

GLOBAL TAX BRIEFING

Latin America

INSIDE

- 1 Ecuador
- 6 Mexico
- 8 Uruguay
- 9 Argentina
- 14 Peru
- 14 Panama

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.

Dramatic Changes to the Capital Flight Tax System in Ecuador

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

One of the reform bills the President sent to the National Assembly for approval, Law for the Environmental Development and Optimization of the Government's Income, contains dramatic changes to Ecuadorian tax policy—for the worse—in its proposed amendment(s) to the Capital Flight Tax System (or ISD in Spanish). The ISD was enacted some four years ago and instituted at a rate of 0.50%. The rate was subsequently increased to 1% and finally to 2%, which stands as the current rate. However, the proposed legislation would increase the ISD rate to up to 5%. Traditionally, the ISD had been levied on all transfers of funds and currency sent abroad from Ecuador. Up until now, certain payments and transfers had been exempt from ISD. For example, payments or transfers made from an overseas account to another overseas account abroad, and made by either Ecuadorians or non-Ecuadorian residents in Ecuador, Ecuadorian corporations and foreign companies, branches, subsidiaries, were not subject to the ISD. Such payments and transfers were exempt from ISD because such payments and transfers were deemed to not have originated from Ecuador, but deemed to have originated from abroad.

Now, the proposed reform would change that. One of the articles of the bill states the following:

All payments made from abroad by Ecuadorian individuals, foreigners residents in Ecuador, Ecuadorian Corporations and foreign companies domiciled or resident in Ecuador, shall be regarded as been effected with resources subject to the ISD in Ecuador, even if the payments or transfers are not effected through remittances or wire transfers, but with financial resources maintained abroad by Ecuadorian individuals, foreigners residents in Ecuador, Ecuadorian Corporations and foreign companies domiciled or resident in Ecuador.

In other words, the bills means that the 5% ISD will be levied on Ecuadorian residents, non-Ecuadorian residents present in Ecuador,

CCH EDITORS**Managing Editor**

Jerome Nestor

Editor

Kristina Kulle

Production

Bagirathy Govarethinam

Designer

Craig Arritola

CCH, a Wolters Kluwer business, has been a leader in topical law reporting since 1913. Today, CCH offers more than 300 print, on-line, and CD-ROM tax and business products across the globe from its offices in the United States, Canada, Europe, Australia, New Zealand and Asia. CCH also offers an extensive tax research library on the internet, at www.CCHGroup.com.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is distributed with the understanding that the publisher is not engaged in rendering legal, accounting or other professional service. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

CCH welcomes articles submitted by outside authors for possible publication. Manuscripts and inquiries may be directed to the Editor, Global Tax Briefing, International Taxation, CCH Incorporated, 2700 Lake Cook Road, Riverwoods, IL 60015.

Ecuadorian corporations, and foreign companies domiciled or resident in Ecuador, who, for example, maintain a checking account in a US bank and make a payment, via wire transfer, or by any other means, to a third party in the US, without the money passing through Ecuador. The payment or transfer will be subject to the 5% ISD even though it did not originate from Ecuador. This is a significant departure from current policy. This is, therefore, going to be a **huge change** in the law.

The payment or transfer will be subject to the 5% ISD even though it did not originate from Ecuador.

Notwithstanding the above, payments remitted abroad on account of dividends and profits, distributed by domestic corporations and foreign companies established in Ecuador, after the payment of the Corporate Income Tax, to their shareholders or Parent Company abroad, shall not be subject to the ISD, provided the beneficiary of such dividends and profits is not domiciled in a Tax Haven Country or Lesser Taxation Jurisdiction. However this exemption will not apply in the case of dividends and profits that are distributed on behalf of foreign corporations that at the same time have as shareholders individuals resident in Ecuador or corporations (domestic and foreign) domiciled in Ecuador, which are also shareholders of the Corporation domiciled in Ecuador that distribute such dividends and profits.

Expected Impact of the Changes in the Capital Flight Tax System

The announcement that the approval of the proposed legislation is imminent has already had an impact: it is anticipated that there will be an outflow of as much funds as possible.

In the past, according to analysts based on statistics kept by the Central Bank of Ecuador, announcements that legislation increasing the ISD generated between 2007 and 2009 would be approved resulted in a downfall or decrease in Direct Foreign Investment, or DFI. Current proposed legislation is calling for a further increase in ISD, from 2% to 5%.

It is believed that DFI decreased because the business community, and entrepreneurs, anticipate the rate increase and seek to move their payments abroad to avoid payment of the 5% ISD before the law is enacted. By shifting the payments overseas before enactment of the legislation, disbursements of funds from Ecuador would exceed inflow of funds into the country.

When ISD was initially enacted with a tax rate of 0.5%, the DFI in the last quarter of 2007 fell to \$286 million (USD). Inbound money to Ecuador was calculated at \$643.9 million (USD) while the outbound flow of money was calculated at \$923 million (USD).

According to economic analysts with the Weekly Analysis Publication, “people work with expectations and as they get frightened, it might happen that they make their payments abroad with anticipation.” Furthermore, it has been pointed out that the outflow stream of currency abroad would occur not only before the dawn of 2012, but that the outflow trend would most likely remain for the entire year, with the aim of preventing further increase of ISD.

There is, however, a notable difference between the messages sent by Brazil and Ecuador regarding capital inflow.

The Chamber of Commerce of Quito believes that speculation at the threshold of the impending approval of the tax reform and the ISD increase will generate immediate fiscal movements. This would include not only a quick leak of capital sent abroad but, mainly, would cause fear among national and foreign investors about allocating new investments in Ecuador.

The outflow of funds could also produce and/or result in a peak in imports in the final months of the year because the business community and entrepreneurs are less likely to be willing to purchase goods with increased tax. Nonetheless, the motivation will depend exclusively on the liquidity of each enterprise to anticipate their orders.

According to the Chamber of Industries of Guayaquil, the anticipated outflow of capital abroad could well be the policy of some corporations. Certain large corporations maintain availability and access to their cash reserves on account in order to amortize their international debts.

However, for the business community, the biggest impact of the proposed tax reform will be to put farther away their direct foreign investment, which encompasses not only capital for new business ventures, but also repatriation of amounts and credits obtained from abroad to finance domestic enterprises.

According to ECLAC (Economic Commission for Latin America and the Caribbean), in 2010, Ecuador was last in line for DFI among 10 countries. During 2010, Ecuador managed to collect \$164.1 million (USD), which is \$155 million (USD) less than in 2009.

Ironically, government spokesmen keep reassuring the public and maintain that the increase of ISD to 5% will not affect DFI because distribution of dividends and profits, and repatriation of profits, would be exempt from ISD under the proposed legislation.

According to the IRS Chief, the purpose of the ISD rate increase is to avoid the outflow of currency and prevent a monetary anemia due to lack of liquidity. Other experts point out that the increase of ISD from 2% to 5% will not result in dollars being taken out of Ecuador but, on the contrary, ensure that dollars will not enter. In other words, they believe there will be no outflow of funds upon the increase of ISD to 5% but there will be no new injections of money, or inflow of capital. They add that the increase works conversely as compared with the mechanism used by Brazil to ban new capital from entering to the economy of that country. Brazil applies a 6% tax on inbound capital entering Brazil, aimed at restricting the excessive arrival of dollars and thus the exorbitant revaluation of its own currency, the Real.

In the case of Ecuador, there is a desire to retain capital in Ecuador. Measures such as the proposed legislation that would increase ISD send the same message as that sent by Brazil. The message: the infusion of capital resources into the Ecuadorian economy is discouraged. There is, however, a notable difference between the messages sent by Brazil and Ecuador regarding capital inflow. Brazil

wants to restrict capital inflow (to preserve the Real) and Ecuador does not. However, the collateral effect of enacting the proposed legislation and increasing ISD to 5% in Ecuador would be the same as enacting legislation with the purpose of restricting capital inflow.

According to government estimations, with the increase in ISD, Ecuador stands to collect \$552 million (USD) in 2012, which is 62.31% more than was collected in 2011.

DFI in the second quarter of 2011 was \$151.08 million (USD). The shortage of DFI in the second quarter compared to the first quarter was 10%. Due to the majority the current government holds in the National Assembly, no one doubts that the National Assembly will approve the tax reform, as presented, without amendment.

2011 In Review

2011 saw several notable tax developments in Ecuador.

In 2011, as previously published, the IRS released the procedural rules for the preparation and filing of the *Tax Compliance Report* (TCR), which is the result of the analysis made by external auditors regarding the compliance of taxpayers subject to external audit with their tax obligations. On the other hand, a tax assessment is the result of the audit made by an IRS auditor and the auditor's team, in accordance with the procedures set forth in the tax law, to the tax returns, accountability and entries, aimed at establishing the existence of a tax event, taxable base and the amount of a determined tax.

The TCR is a document that shows the external auditor's opinion with respect to the fulfillment of the tax laws and regulations by taxpayers subject to such audit. Generally, the TCR must be filed by all external auditors approved and qualified by the Superintendencia of Banks and Superintendencia of Companies, with respect to their clients' taxpayers that are under the obligation to hire such external audit. External Auditors must file the TCR in the Regional Secretaries

of the IRS at a national level corresponding to the jurisdiction where the audited taxpayer has its tax residence, attaching all annexes and with the contents required by the IRS.

New regulations were issued, calculating the Advanced Payment of Income Tax for 2011. According to the new regulations, several aspects must be considered for accurate calculation, among others:

- (1) APIT must be calculated and paid after the complete second year of effective operations;
- (2) If you are an individual, you should not include your personal use assets, and the total assets in the calculation of the APIT; and
- (3) If you consider that you have committed a mistake in calculating the APIT, it is better to proceed on correcting the calculation, with the purpose to avoid penalties.

Corporations, individuals, and undivided inheritances that must keep accounting records are obligated to calculate the APIT. To calculate APIT, the taxpayer must make a sum of the following items:

- 0.2% of the total equity
- 0.2% of the total costs and expenses
- 0.4% of the total assets
- 0.4% of the total income

Withholdings at source that were effected during the tax period, must also be considered.

All items that constitute the equity must be included, such as: paid-in capital, reserves, accrued results and contributions for future capitalizations.

Once the above mentioned percentages are applied to the items included in the calculation, the APIT is obtained. Withholdings at source must be deducted from the APIT in order to obtain the exact amount of the installments to be paid in the tax year. The APIT must be paid in three installments:

- First installment in July

- Second installment in September
- The difference will be paid along with the tax return corresponding to the fiscal year

A claim for payment in excess can be filed in the following cases:

- For the total withholdings that exceed the pending balance of the advanced tax paid, if no tax is due in the current tax year or if the tax due is lesser than such advanced tax. In case that withholdings do not exceed the pending balance of the advanced tax, prior to payment of this balance, the amount of withholdings will be offset.
- For the withholdings that have been effected, in the portion that have not been applied to the payment of the income tax, taken into consideration the pending balance of the advanced tax, in the event that the income tax due is bigger than the advanced tax paid.

In 2011, the IRS also issued Resolution No. NAC-DGECCGC11, outlining the treatment of dividends, profits or benefits obtained by individuals since 2010. Highlights of this Resolution follow:

Registry of Income Where Accounting Book Maintenance is Required and Shares are Registered—Ecuadorian Accounting Standards (NEC) mandate that dividends must be recognized when the right of the shareholder to receive the dividends is also recognized. Therefore, the shareholder must register his dividends and profits at the moment when the Corporation that distributes them recognized his right to receive payment.

Registry of Income Where (1) Accounting Book Maintenance is Not Required or (2) Accounting Book Maintenance is Required But Shares Not Registered. Registry of Income for Individuals (Not Required to Keep Accounting Books) or Individuals Who are Required to Keep Accounting Records but do Not Have Registered Shares —where a taxpayer is not required to maintain accounting books or where the taxpayer is required to maintain accounting books but, due to

their entrepreneurial activity, does not register shares in the book (alleging that the shares do not correspond to their business activity), the taxpayer should have recognized the income and therefore registered the dividends of profits in his income & expenditure account at the time he received payment.

Tax Withholding for Individuals Required and Not Required to Maintain Accounting Records—according to Article 50 of the Internal Revenue System Law (the Tax Law) at source withholding must be effected at the time of payment or credit into account whichever occurs first. In this case the accounting registry made by the Corporation that distributes the profits comes first; hence this will be the moment when the withholding agent must withhold the applicable tax. The tax withheld constitutes tax credit for the beneficiary for the tax year in which the dividend was received or registered.

For those anticipated payments of profits, dividends or benefit made during the 2010 tax period, before the enactment of the new General Regulation to the Tax Law, the applicable withholding percentage was of 2% of the taxable income.

According to literal e) of Article 36 of the Tax Law for purposes of determining the tax credit to be granted to taxpayer for the tax paid by the Corporation that distributes the dividends, profits or benefits, it must be considered the LESSER VALUE of the following items must be considered:

- (1) Tax paid by the Corporation, corresponding to the dividend;
- (2) Rate of Corporate Income Tax applicable to Corporations, multiplied by the amount considered as taxable income; and
- (3) The income tax due corresponding to the individual for that income within his global income; in other words, the resulting difference from subtracting the tax due in his global income, including the total amount of the dividend, minus the tax due in his global income, if such dividend or benefit are not considered.

When an individual receive dividends distributed by more than one Corporation established in Ecuador, for purposes of determining his tax credit for the tax paid on his behalf for the Corporations, it must be considered:

- (1) The sum of the corresponding portion of the taxes paid by those companies in which he is a shareholder;
- (2) The corporate income tax rate applicable for corporations, multiplied by the sum of the amounts considered as taxable income; and
- (3) The income tax due corresponding to the individual for that income within his global income; in other words, the resulting difference from subtracting the tax due in his global income, including the total amount of the dividends, minus the tax due in his global income, if such dividend or benefit are not considered. ♦

Relevant Tax Matters for Fiscal Year 2012 in Mexico

by C.P. Miguel Ortiz Aguilar, Partner; Lic. Luis Curiel Piña, Partner; C.P. Jorge Ricardo Flores Castillo, Associate; Lic. Pedro Gerardo Olivares Badillo, Attorney, Ortiz, Sosa, Ysusi y Cía., S.C, Mexico City, Mexico

The purpose of this article is to make a number of comments on the reforms proposed to the Federal Tax Code for fiscal year 2012.

Advanced electronic signature—The Executive Branch proposes extending the effective duration for the certificate of the Advanced Electronic Signature (FEA) from two to four years, computed as of the date on which the respective certificate was issued.

Form of payment for commercial governmental revenues and administrative revenues—In the same way as for the payment of taxes, it is proposed that the electronic transfer of funds should also be used as a mean of payment of commercial governmental revenues and other administrative revenues.

Form of making tax refunds—A proposal has been made to eliminate the nominative check and the special certificates as a form of carrying out refunds, by keeping the electronic transfer of funds as the only mean authorized for tax refunds. The proposal is justified by the increase in the number of taxpayers who have bank accounts, the facilities currently provided by such institutions for the opening of such accounts, and the major effort which the Federal Government has been making in recent years to use technological resources in banking and financial operations, apart

from the fact that making deposits in bank accounts represents greater legal assurance for the taxpayer.

In this regard, the Executive Branch argues that nominative checks have several drawbacks, one of which is that they are valid for only 180 days. As a result, after this deadline has elapsed a request must be made to reissue the check. Furthermore, a bank account must be opened in the name of the taxpayer in order to cash the check and, finally, there is still the risk that it may be cashed by third parties.

In the case of the special certificates, it is proposed that they should be eliminated because they are obsolete, since they have not been requested by taxpayers for over eight years and their continued presence in the electronic systems of the Federal Treasury generates maintenance expenses, as well as operating expenses with the Bank of Mexico.

Audit Report—To provide greater legal assurance for taxpayers, the penalty established in the Regulations of the Federal Tax Code is now incorporated into such Code, whereby if the audit report prepared by a certified public accountant and the related information are filed after the authorized deadlines, they will be considered as not having been filed and will therefore have no tax effects.

In this regard, the Second Chamber of the Mexican Supreme Court of Justice had declared as unconstitutional the former article 49, final paragraph of the Regulations of the Federal Tax Code in effect up to December 7, 2009, for establishing a new and greater penalty than that established in the Code which it regulates.

We believe that if such reform is approved, the aforementioned constitutional flaw would be corrected.

National Consumer Price Index—Reforms are proposed to several provisions of the Federal Tax Code to establish that the National Institute of Statistics and Geography (INEGI) is the only competent authority authorized to calculate the National Consumer Price Index (INPC).

By way of background, in article 59, section III of the Law of the National Statistical and Geographical Information System (LINEGI), published in the Federal Official Gazette on April 16, 2008, the INEGI was granted the power to prepare and calculate the INPC.

By means of the Transitory Article First of the LINEGI, it was established that the power of the aforementioned Institute to calculate the INPC would go into effect three years after the LINEGI went into effect. In other words, on July 15, 2011.

Notwithstanding the above, the aforementioned Law did not specify whether the procedure to be used by the INEGI to calculate the INPC should be the same as that established for the Bank of Mexico in articles 20 and 20-BIS of the Federal Tax Code, for which reason based on the reform proposed the aforementioned legislative flaw would be rectified.

Tax receipts—The purpose of the proposal, according to the considerations submitted by the Executive Branch, is to compile, simplify and unify within the Federal Tax Code, all those requirements that have to be included in tax receipts, which are distributed

among several different laws, regulations and general rules issued by the authorities.

In some cases, the intention is to raise to the level of law, provisions which are now contained in general rules, related to the requirements of the tax receipts and account statements issued by credit institutions and other persons authorized to do so. In other cases, the intention is to eliminate certain requirements contained in tax receipts. Specifically, for purposes of digital tax receipts, the proposal is to continue with the general rule of issuing tax receipts in digital form through the webpage of the Tax Administration Service. Furthermore, it is proposed to eliminate the data regarding the name, corporate name or business name and fiscal domicile of the taxpayers who issue such digital tax receipts, and retain only their Federal Taxpayer's Registry (RFC).

It is proposed to eliminate the option that taxpayers had of issuing printed tax receipts in the case of transactions up to \$2,000. With this reform, as a general rule, taxpayers would be obliged to issue tax receipts in digital form through the webpage of the Tax Administration Service for all the transactions carried out with their clients.

Another proposal is to provide the option of indicating a generic RFC number for those cases where the person to whom the tax receipt is issued is a foreigner or a person who is not obligated to register with the RFC, in which case the tax receipt issued is considered as simplified and cannot be deducted or credited, except for the refunds of Value Added Tax requested by foreign tourists.

Likewise, certain additional requirements are established which must be included in tax receipts that support deductible donations, leasing or rental income, sale of tobacco, school transportation service, among others.

Final comments—According to article 42, section IV of the Federal Budget and Fiscal Responsibility Law, the Federal Tax Code must be approved by the Lower

House at the latest on October 20, 2011 and by the Senate at the latest on October 31, 2011.

The bill of the Federal Tax Code for fiscal year 2012 was approved by the Lower House on October 20,

2011, and by the Senate on October 26, 2011, and turned to the Executive Branch for its approval and publication in the Federal Official Gazette at the latest 20 calendar days after the respective approval has been granted. ♦

Uruguay Regulates Bank Secrecy

by Isabel Laventure, Ferrere, Montevideo, Uruguay

In 2010, Law No. 18,718 opened the way for Uruguayan tax authorities to request the lifting of bank secrecy by court order upon accrediting the existence of objective indicia leading to a reasonable presumption of existence of evasion. The Uruguayan Tax Administration (Dirección General Impositiva) will also be able to request the lifting of bank secrecy by the courts upon request by a foreign tax authority of a country with which Uruguay has signed a double taxation or exchange of information treaty.

Decree No. 282/011, regulating the relaxation of bank secrecy, was recently approved. Under the Decree, the Uruguayan tax authority can only turn to the courts to obtain lifting of secrecy after having attempted to obtain a voluntary agreement to review a taxpayer's bank accounts.

If the taxpayer does not expressly authorize disclosure of the information requested, or the terms provided lapse without a response, tax authorities may petition the courts to lift bank secrecy.

As compensation, taxpayers giving their consent will have the benefit of a reduction in the statute of limitations period. Nevertheless, the terms of this benefit have not yet been regulated.

The prior condition of attempting to obtain consent is provided only for taxpayers having reported their domicile to the Tax Administration, and is not applicable for those not having established domicile, or for persons liable for taxes or other

individuals or legal entities that could be used for instrumental purposes.

Lifting of bank secrecy will also be applicable to nonresident accounts in Uruguay upon request by the depositor's country of origin, provided there is an information exchange or double taxation treaty in effect between the two nations. However, the decree does not regulate the procedure to be followed by countries requesting information.

Taxpayer-Tax Administration Relationship Law Approved

With a view to improving the relationship between taxpayers and the Tax Administration, in August 2011 Parliament approved Law No. 18,788.

It tasks the Executive Branch with preparing a Bill of Taxpayer Rights systematizing current rules on taxpayer guarantees and duties in the context of their relationship with the Tax Administration.

The text is to be prepared within a maximum of one year and must be updated every two years.

The law also contains other provisions on the relationship between taxpayers and Uruguayan tax authorities. For example, it establishes that statutes of limitations must be indicated *ex officio* by the Tax Administration in the case of administrative proceedings. It also sets a minimum amount for instituting executory proceedings, and a limit for reinstating generic attachments no more than four times in

executory proceedings shelved due to lack of information on attachable assets.

In turn, it repealed the regimen for updating penalties for tax violations related to taxes collected by the Tax Administration while administrative appeals are being processed. That adjustment was calculated based on

the variation in the consumer price index between the third month preceding the date of demandability and payment. Traditionally, Uruguayan tax doctrine had questioned the adjustment insofar as it implied discrimination against taxpayers who had exercised their right to bring administrative appeals, given that updating of penalties and surcharges was applicable only to them. ♦

Argentine Tax Update

by Eduardo Aguilera, Mitrani, Caballero, Rosso Alba, Francia, Ojam & Ruiz Moreno, Buenos Aires, Argentina

As we reach the final quarter of the year, we report on a judicial downfall in the ARS's massive suspensions of grain export companies from the Fiscal Registry of Grain Operators in *Bunge Argentina S.A. c/ AFIP – Amparo*; a Supreme Court decision broadening the standards to admit tax-free corporate reorganizations in *Frigorífico Paladini SA c/ AFIP s/ demanda*; and yet another Supreme Court ruling regarding the accrual method in *Compañía Tucumana de Refrescos S.A.*.

Despite being a voluntary regime, companies excluded, suspended or simply not admitted to the FRGO stand handicapped

Suspension from the Federal Registry of Grain Operators: *Bunge Argentina S.A. c/ AFIP – Amparo*

During the months of February and March 2011, the ARS imposed sanctions on the nation's major grain exporters, claiming that the companies were tampering with the prices of their export operations through triangulations and therefore evading income tax.

The imposed sanctions mainly included the suspension from the Fiscal Registry of Grain Operators (FRGO). The FRGO is a beneficial mechanism established by General Resolution 2300, to which grain operators may apply in order to obtain a number of fiscal and operative benefits including, lower withholding rates of VAT and Income

Tax and an unlimited amount of grain transport permits and other forms required to document local operations. Despite being a voluntary regime, companies excluded, suspended or simply not admitted to the FRGO stand handicapped compared to the rest of the industry as they will face difficulties in the transport of goods—as only a limited amount of transport permits are granted—and an accumulation of their VAT credit—due to the higher withholding rate, which would exceed the VAT debit thus becoming an extra cost.

The mechanism used by the ARS to apply the suspensions is particularly relevant to the case under analysis: a list, simply containing the name of the suspended companies, was published in the Official

Gazette, without previous notice or any other sort of discussion. Furthermore, the causes that led to the suspensions were not precisely stated and the suspensions were directly executed by the ARS.

One of the suspended companies, Bunge Argentina S.A., filed an *amparo* action, petitioning the Federal Court to lift the suspension. A federal court in the Province of Cordoba granted the plaintiff's motion. The case was appealed to the Federal Court of Appeals of Cordoba, which confirmed the previous ruling.

According to the Court of Appeals, the ARS violated Bunge Argentina's right to substantial due process when

it was deprived from its right to be heard prior to the imposition and execution of the sanction. This much implies that the Court accepted that even though the FRGO is a beneficial mechanism, the suspension from it constitutes a sanction. The ARS had insisted that the acceptance to the FRGO was voluntary and thus the suspension from it simply overrides the prior acceptance.

Furthermore, the Court considered that the causes of the suspension—the ARS had stated that Bunge Argentina's income tax statements were in the process of being challenged—were unacceptable as they violated the right of the taxpayer to appeal the future assessment to the National Tax Court. This appeal, pursuant to the Tax Proceeding Act, suspends the effects of the assessment and, according to the ruling, also precludes any other collateral effect it might be given by the ARS—i.e. invoking the assessments as a sort of probable cause to support the sanctions.

The ruling represents a downfall in the ARS clear intent to force companies to accept the challenges on their transfer prices, as other companies may now seek to obtain court ordered reinstatements to the FRGO.

Tax free corporate reorganizations: *Frigorifico Paladini SA c/ AFIP s/ demanda*

Under Section 77 of the Argentine Income Tax Law (ITL), capital gains arising out of mergers, divisive reorganizations and the transfer of assets between affiliated companies are not subject to tax. However, in order to carry on a tax-free reorganization, taxpayers must comply with certain requisites established in the ITL and its Implementing Decree and give notice to the ARS.

In the case, Frigorifico Paladini S.A. gave the ARS notice of its plan to merge with Frigorifico Villa Diego S.A.—an affiliated company—under Section 77 a) of the ITL (mergers). After analyzing the scenario, the ARS rejected the merger as a tax-free corporate reorganization and pointed out that the solicitor was not complying with two separate requisites. First, the ARS stated that both merging companies should have been active by the time of the merger, whereas Frigorifico

Villa Diego S.A. was an idle company. On the other hand, while both companies should share the same business activity, according to the ARS, Frigorifico Paladini S.A. was a meat processing company and Frigorifico Villa Diego S.A. a real estate company.

The rejection was challenged in court, where the taxpayer argued that even if its reorganization did not meet the requisites to be characterized as a tax free merger, the ARS should be ordered to accept the transaction as a tax-free transfer of assets between affiliated companies under Section 77 c) of the ITL.

Both a Federal Court and the Court of Appeals ruled that the plaintiff had not met the statutory requisites in order to benefit from a tax-free merger. Moreover, the request to recharacterize the reorganization as a transfer of assets between affiliated companies under Section 77 c) of the ITL was inadmissible, as the taxpayer already selected the reorganization mode and could not alter it by means of a legal action in court. And even if it were admissible, the different business activities of the involved companies precluded them from the benefits of the regime even under Section 77 c) of the ITL.

The ruling was appealed to the Federal Supreme Court.

The Attorney General for Tax Matters, Miss Laura Monti, elaborated an opinion that was later accepted and quoted by the Court on its ruling. According to Miss Monti, under the principle of formal flexibility established in the Administrative Proceedings Law—applicable to tax law in the absence of a clear rule indicating otherwise—formal requirements cannot be invoked to prevent taxpayer from exercising a right or to access a beneficial regime.

Therefore, as long as no clear rule indicates that once the taxpayer has given notice of a merger under Section 77 a) of the ITL he is banned from shifting to a corporate reorganization under Section 77 c), the mentioned formal requisites—previous notice—should be bent in favor of the taxpayer.

Moving to the fact that the companies lack of an identical business activity, Miss Monti pointed out

that this substantial requisite should be read under the substance over form principle. The ARS simply argued that Frigorífico Villa Diego S.A. had stated to the ARS officials that its business activity was related to real estate but failed to show any evidence to that extent. Setting aside that statement, the facts of the case showed that both companies share their location, administration, accounting system, machinery, etc. Therefore, the two companies were substantially a unit with an identical activity.

The ruling is likely to become a milestone decision on the interpretation and analysis of the tax-free corporate reorganization regime, as it broadens the means to verify that a certain reorganization falls within the legal standards, in spite of the formal barriers that the ARS usually invoke.

The Accrual Method: *Compañía Tucumana de Refrescos S.A.*

Under Section 18 of the ITL, corporate income and expenses must be allocated according to the accrual method which, as regards to expenses, means their deduction is allowed when the obligation to pay becomes fixed, regardless of when it is actually paid.

However, there has always been controversy regarding the correct allocation of expenses arising out of long term contracts. In fact, the whole concept causes confusion among tax experts and courts due to the lack of a definition in the ITL and because both usually forget that the accrued method is an accounting concept and not a legal one.

In the case, *Compañía Tucumana de Refrescos S.A.*—a soda manufacturer company—had executed a number of agreements with its customers, pursuant to which the latter would, during the term of the agreement, exclusively buy sodas manufactured by the company in exchange of a settled price. The expenses related to these agreements were deducted in the fiscal year of its execution.

The ARS did not challenge the deduction itself but its allocation to a single fiscal year. According to the fiscal

authority, the company should have divided the amounts of the expenses over the term of the agreement, as the necessary cost to generate or maintain the source of income was not accrued immediately but along a period of time.

Both the National Tax Court and the Court of Appeals confirmed the fiscal assessment. The case was appealed to the Supreme Court.

Once again, the Court quoted the opinion of the Attorney General for Tax Matters, Laura Monti. Miss Monti's opinion didn't so much define the accrued method—as lower courts tried to do—but instead simply concluded that its application to the case implies an allocation of the expenses to the year of the execution of the agreements.

Her conclusion stands on two different arguments. First, whereas the ITL provides for a number of exceptions to the application of the accrued method for corporate income, none applied to the case nor had the ARS or the lower courts argued that an exception was applicable. Therefore, the opinion seems to suggest that previous rulings simply failed to understand the correct mechanism of the accrued method.

On the other hand, Miss Monti pointed out that the taxpayer allocated its income using the accrued method and that the allocation mechanisms established in the ITL were designed to apply identically to both income and expenses. Therefore, the ARS challenged of the deduction was unjustified.

2011 in Review

The Argentine Supreme Court was very active in 2011. As reported in June, the Supreme Court began the year by rendering milestone decisions on relevant international tax issues including transfer pricing. The Court began by rendering decisions in *Application Software S.A.*, *Astra CAPSA*, and *Autolatina Argentina*.

In *Application Software S.A.*, the Court ended a long term debate regarding cross border provisions of

software and the licensing of copyrights by corporations. The case involved a foreign corporation that owned the copyright to software it leased, as a grantor, to a local entity. That the foreign corporation's income was of Argentine source subject to withholding at source was not in dispute. The dispute focused on the rate of the withholding. According to article 93 b) of the Federal Income Tax Law, payments made to foreign beneficiaries for the use of copyrights are subject to an effective withholding rate of 12.25%, as long as they comply with the set requisites of another norm (i.e. article 20 j) of the same statute). Otherwise, those payments are subject to a withholding rate of 31.5% (according to article 93 h) applicable to non-specifically regulated payments). The Court resolved the long-standing debate regarding the possibility of corporations to be considered authors of copyrights and decided that only individuals can be considered authors of copyrights and, together with their heirs, the direct taxed subjects, as required by article 20 j). Therefore, payments made to foreign corporations for the use of copyrights in Argentina are subject to a 31.5% withholding rate.

Later, in *Astra CAPSA*, the Court decided a matter crucial to many oil companies: the deductibility of expenses incurred to control damages in oil wells during the exploration phase. The company deducted from its net income the amount expended to fix a malfunctioning well under article 82 c) of the Federal Income Tax Law, which allows for the deduction of extraordinary losses caused by *force majeure* on productive assets. The IRS challenged the deduction arguing that in order to deduct an extraordinary loss under article 82 c) the good has to have been productive before the incident. The Court rejected the analysis of the case under article 82 c) stating that the question presented to the Court should have been the deductibility of the cost of the procedure to repair the well, under the general rules of deductibility of articles 17 and 80, which establish that every expense incurred to create, maintain or conserve a source of income may be deducted. However, in the opinion of the Court this was not the governing rule, rather the one prohibiting the deduction of capital outlays. According to the Court, the expenses incurred in this case (and for that matter, all the costs at the exploration stage of

a well) should have been capitalized into the value of the well for future depletion allowances.

Finally, the Court set material standards with regards to back-to-back international financing in *Autolatina Argentina*. In this case, the taxpayer argued that it had received a loan for \$10 million (US) from a foreign entity, Deutsche Bank New York. The taxpayer claimed that the company was required to place collateral abroad to secure the debt. However, the IRS sustained that, according to the evidence collected, Deutsche Bank was not the actual lender, but rather an agent acting on the behalf of another and thus undertaking no credit risk. In fact, the IRS proved that the bank was only entitled to a half percent annual intermediation fee, to be deducted from the sums to be paid onto the actual lender. The Supreme Court held that in case of back-to-back financing, even if the taxpayer proves that the funds came from abroad, the legal standards require a higher effort to show the actual originator of the funds, namely the final lender exposed to the credit risk. The lack of such evidence allows upholding the assessment made by the IRS.

In 2011, court rulings also greatly impacted major Argentine industries. Some rulings can even be construed as fiscal guidelines for their respective industries. In *Union Pak S.A. s/ recurso de apelación*, the National Tax Court established that payments from a local courier to a foreign courier are of Argentine source. In *Banco Frances S.A.*, the Supreme Court decided that the customs and usage of banks can be taken into account to deduct bad credits.

There have also been notable transfer pricing cases the impact of which could affect all industries. Recently, the National Tax Court decided more transfer pricing cases for the 1998 and 1999 fiscal periods, thus clearing many of the uncertainties obtained in the statutes.

In *Nobleza Piccardo*, the court established a transfer pricing methods hierarchy. 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.

In *Nobleza Piccardo*, the 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 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. 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.

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 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.

However, in *Volkswagen Argentina S.A.*, the court pointed out that 1999 was a very particular year for the automobile industry (leading to the influx of transfer pricing cases recently before the court). A negative economic scenario produced a serious of unwanted effects such as massive lay offs, default of debtors and excess productive capacity.

In *Volkswagen Argentina S.A.*, Volkswagen (VW) took into account that it 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 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 required and 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. ♦

New Peruvian Taxes & Royalties on Mining

by Cesar Luna-Victoria, Rubio, Leguia & Normand, Lima, Perú

Three new laws (29788, 29789 and 29790) have been enacted to modify the existing mining royalty and to introduce a new tax and an “auto tax” on mining depending whether, or not, the company has subscribed a Tax Stability Agreement. The main features of the new royalty and taxes are as follows:

Special Mining Burden (GEM)

The GEM is applicable to mining companies subject to stabilization agreements which voluntarily decide to subscribe an agreement with the Peruvian government. Quarterly payments applied on operating profit based on a sliding scale with rates ranging from 4% to 13.12%, depending on operating margin. It is deductible as an expense for corporate income tax purposes. Funds are considered federal government revenue.

Special Mining Tax (IEM)

The IEM is applicable to mining companies not subject to stabilization agreements. It is supplementary to

the royalty regime. Quarterly tax applied on operating profit based on a sliding scale with rates ranging from 2% to 8.4%, depending on the company’s operating margin. It is deductible as an expense for corporate income tax purposes. Funds are considered federal government revenue.

Modified Royalty

The Modified Royalty replaces existing royalty and is applicable on operating profit, rather than sales. It must be paid quarterly according to a sliding scale with rates ranging from 1% to 12%, depending on operating margin. There is a minimum royalty equal to 1% of sales and is deductible for corporate income tax purposes. Funds are considered regional government revenues in same manner as existing royalty. ♦

New Modifications to the Municipal Tax System of Panama

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

By means of Agreement No. 73 of July 26, 2011, published in the Official Gazette No. 26906-B, the Panama City Council approved a series of modifications to some of the Tax Tables contained in Agreement No. 40 of April 19, 2011, which resulted in a tax reduction in some of the modified Charts, and an increase in others, being the latter those that are basically related to municipal public markets and other entities and activities that are directly managed by the City Hall.

In this sense, the Tables modified by this Agreement are:

- Table 1 (Wholesale Establishments),
- Table 2 (Retail Establishments),
- Table 29 (Representation Agents and Distributors),
- Table 81 (Farmers Market and other Municipal Markets),
- Table 82 (Street and Sidewalk Use),
- Table 83 (Funerary services),
- Table 84 (Soup Kitchens),

- Table 95 (Summit Gardens Park) and
- Table 96 (Mi Pueblito), all of them contained in Article 2 of Agreement No. 40.

It is necessary to remember that the Municipal Tax Tables that impose taxes on lucrative businesses in the District of Panama classify the taxpayers progressively in different categories, according to their annual sales or gross income. In this vein, the changes made on these tables are directly reflected in specific categories thereof.

First, Table 1 corresponding to Wholesale Establishments, reflects a decrease with respect to the second and third categories. In the second category, which includes those taxpayers with annual gross sales between \$1,000,000 and \$4,000,000, a progressive tax decrease between \$200 and \$400 is established, thus modifying the previous range (between \$250 and \$500). In the third category, there is a progressive decrease that establishes a maximum tax payment of \$150 for those taxpayers with annual gross income of up to \$1,000,000.

Table 2 covers the greatest number of lucrative activities taxed by the municipality, including activities like retail stores, taxi businesses, consulting businesses, perfume and cosmetics stores, jewelry stores, among others. In the present Table, as well as in Table 1, modifications are reflected in the second and third categories. In this vein, we observe that the second category, which includes taxpayers with annual gross sales between \$500,000 and \$2,000,000, there is a progressive tax decrease, with a tax range between \$200 and \$400, instead of the previous range that classified the taxpayers with a maximum tax payment of \$500. The third category of the present Table was modified to a maximum tax payment of \$175 thus reducing the previous maximum amount of \$190.

For the taxpayers engaged in the activities of Representation Agents and Distributors listed in Table 29, a tax decrease is introduced in relation to the first category, which includes those taxpayers with higher gross income, with a progressive decrease in such category of the maximum tax to pay which will be

\$1,500 for those taxpayers that report annual gross incomes higher than \$30,000,000.

Funerary Services, Municipal Public Markets and Others

The rest of the modified Tax Tables are those which establish fees and taxes to be paid for activities that are directly managed by the Panama City Hall. In those tables, unlike what happened with the tables previously mentioned, there have been few changes, however, they reflect an increase in charges, fees, and all other taxes therein, in respect of services under Municipal administration, such as the case of Municipal markets (Farmers' market, Seafood market, etc.), in which some increases have been introduced regarding the charges made by the City Hall to the markets' operators. A similar situation can be observed with some charges related to funerary services, and those related to Summit Gardens Municipal Park and Mi Pueblito Tourist Center.

The changes introduced to Tables 1, 2 and 29 by the present Agreement became effective in November 1, 2011, and the rest of the Tables will be effective in January 1, 2012.

The present modifications to the Municipal Tax System, are an addition to those previously introduced by means of Agreement 95 of year 2011, about Withholding Agents, a controversial issue that should be studied deeply, regarding its application by the Municipal Authorities in relation to the legal irregularities (breach of law) that it would imply, in case there is no amendment to Law 106 of year 1973 about the Municipal Tax System.

The information previously stated is an indication that Municipal Authorities are working in order to increase the Municipal income to cover for the investments needed in the District, therefore, we should pay special attention not only to the possible changes that might be introduced to the Municipal Tax System, but also to the investments in infrastructures and projects developed by the City Hall that justify these measures. ◆



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.

NAME	COUNTRY	PHONE	E-MAIL
Mike Valdés (President)	USA/Brazil	1 773 8678629	mvaldes@machadoassociados.com.br
Luis A. Hernandez (Coordinator)	Uruguay	598 96207050	lhernandez@lataxnet.net
Cristian E. Rosso Alba	Argentina	541145908713	cristian.rossoalba@mcrlex.com
Ramiro Guevara	Bolivia	5912 2770808	rguevara@gg-lex.com
Luis Rogério Farinelli	Brasil	5511 30934855	lfarinelli@machadoassociados.com.br
Paul Tadros	Caribbean	1 514 6970901	paul.tadros@sympatico.ca
Jorge Espinosa	Chile	562 365 1415	jespinos@espinosayasociados.cl
Alfredo Lewin	Colombia	5713 125577	alewin@lewinywills.com
Adrian Torrealba	Costa Rica	506 2565555	atorrealba@fayca.com
Norman Decastro	Dominican Republic	809 5415200	n.decastro@phlaw.com
Cesar R. Holguin	Ecuador	5934 2562908	cholguin@lawnetworker.com
Roberto Flores	El Salvador	503 25055555	rflores@romeropineda.com
Eduardo Mayora	Guatemala	502 23662531	emayora@mayora-mayora.com
Jorge Salles-Berges	Mexico	5255 1084 7017	salles@osy.com.mx
Gloria Alvarado	Nicaragua	505 2278 7708	gmaivara@alvaradoyasociados.com.ni
Said Acuña	Panama	507 2691127	saidacuna@riveboca.com
Cesar Luna-Victoria	Peru	511 442 4900	clunavictoria@erubio.com.pe
Fernando Goyco-Covas	Puerto Rico	1 787 2811802	goyco@amgblaw.com
Alberto Varela	Uruguay	598 2623 0000	avarela@ferrere.com
Peter Byrne	USA	1 703 387 3009	pbyrne_taxlaw@attglobal.net
Federico Araujo Medina	Venezuela	5821 29050293	faraujo@tpa.com.ve