage of low prices due to their currency appreciation and its increased purchasing power.

Several legislators find it is extremely important for the Government to develop a serious policy in relation to the tourism brought in by the tax free shops. To that end, parliament is analyzing a bill that would aid in making the most of this Brazilian tourist traffic.

The tax free shops pay a monthly fee that generally varies depending on the merchandise they bring into Uruguay. The initiative currently under study by parliament intends to allocate 30% of the funds collected to carrying out tourist projects in border areas.

Approaching the OECD White List

On August 12, 2010, Uruguay concluded its negotiations with India for the purpose of signing a treaty to avoid double taxation, thus getting closer to the list of countries that cooperate in terms of tax information exchange, created by the OECD.

In April 2009, the OECD put Uruguay (together with other countries such as Costa Rica, Philippines and Malaysia) on the list of countries that do not comply with international standards in terms in tax information exchange.

Why did the OECD place Uruguay on that list? Because, traditionally, Uruguay has always adopted a strict position regarding the non-disclosure of bank secrecy upon request by foreign tax bureaus. For this reason, Uruguay is often called the “Switzerland of South America.”

Yet, 72 hours later, Uruguay had already been removed from the list as it had agreed to adopt international standards promoted by the OECD, promising to sign at least 12 treaties to make tax information exchange with other countries easier.

The alternative of maintaining the former policy implied the risk of Uruguay's having to face severe sanctions. OECD countries could rethink their investments and commercial relationships with Uruguay, and even recommend that international finance organizations not grant loans to the country.

Thus far, Uruguay has signed six agreements with Mexico, Spain, Portugal, France, Germany and Switzerland. And until last August, it had only finished negotiations for execution of agreements with five countries (Belgium, Liechtenstein, Malta, South Korea and Finland). Uruguay has just concluded negotiations with India for its twelfth agreement.

Now Uruguay is halfway to joining the group of countries that meet the OECD's international standards for tax information exchange.

Budget News

On August 31, 2010, the Government presented its bill including the National Budget for income and spending for the next five years. The initial official announcements indicated that the bill would not contain any surprises in terms of taxes but, as is often the case, last minute changes have brought significant innovation.

Foreign companies established in Uruguay to provide services of any nature will in all cases pay 25% income tax (IRAE), even if personnel is contracted abroad. They currently only pay that tax when they hire personnel in Uruguayan territory.

Foreign companies established in Uruguay to provide services or undertake construction work will not be taxed on income not directly linked to their activities. Currently all their income is taxed.

The past Administration had planned to repeal as of January 2011 a tax (Consular Tax) paid by importers equivalent to 2% of the value of imported merchandise. The current Administration has now decided that importers will continue paying the tax, as they have done thus far.

Persons engaged as employees of companies located in Uruguay will pay personal income tax (IRPF) on income generated in Uruguayan territory as well as income generated abroad. For example, until now, a manager of a Uruguayan company who because of his or her regional coordination work travels constantly to other countries did not pay tax on the portion of his or her salary generated abroad. Upon parliamentary approval of the National Budget, such regional managers will have to pay tax on their total salaries.

Technical personnel (for example, software experts) performing services for a company located in Uruguay will now also have to pay personal income tax (IRPF) on all of their income (including income generated abroad). Until now they have paid tax but only on the portion of their services rendered in Uruguayan territory.

Henceforth, in the case of death of the director of a company located in Uruguay, the director's heirs will have to pay -in addition to the director's personal debts- any tax owed by the company. ♦

Transfer Pricing: Rules, Compliance and Controversy

Marc M. Levey, J.D. and Steven C. Wrappe, J.D., CPA



Transfer pricing is one of the most significant tax issues for corporations having international operations. It attracts the scrutiny of tax authorities worldwide and continues to draw attention of more and more countries' tax legislatures. Because of the heavy impact of income allocations on the bottom line of a corporation's business, especially potentially forced ones, international tax and business professionals need to be very careful about their tax planning and compliance efforts in order to meet the established transfer pricing standards.

Transfer Pricing: Rules, Compliance and Controversy offers extensive yet clear guidance through the complex maze of U.S. transfer pricing rules. The book is authored by leading experts in the transfer pricing scene. Throughout the book, the authors cover all aspects of transfer pricing relevant to the practitioner, starting with general legal principles and apportionment methods, then moving on to more specific subjects such as transfers of tangible vs. intangible goods and the impact of e-commerce and U.S. customs on transfer pricing, and finally exploring highly practical matters like procedural strategies and post-examination procedures.

Given the potential for transfer pricing decisions to globally impact tax, financial and operational results, it is important that financial and operational personnel at multinational entities who are making transfer pricing decisions possess the information they need. This book includes topics that will help them to make informed decisions, including:

- Comprehensive analysis of the U.S. rules, case law and guidance on transfer pricing for tangible goods, intangibles, and services
- Complex cost-sharing planning principles, including buy-in
- Cutting edge e-commerce transfer pricing issues
- U.S. penalty and documentation rules
- Documentation with checklists, questionnaires and model report
- U.S. penalty rules compared to those of other important countries
- Overlap between transfer pricing and Customs valuation issues
- Customs ruling based on an APA
- In-depth, step-by-step analysis of the favored approach to transfer pricing controversy, including:
 - Developing a substantive/procedural strategy (with detailed flow-chart)
 - Preparing for examination
 - Identifying post-examination opportunities to resolve the dispute

Special appendices provide a variety of "practice tools" designed to facilitate the understanding of IRS provisions and their translation into action, e.g., IRS forms, tables and charts of relevant cases, and comparisons of international transfer pricing rules within particular contexts.

The thorough elaboration of the topics discussed, paired with clear and understandable writing, makes this new volume an excellent reference for both the experienced practitioner and the newcomer to the transfer pricing field.



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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