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Argentine Revenue Service Amends Transfer Pricing Regulations

BY CRISTIAN ROSSO ALBA AND SILVIA GUADALUPE CATINOT
(ROSSO ALBA, FRANCIA & RUIZ MORENO)

A Resolution recently issued by the Argentine Revenue Service ("AFIP") has introduced significant amendments to the transfer pricing regulations, particularly with regards to international transactions subject to reporting under the Income Tax Law (as amended by Law 25,784) and its Implementing Decree (as amended by Decree 916/2004).

The amendments are related to transactions between both related and unrelated parties. Changes to the regulations aggravate penalties when full transfer pricing documentation is not timely filed.

In connection with unrelated-party transactions, new documentation and reporting requirements are implemented, particularly in connection with imports and exports of goods that do not have internationally known prices (i.e., goods that are not commodities). The goal seems to be to allow

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Termination of the Double Taxation Treaty Between Brazil and Germany

Dispute Provides Insight into Brazil's Treatment of DTT Provisions

BY GUSTAVO L. HADDAD AND BRUNO M. CARRAMASCHI
(LEFOSSE ADVOGADOS)

Brazil has traditionally been seen as one of the countries in Latin America with the most extensive treaty network. Brazil has treaties with several European countries (including France, Italy, Spain, Portugal and the Netherlands) and Asian countries (e.g., China, Japan and India). Notably, it does not have treaties with the U.S. or the United Kingdom.

However, this situation may be in jeopardy in the future following the recent communication by the German government of its intention to terminate the Double Taxation Treaty with Brazil ("DTT") - it is expected that the DTT will expire on December 31, 2005.

The purpose of this article is to outline some important consequences of the termination of the DTT for companies doing business in Brazil and

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the AFIP to find and audit a disguised affiliation of companies, which could be evidenced by undervalued prices of export and import.

General Resolution 1918, published in the Official Gazette on August 3, 2005 (the "Resolution"), introduces significant amendments to the transfer pricing regs set forth in General Resolution 1122.[1]

It is worth recalling that General Resolution 1122 sets forth the formalities, requirements and conditions that taxpayers engaging in international transactions must observe in order to demonstrate that prices, transacted values or income margins in transactions with both related and unrelated foreign parties—as well as with entities incorporated in low-tax jurisdiction—comply with the arm's length standard.

The new Resolution adopts some of the changes introduced by Law 25.784[2] to the text of the ITL which were later incorporated into the Implementing Decree by Decree 916/04[3] (the "Decree"). In effect, the Resolution:

(i) sets forth new documentation and information requirements that taxpayers

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Brazil’s Congress Creates More Tax Breaks

BY EDWIN TAYLOR

The lower house of Brazil’s Congress on August 24 approved additions to a government bill creating tax incentives.

The congressmen voted to extend the scope of an already existing tax program which provides tax breaks to small companies. Companies whose monthly sales do not pass a certain limit qualify for the program which effectively reduces their federal taxes. The lower house doubled this limit, thus increasing significantly the number of companies eligible for the program.

The congressmen also approved a measure that gives electricity utilities a break on the payment of their PIS/Cofins social security taxes which will be reduced from 9.25 percent of sales to 3.65 percent. This applies to the sale of electricity to residential and rural consumers as well as government organs.

Government officials estimated that these two measures will reduce annual tax collections by up to $942 million. Both proposals were opposed by the government’s tax department but opposition forces in congress were able to muster a majority to approve both.

In addition, the lower house extended another measure of the original tax incentives package which was announced in June. That package eliminated the PIS/Cofins taxes on desktop computers whose prices do not exceed $1,000. The version approved by the lower house extends this exemption to cover laptops and notebook computers.

The congressmen maintained all of the measures of the original government tax package which contained 20 items including incentives for exports and new investments.

One of the most important measures was the immediate suspension of the industrial excise tax (IPI) on capital goods. This was only scheduled to take effect in December 2006.

The approved bill also provides tax exemptions for companies making new investments. To qualify for the tax breaks, companies must show that at least 80 percent of their revenues come from exports.

These companies will not have to pay the PIS/Cofins taxes in the purchase of machinery and equipment, including imports, destined for use in new projects. The government estimates that this will result in a 12 percent to 20 percent reduction in the costs of new investments for companies participating in the program.

The bill also grants a five-year exemption for the PIS/Cofins taxes for the purchase of goods and services by companies that export software or information technology services. This exemption will also be limited to companies whose exports account for at least 80 percent of their revenues.

In order to permit companies to make use of the exemption on imported equipment, the government had to issue on August 8 a second decree, number 5505. The decree suspends the requirement for payment of the PIS/Cofins taxes on imported machinery, equipment and instruments when these goods are imported through the Recap program, the Portuguese acronym for Special Regime for the Acquisition of Capital Goods for Exporting Firms.

The decree also grants the same exemption for goods and services imported by companies that export software or information technology services.

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Since the June package was first announced, business associations have been actively lobbying congress to expand the incentives. Over 300 proposed amendments have been submitted including some 30 from power companies. The approved bill now goes to the Senate where the business lobby is expected to continue to push for more incentives.

The bill also grants a five-year exemption for the PIS/Cofins taxes for the purchase of goods and services by companies that export software or information technology services.

Pharmaceutical Company Suffers Defeat in Transfer Pricing Dispute

After registering a string of victories in Brazilian tax courts, multinational pharmaceutical firms challenging a tax department ruling on transfer pricing have suffered what could be a serious reversal. The Third Taxpayers Council, an appeals court that operates under Brazil’s finance ministry, ruled by a vote of five to three in favor of the tax department and against the Brazilian subsidiary of Belgium-based Janssen-Cilag.

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The court in effect maintained the previous decision of tax officials prohibiting pharmaceutical companies from using the "resale price less profit" transfer pricing method (RPM) in cases where the active ingredients of medications were imported.

A law passed at the end of 1999 and which took effect January 1, 2000 permits this operation but the tax department has ruled that ingredients imported prior to this law were not eligible.

The rationale of the department was that these ingredients did not constitute a finished product and prior to the 2000 law only finished products could make use of the RPM method. As a result, tax officials insisted on assessing pharmaceutical companies that attempted to use this method. Several pharmaceutical firms have challenged this interpretation and starting in 2004 had won a series of six straight victories in the Taxpayers Councils. But in its ruling, the Third Council ended this winning streak, accepting the argument of finance ministry lawyers that Janssen-Cilag could not use the RPM transfer pricing method.

One of the most important measures was the immediate suspension of the industrial excise tax (IPI) on capital goods. This was only scheduled to take effect in December 2006.

The approved bill also provides tax exemptions for companies making new investments. To qualify for the tax breaks, companies must show that at least 80 percent of their revenues come from exports.

"When the issue began to be judged by the councils last year, it looked like an easy win for the companies but that is not the way it is," said Paulo Roberto Riscardo Junior, the head of the finance ministry's legal team. "We are going to work now to see if the interpretation of the Third Council prevails."

The lawyer for Janssen-Cilag, Luis Eduardo Schoueri, however, said that the battle is not over and stated that the matter "can still be resolved within the Taxpayers Councils." He added that he will prepare an appeal of the third council's decision.

According to the finance ministry, the six multinational pharmaceutical firms that have won decisions on the transfer pricing question are AstraZeneca, Aventis, Merck Sharp & Dohme, Schering, Novartis and Bristol Myers Squibb.

Tax Collections up 14% Through July

Federal tax collections set another monthly record in July, totaling $13.3 billion, the highest ever for July.

The total was 5.48% greater than in July 2004 and left collections for the year at $87.4 billion, an increase of 14% over the first seven months of last year.

The tax department also announced that Brazil's total tax load in 2004, including state, municipal and federal taxes, was equal to 35.91% of GDP, a 1.01 percentage point increase over 2003 when the tax load was 34.90% of GDP. Last year's result was also higher than the 2002 figure of 35.61% despite promises by Finance Minister Antonio Palocci that the government would not raise the tax load from the previous government.

Tax officials, though, argued that the increase was only for gross revenues and that the net tax load, discounting tax refunds, actually declined from 16.34% of GDP in 2002 to 16.23% last year.

According to the Finance Ministry, last year's expansion from 2003 was due to the 4.6% growth of the economy plus a real increase in tax collections of 7.62%. The largest increase in 2004 came from the Cofins social security tax whose collections rose from 3.74% of GDP in 2003 to 4.39%. The state ICMS tax, however, continued to lead all taxes with revenues equal to 7.83% of GDP, the same level as in 2003.

Super Tax Department Begins Operations

The Brazilian government's new super tax department, uniting the federal tax department with the tax collection area of the social security ministry, officially began to operate in August.

Jorge Rachid, the former head of the federal tax department is now the government's tax czar, taking charge of the new expanded structure. According to Rachid, four areas have already been unified legal questions, information gathering, technology and human resources.

An immediate goal of the new structure will be to increase the government's collections from the social security tax and reduce Brazil's perennial social security deficit. Tax officials feel that by uniting the data bases on social security tax payments and other federal tax payments and by placing all tax collections in the hands of one organ they will be better able to combat tax fraud.

This part of the unification, however, is expected to take longer and probably will not be in operation until next year. ❑

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Brazil's Super Federal Revenue Office

BY LUIZ ROBERTO PEROBA BARBOSA, MARIA TERESA LEIS DI CIERO AND TERCIO CHIAVASSA (PINHEIRO NETO ADVOGADOS)

Provisional Measure 258 (MP 258) was published in the Official Gazette of the Federal Executive on July 22, 2005. MP 258 primarily intends to unify into a single body the administration, inspection, collection, assessment and regulation of federal taxes, formerly under the authority of the Federal Revenue Office and the National Social Security Institute (INSS). As a result, the beefed-up Brazilian Federal Revenue Office (*Receita Federal do Brasil*) will encroach upon social contributions previously administered by INSS, namely: (a) contributions owed by companies on the payroll; (b) contributions payable by domestic employers; (c) contributions payable by workers on their contribution salary, as well as contributions payable by third parties that are similar to such contributions.

One of the innovations is the transfer of tax administrative proceedings to the Brazilian Federal Revenue Office, including those formalized or being formalized, as well as of payment forms and statements submitted to the Ministry of Social Security and the INSS. Effective August 2006, the rules set out in Decree 70235/72 will also apply to such "social security" contributions that were incorporated into the authority of the Brazilian Federal Revenue Office. Such deadline may be changed by the Executive Branch for tax proceedings and first-instance authority for judgment of those disputes.

An important aspect is that MP 258 maintained the rules dealing with offsetting, refund, reimbursement, immunity and exemption, which continue to be regulated by the rules in effect at the time MP 258 was published. Article 74 of Law 9430/96, however, does not apply to the contributions formerly under the authority of the INSS, which are now entrusted to the Brazilian Federal Revenue Office.

Requests for advance tax ruling will observe a single system, in accordance with the rules set forth in Decree 70235/72 and articles 48 and 49 of Law 9430/96. Requests pending review and determination by the Social Security Revenue Office of the Ministry of Social Security will be voided and must be resubmitted. Taxpayers should check carefully whether this case applies to them.

On the other hand, MP 258 does not change the INSS authority, which is established in specific legislation, particularly in connection with (i) granting and payment of benefits and rendering of social security services; (ii) services provided to those qualified for such benefits; (iii) review of administrative proceedings involving entitlement to social security benefits and services linked or related to the social contributions addressed above; and (iv) issuance of a certificate for length of contribution.

MP 258 transfers the authority to rule on appeals filed in relation to contributions, which are now under the authority of the Brazilian Federal Revenue Office, from the Social Security Appeals Board to the 2nd Taxpayers' Council of the Ministry of Finance. Cases currently underway at the Social Security Appeals Board will be sent over to the 2nd Taxpayers' Council within 30 days from creation of the new chambers. Until then, the Social Security Appeals Board will continue with authority to rule on existing appeals.

Provisional Measure 258 intends to unify into a single body the administration, inspection, collection, assessment and regulation of federal taxes.

MP 258 created the office of Tax Auditor of the Brazilian Federal Revenue Office to exercise the authority bestowed on the Brazilian Federal Revenue Office. The Tax Auditor will (i) exclusively, formalize, by assessment, the tax liability arising from taxes that fall under the authority of the Brazilian Federal Revenue Office; (ii) make and render decisions on and take part in tax administrative proceedings, and in requests for an advance ruling involving refund, offsetting and acknowledgement of tax benefits; (iii) conduct inspection procedures, including customs inspection procedures; (iv) examine the accounting records of business companies, bodies, entities, funds and taxpayers in general, without applying the restrictions set out in articles 1190 and 1192, but with due regard for article 1193, all of the Civil Code; and (v) audit the collecting network in connection with receipt and transfer of taxes collected by the Brazilian Federal Revenue Office.

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Revenue Office **from page 5**

The National Treasury Attorney's Office will act as advisor, represent the Federal Government in and out of court, and ascertain the liquidated nature and certainty of the debts posted in the federal overdue tax liability roster in connection with the "social security" contributions transferred to the realm of the Brazilian Federal Revenue Office. Such powers were previously entrusted to the INSS Attorney General's Office. Until July 31, 2006, INSS will be represented by the Federal Government Attorney's Office in issues involving tax liabilities predating the effectiveness of MP 258. A Transition Committee was created, and will report to the Attorney-General of the Federal Government and to the Minister of Finance.

In order to accommodate the recently-created duties and obligations, MP 258 has instituted 120 National Treasury Regional Attorney's Offices, to be set up by a ruling of the State Ministry of Finance in the cities where there are federal lower courts, as well as 1200 new National Treasury Attorney positions. Likewise, the Brazilian Federal Revenue Office will have five Judgment Boards and 60 Judgment Panels to take joint internal resolutions, with authority to render a first-instance decision on proceedings claiming taxes administered by the Brazilian Federal Revenue Office. Such measures will be implemented in accordance with the need for the services and availability of budgetary resources.

An important aspect is that MP 258 maintained the rules dealing with offsetting, refund, reimbursement, immunity and exemption, which continue to be regulated by the rules in effect at the time MP 258 was published.

MP 258 has modified article 44 of the Social Security Organic Law (Law No. 8212 of July 24, 1991), providing that the Brazilian Federal Revenue Office, through the National Treasury Attorney's Office (charged with representation in court), will also be responsible for collecting social security contributions levied on payments made in labor claims. The other provisions of Law 8212/91 remain in full force and effect.

MP 258 will come into force on the date of its publication in relation to articles 32 and 37, which state, respectively, that DATAPREV will be authorized to provide services to the Ministry of Finance for the purposes of MP 258, and that the Federal Revenue Office and the Social Security Revenue Office will issue up to August 14, 2005 the joint rules required for operation of the Brazilian Federal Revenue Office as from August 15, 2005. The other articles of MP 258 become effective as from August 15, 2005.

The notion of consolidating the INSS and the Federal Revenue Office duties is not a novelty, having been heard of since the former Administration, particularly due to the Federal Revenue Office's constantly-improved and dynamic procedures, which increased considerably tax revenues and improved the efficiency and automation of such office. Inspection activities have been divided by specific matters (Department of International Affairs, Special Financial Institutions Office, etc.). Such efficiency will be very useful to manage social security liabilities and reduce costs, since only one body will be in charge of tax revenues.

However, one can't be careful enough! Automation and development of the Federal Revenue Office have greatly contributed to augment tax revenues in recent years. On the other hand, several hurdles were created for taxpayers, especially a good number of new tax statements, which hinder the issuance of debt clearance certificates as a result of errors in the information filled out or absence of correlation in the information obtained by the Federal Revenue Office, and so forth. Hopefully, the new Brazilian Federal Revenue Office will not create further difficulties for taxpayers, but rather make their life easier, as taxpayers are in fact the actual clients of the Brazilian Federal Revenue Office and should be treated as such, never as enemies.

The first impression one gets is that the Federal Government has hit the target, since MP 258 is extremely salutary in several aspects. However, the tool chosen to attain the envisaged purpose has once again proved to be inadequate, as such a significant change would be more legitimate if made via a law proposed by the President of the Republic rather than via such a precarious instrument as a Provisional Measure, encroaching once more upon the full authority of the National Congress. ❑

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Statute of Limitations for Tax Purposes in Chile

Some Information Should Be Saved Beyond Limitation Period

BY OSCAR FERRARI (CARIOLA, DIEZ, PÉREZ-COTAPOS Y CÍA LTDA.)

The Chilean Tax Code provides that the Internal Revenue Service may review any deficiency in tax payments within three years from the expiration of the legal term within which the tax should have been paid.

As an example, in Chile the fiscal year coincides with the calendar year and yearly income taxes must be paid in April of each year on taxable profit of the prior calendar year. Thus, for example, the income tax 2002 taxable profits should have been paid in April 2003 and the normal term of the statute of limitations would expire in April 2006.

This term is extended to six years if no tax return has been filed or if the return that was filed is maliciously false.

The Chilean Commerce Code provides that the accounting records must be kept until the termination of the business.

The Tax Code provides that accounting records must be maintained, jointly with its supporting documents while the term the Internal Revenue Service has to review is pending.

Finally, the Chilean Civil Code establishes certain short term and long term statute of limitations terms, the longest being ten years.

This has led many taxpayers to consider that they can at least eliminate accounting records that have more than 10 years, since this period is the longest under which an obligation can be enforced.

Notwithstanding the above provisions, the Chilean Internal Revenue Service (IRS) has defined certain areas where in their opinion the statute of limitations does not apply.

In a 1986 ruling, the IRS has stated that notwithstanding the maximum 6 year statute of limitations for tax purposes, taxpayers must maintain their accounting records and supporting documents when they are the basis to determine taxes due in tax periods which are still open for review. It provides examples such as carry forward of losses, retained tax profits, depreciation of assets and similar situations.

Under the Chilean Income Tax Law, the carry forward of losses is indefinite. Thus, the position of the IRS is that all information regarding the origin of the loss must be maintained, even if it has more than six years.

The same rule applies, for instance, to the supporting information regarding the acquisition of fixed assets subject to depreciation, which must be maintained even if the acquisition has more than six years. In other terms, for this purpose, the information must be kept at least three years or even six years after the depreciation of the asset has concluded.

As regards to retained tax profits, under the Chilean tax system they must be recorded separating the profits for each year, since certain credits against taxes on personal income taxes or taxes on remittance of profits outside Chile change depending of the year the profits originated. Thus,

Under the Chilean Income Tax Law, the carry forward of losses is indefinite. Thus, the position of the IRS is that all information regarding the origin of the loss must be maintained, even if it has more than six years.

the statute of limitations will only operate after three or six years as of the full distribution of the retained profits.

The IRS has consistently maintained the same criteria in later rulings.

Even though the opinion of the IRS may be debatable from a strictly legal point of view, taxpayers should be careful and maintain their accounting records and supporting documentation available, considering the above comments. ❏

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Brazil Reduces Taxes

BY THE PRICEWATERHOUSECOOPERS LATIN AMERICAN TAX (LATAX) GROUP

On June 15, 2005, the Brazilian tax authorities issued Provisional Measure 252 (PM 252), granting specific tax incentives and creating special tax regimes. These incentives are granted mainly to exporting Brazilian entities and to companies operating in the Information Technology (IT) industry. The key incentives set forth in PM 252 are summarized as follows:

Special Tax Regime for Export of Information Technology Services (REPES)

REPES was established for companies that satisfy two requirements: (1) its activities consist exclusively of the development of software and the supply of IT services and (2) its export revenue represents more than 80% of its annual gross revenue from the sales of goods and/or services. The percentage of export revenue over gross revenue must be calculated as the average of the three year period beginning with the first year following the acquisition of the fixed asset(s) under REPES. The tax incentive provided under REPES is the suspension of the PIS (Program for Social Integration) and COFINS (Contribution for the Financing of Social Security) taxes that would otherwise be imposed upon importation of specific assets and services at the general rates of 1.65% and 7.6%, respectively.

The tax incentive provided under RECAP is the suspension of the PIS and COFINS taxes that would otherwise be imposed upon importation of specific assets at the general rates of 1.65% and 7.6%, respectively.

Only those fixed assets and services (as specifically defined by the Brazilian legislation) used in the development of software and the supply of IT services qualify for this benefit.

REPES also provides for the suspension of PIS and COFINS that would otherwise be levied on the gross revenue generated from qualifying software sales and the provision of qualifying IT services by qualifying companies.

Special Tax Regime for Acquisition of Capital Goods for Export Companies (RECAP)

RECAP is a special tax regime established for Brazilian entities whose revenue from export transactions represents at least 80% of total gross revenue from sales of goods and/or services in the year prior to the year in which RECAP is adopted. In order to qualify for the incentives provided by RECAP, the Brazilian entity must maintain such percentage of export gross revenue for the two calendar years following its adoption of RECAP.

The tax incentive provided under RECAP is the suspension of the PIS and COFINS taxes that would otherwise be imposed upon importation of specific assets at the general rates of 1.65% and 7.6%, respectively.

Only those capital assets (e.g., machinery, equipment, tools, etc.) that are specifically defined by the Brazilian legislation may qualify for this benefit. RECAP also provides for the suspension of PIS and COFINS that would otherwise be levied on the gross revenue generated from the sale of such capital assets.

Note that newly incorporated entities or entities that do not achieve the "80% of export revenue" requirement in the previous year may still qualify for the RECAP incentive if it can demonstrate that its revenue from export transactions will represent at least 80% of its total gross revenue for 3 subsequent years.

Royalty Withholding Tax Credit

As of January 1, 2006, PM 252 will allow Brazilian entities to take a credit of 20% of the withholding income tax levied on royalties or payments for technical or scientific services (including transfers of technology or know-how to the Brazilian entity) paid to a foreign entity. Brazil imposes a withholding income tax on royalties and technical services/assistance at a rate of 15% (or 25% if the non-resident beneficiary is located in a country considered to be a tax haven for Brazilian tax purposes). To qualify for such credit, the Brazilian entity must invest in research and development activities in Brazil in an amount equivalent to at least twice the credit amount.

Regulations that would further clarify the calculation and use of such credit are expected to be issued shortly.

Capital Gain on Sale of Personal Property - Individuals

PM 252 also increased the limit on the capital gain exemption for individuals from R$20,000 (approximately USD $8,300) to

R$35,000 (approximately USD $14,500). As such, if proceeds from the sale of personal property (or similar asset) exceed R$35,000 in the month of sale, the related capital gain will be subject to tax at a rate of 15%. However, if such proceeds for the month do not exceed R$35,000, no capital gain tax is due. With respect to gain on the sale of shares, the R$35,000 limit only applies if shares are sold via stock exchanges. Otherwise, the threshold remains R$20,000. ❑

The article was written by the PricewaterhouseCoopers Latin American Tax (LATAX) Group.

Tax Incentives

Brazil Looks for Refund for “Unused” Hi-tech Incentives

BY CRISTIÁN FRANCOS (WHITE & CASE)

The Brazilian Ministry of Science and Technology recently launched an initiative to recover debts from technology companies that received tax breaks from fiscal incentives through Brazil’s Informatics Technology Law.

According to Brazil’s 1991 Informatics Technology Law (Lei de Informatica), companies must conduct mandatory investments in developing new industrial products in order to receive fiscal benefits from the government.

The law stipulates that companies may lose fiscal and other benefits if they fail to comply with the law. Moreover, they might have to repay the government an amount equivalent to the value of the fiscal benefits.

Some of the key benefits include exemption from a sales tax applied to several industrial products including computers, cellular phones, telecommunications equipment, and other related products. Dell, Motorola, Ericsson, and Siemens are among the companies that benefit from this law.

The government’s main goal in pursuing this action is to penalize companies that have failed to conduct investment on research and development of new technology products. The Ministry is investigating 52 companies that have failed to comply with the law.

According to the Ministry, these companies have accumulated $200 million in debt or “undone investments” over the last eight years.

In most cases, companies failed to invest stipulated amounts in new technology projects or invested in areas not considered for “research and development” purposes.

In general, companies are required to invest a percentage of their profits obtained from the sales of exempted industrial products. This percentage changes every year and should be at least 4 percent for 2005.

It is not clear whether the Brazilian government will be able to successfully claim these debts since many of them are overdue or difficult to calculate.

Outlook

It is not clear whether the Brazilian government will be able to successfully claim these debts since many of them are overdue or difficult to calculate. Nevertheless, affected domestic and foreign companies might be penalized by the government’s recent initiative. Since the measure took many companies by surprise, representatives from technology firms are conducting talks with Brazilian officials to seek a negotiated solution. ❑

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Chile/Ireland Double Tax Treaty Signed

BY LIAM DIAMOND AND JOHN SALERNO (PRICEWATERHOUSECOOPERS)

A new Chile/Ireland double tax treaty was signed on June 2, 2005 in Dublin. The treaty is comprehensive in scope, providing reduced source country taxation of interest, royalties and dividends, as well as including important provisions on double tax relief. The treaty, which is likely to enter into effect on January 1, 2006, may positively impact trade and investment between the two countries.

Summary of key treaty provisions

Some of the more salient aspects of the treaty include the following:

- Reduced dividend withholding tax rate of 5% (or 15% if less than 20% control of voting power). Note that the treaty does not reduce the 35% Additional Tax payable in Chile provided that the 17% First Category Tax is fully creditable in computing the amount of Additional Tax (which is the case under current Chilean law). Dividends paid to non-residents are subject to a 35% withholding of Additional Tax. The First Category tax (i.e., the basic tax on income of a Chilean corporation, currently 17%) paid by the Chilean corporation is creditable against such Additional Tax. Therefore, the tax burden for a nonresident recipient of dividends, including taxes at the company level, is 35%.

The Chile/Ireland tax treaty, if ratified, may present significant opportunities for Irish and Chilean groups, as well as other groups with Chilean/Irish operations vis-à-vis their international holding, operational and IP/financing arrangements.

- Reduced interest withholding tax rate of 15% (or 5% in the case of loans from banks/insurance companies, traded bonds/securities, equipment vendors).
- Reduced withholding tax rate of 5% on equipment lease rentals from Chile to Ireland (Ireland does not withhold tax on lease rentals).
- Reduced withholding tax rate of 10% on royalties in general, but:
  - 5% for royalties for the use of, or the right to use, any industrial, commercial or scientific equipment.
  - Payments for non-customized software (e.g., shrink-wrapped software) is accepted by the Protocol to the treaty as constituting business profits which are not taxable in the absence of a permanent establishment.
- Gain on disposal of shares (or comparable interests/rights) in one country by a resident of the other may be taxed in the latter country:
  - if 20% is held at any time in the preceding 12 months, or
  - if the gains derive the greater part of their value from immovable property in that country.

The maximum tax that may be levied by the other country on any gains on disposals of shares (or comparable interests/rights) other than those detailed above is 16%.

- A "most favored nation" article under which Chile will make available any more favorable withholding tax rates on interest and royalties agreed with any other OECD members.
- Tax suffered in one country will generally be available for credit in the other country.

However, taxes suffered on Chilean dividends will be creditable for the Irish recipient provided it controls at least 10% of the voting power. This should result in no incremental Irish tax as the Chilean tax credits will exceed the corresponding Irish tax (e.g. on a gross dividend of 100, Irish tax of 25 would be offset by Chilean tax credits of 35). If there is less than 10% control, the credit is limited to the lesser of the Chilean withholding tax (typically 18%) or 15%.

- A novel "tie-breaker" provision for dual corporate residents based on their place of incorporation, with additional mutual agreement provisions.
- A provision which deems an insurer (but not a re-insurer) resident in one country to have a PE in the other if it insures local risks through a related agent.

- Provisions which provide for comparable treatment for employee and self-employed contributions to pension plans in both states.

Chilean Tax Implications and Opportunities

- 35% lease rental withholding tax rate reduced to 5% when not eligible for the 1.75% effective rate under domestic legislation.
- 30% royalty withholding tax rate reduced to 10%.
- 35% interest withholding tax rate reduced to 15% or 5% when not eligible for the 4% reduced rate under domestic legislation. (It is important to note that thin capitalization rules must be considered).

• Payments for technical assistance may be viewed as business profits and, consequently, not subject to Chilean withholding tax.

Irish Tax Implications and Opportunities

Ireland is a member of the EU/Eurozone. A 12.5% corporate income tax rate applies to active business income. For Irish investors, a Chile/Ireland treaty may be particularly important as it gives access to certain features of Ireland's domestic tax regime (including 0% withholding tax on dividends and interest, access to participation exemption for disposal of Chilean shareholdings, deductibility of interest paid to Chilean affiliates and the creditability of Chilean branch taxes in Ireland).

Conclusion

The Chile/Ireland tax treaty, if ratified, may present significant opportunities for Irish and Chilean groups, as well as other groups with Chilean/Irish operations vis-à-vis their international holding, operational and IP/financing arrangements. ❑

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Peru: Uncertainty and Potential Double Taxation Under Andean Community Decision

BY GUSTAVO LÓPEZ AMERI AND WALKER VILLANUEVA GUTIÉRREZ
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Decision No. 578 issued by the Andean Community Commission in 2004 revised the tax regime applicable to Andean Community (CAN) member countries (i.e., Bolivia, Colombia, Ecuador, Peru and Venezuela), with a view to promoting cooperation between the administrations of the member states, facilitating foreign investment and preventing tax evasion.

Unfortunately, Decision No. 578 introduces some rules that appear to conflict with the objectives of double tax agreements, in particular the prevention of double or multiple taxation of income from operations conducted between two or more countries. This article examines some of the defects of Decision No. 578, in particular the uncertainties and technical anomalies with which it appears to be fraught and its potential for creating excess tax costs.

The problem that arises as regards article 14 of Decision No. 578 is that the definition of "source" it provides is open to more than one interpretation.

The most notable area of uncertainty concerns the interpretation of article 14 of Decision No. 578, which relates to business income derived from the provision of services. Article 14 provides that income derived by professional, technical, technical assistance and consulting service firms will be subject to taxation only in the contracting state in which the benefit of such services occurs. In the absence of evidence to the contrary, the place where the "benefit occurs" is presumed to be the place where the corresponding expense is attributed and recorded.

In Peru, there seems to be a consensus that taxing rights are properly allocable to the state in which the benefit for the user of the service is produced (i.e. the country of destination); outside Peru, however, it has been held that the right to tax should be allocated to the state in which the benefit (profit) for the provider of the service is produced (i.e. the country of destination or the country of origin, depending on where the service was provided). Thus, for example, if a company resident in Peru provides technical services from Peru to a company resident in Colombia, under the Peruvian interpretation, the service would be subject to tax in Colombia. Under the alternative interpretation, the service would be subject to tax in Peru.

In the author's opinion, the correct interpretation of article 14 of Decision No. 578 is that it grants taxing rights to the jurisdiction in which the benefit of the service for the user is produced. The general rule in Decision No. 578 is that taxing rights are allocated to the state where the income is sourced, i.e. the state in which the income has its producing source (article 3). "Producing source" is understood to mean the activity, right or asset that generates or may generate the income concerned (article 2, clause f). Theoretically there are three ways to interpret the source criterion for the provision of services, i.e. by reference to: (i) the place where the service is rendered, (ii) the place where the benefit of the service is used, and (iii) the location of the paying source.

The problem that arises as regards article 14 of Decision No. 578 is that the definition of "source" it provides is open to more than one interpretation. As noted above, it could refer to the place where the benefit for the provider of the service is generated; alternatively, it could refer to the place where the service is used, that is, to the place where a benefit is generated by the use of the service.

In the author's opinion, the source as defined in article 14 of Decision No. 578 should be construed as the place where the service is used, i.e. the place where the benefit of the service is produced for the user of the service. The reasons supporting this interpretation are as follows:

- Had it been intended that the source should be construed as the place where the service is provided, the wording of former article 14 (Decision 40) would have been retained or the same wording would have been used as is used in current article 6. Current article 6 of Decision No. 578 refers to the place where the business activities are conducted (i.e. the place where the service is rendered), while former article 14 uses the same rule (i.e. the place where the service is rendered), albeit differently phrased. It makes little sense that the same criterion (i.e. the place where the service is rendered) should be stated in different ways in the same agreement to refer to the same income-producing source. Rather, the two articles are referring to different criteria: one to the place where the service is rendered (article 6), the other to the place where the benefit of the rendering of the services occurs (article 14).

- The taxable income is generated by the business activity. Usually, the source of the income generated by the business activity is identified by reference to the place where the business is carried on (as in article 6 of the Decision), rather than by reference to the result of the business activity (i.e. the benefit (result) it generates). There is a clear distinction between the source and its yield (result). If article 14 of Decision No. 578 is intended to define the income-generating source by reference to the result of the income-generating activity, it would constitute a very strange, indeed unique, definition. In essence, it would define the income-generating source by reference to the benefits or income generated rather than by reference to the business activity that generates them, which would seem to indicate that this is not the sense in which the reference to benefits derived from the service should be construed.
- As well as allocating the taxing right to the state where the benefit of the service occurs, article 14 of the Decision establishes a rebuttable presumption that this right is presumed to belong to the state where the corresponding expense is attributed and recorded. Logic and experience both suggest that the place where expenses are attributed and recorded is usually the place where the benefit for the user of the service has occurred. In other words, the place where expenses are deducted is the place where the benefit is produced for the user of the service.
- Logic and experience also would seem to suggest that the place where expenses are deducted usually bears no relation to the place where the benefit for the provider of the service is generated. There is no connection between these two criteria because the deduction of expenses in a jurisdiction is no indication that the benefit for the provider has been generated in that jurisdiction. The deduction of the expense has no logical connection with the place where the benefit (for the provider) was generated.

Article 3 of Decision No. 578 provides that, once the power of taxation has been determined to belong to one of the states concerned, the income should be treated as exempt in the other state. For example, if a technical service is provided from Peru to Colombia, the power of taxation would belong, in principle, to Colombia because it is the place where the benefit for the user of the service occurs and the income from the provision of the service would be exempt in Peru.

This treatment of the income as exempt in the other state would seem to be incorrect from a technical point of view as well as being potentially disadvantageous to taxpayers. It would seem to be technically incorrect for the following reason. Contracting states entering into in a double taxation agreement agree on rules as to which state will exercise the right to tax each particular type of income. Once the right to tax is attributed to one of the contracting states, that state may exercise this right by taxing the income concerned or by granting an exemption if it so wishes. As the other state may not exercise that right, the situation in that other state (even though the Peruvian tax administration opined several years ago, that this would be considered an exemption) resembles a tax immunity rather than an exemption.

The treatment of the income as exempt in the other state is potentially disadvantageous to taxpayers because the expenses relating to the exempt income will not be deductible, with the result that taxes are paid in the country of destination via withholding at source and in the country of origin as a result of the non-deductibility of expenses, thus giving rise to double taxation. Furthermore, tax paid in the country of destination would not be deductible in the country of origin, either by way of tax credit or as an expense, thus giving rise to further tax costs.

This uneven result could be somewhat brightened by the application of the equal treatment principle in article 18 of Decision No. 578, which, it could be argued, requires that withholding in the country of destination should be made on net, rather than gross, income. However, the equal treatment of residents and nonresidents that this principle proposes is an even more contentious issue. ❑

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Germany. However, before addressing the consequences arising from such termination, it is important to highlight what we think are the main reasons that drove the decision by the German government, as this can give the reader an insight into how the Brazilian tax authorities have been dealing with DTT interpretation over the last years.

The issue is, in a nutshell, the Brazilian position to withhold income tax on payment to German residents for non-technical services.

Main Reasons for the Termination

(i) **Differing Interpretations**. One of the reasons for the termination is the divergent interpretation given by the Brazilian tax authorities of important provisions of the DTT (such as *Article 7° – Business Profits* – and *Article 9° – Associated Enterprises)*. Over recent years, Brazilian tax authorities have frequently held different opinions than most countries of the European Union, even the Organization for Economic Cooperation and Development ("OECD"), regarding the interpretation of DTT clauses. Although Brazil is not officially a member of the OECD, it has used its model treaty as a basis for the DTT's it has signed (24 currently in force).

(ii) **Creation of Additional Taxes on Import of Services**. The Brazilian Government created additional taxes[1] applicable on the import of services by Brazilian residents that, as distinct from the income tax, are held by the Brazilian tax authorities as out of the scope of the DTT. This practice, in addition to substantially increasing the tax burden on cross-border services, has been considered as a way to legally circumvent the limitations established by the DTT.

In general, the termination of the DTT does not seem to herald a disaster for German companies with investments in Brazil.

(iii) **No Need for Matching Credits**. The German authorities understand that there is no longer any need for granting "matching credits" for German taxpayers that invest in Brazil[2], as both the present economies of Brazil and Germany are not comparable to that of 1975, when the DTT was signed[3]. In other words, Brazil is no longer considered by Germany as a developing country.

Consequences of the Termination

In general, the termination of the DTT does not seem to herald a disaster for German companies with investments in Brazil. This is because Brazilian withholding tax rates levied on interest, dividends and royalties generally do not exceed the maximum limits established under the DTT (though there are a few exceptions). There will be, however, certain immediate effects that shall be outlined. The most important areas of interest are as follows:

Business Profits (Article 7 of the DTT)

The issue is, in a nutshell, the Brazilian position to withhold income tax on payment to German residents for non-technical services. Although the prevailing position among international tax practitioners is that this taxation should be excluded under article 7 of the DTT ("business profits"), the Brazilian tax authorities interpret Article 7 differently than the OECD and most countries of the European Union, levying withholding tax on such payments.

This often results in double taxation, as German authorities have been reluctant to grant a tax credit with respect to the Brazilian withholding tax under the argument that Brazil should not have the right to tax such income.

Provided the DTT exists, taxpayers have at least a legal basis from which to argue that Brazil has no right to impose withholding tax on payments for non-technical services rendered by and paid to German residents, and thereby try to contest the position of the tax authorities in courts. The termination of the DTT eliminates such possibility.

Transfer Pricing Rules (Article 9 of the DTT)

The current Brazilian transfer pricing rules establish rigid arithmetical methods with prefixed profit margins and very little consideration of economic, risk and functional issues. The Brazilian tax authorities have always argued that these rules are in strict compliance with the DTT, despite the fact that this policy is arguably contrary to what it is stated in Article 9 of the DTT, according to which the transactions between related parties would only be subject to transfer pricing rules if they do not comply with the arm's length principle (that is if the commercial or financial conditions differ from those agreed between independent parties).

We are aware of certain Brazilian taxpayers that are challenging the position of the Brazilian tax authorities in courts. The termination of the DTT removes the legal grounds for this interpretative argument.

Brazilian Withholding Tax on Dividends, Interest and Royalties

Dividends (Art. 10 of the DTT)

The payment of dividends out of profits generated after 1995 are exempt from withholding income tax in Brazil and, in practice, subject to minimal taxation in Germany (*i.e.* the corporate income tax to be paid is calculated on 5% of the amount of the dividend received).

The termination of the DTT would not change this *per se*. It should be noted, however, that in the absence of the protection provided by the DTT, both countries are free to change this tax treatment in the future.

Interest (Art. 11 of the DTT)

Reduced Tax Rates and Tax Exemption. The termination of the DTT would have a very important negative effect on certain interest payments made by Brazilian residents to German residents, as currently the DTT foresees situations where interest payments are taxed at a lower rate or are even tax exempt, as follows:

- A tax rate of 10% (and not 15% as it is established by the Brazilian legislation) applies under the DTT if loans of a German bank are granted for a period of at least 7 years with the specific purpose to finance (i) the purchase of industrial equipment, (ii) research, (iii) the purchase and installation of industrial or scientific sites, or (iv) public works; and
- A complete exemption from tax applies if the recipient of the interest payment is the German Government, a political subdivision or any agency (including a financial institution) wholly owned by the German Government.

If the DTT were terminated, all existing loans that currently benefit from this reduced tax rate, or are even exempt from taxation in Brazil, would be affected. Furthermore, it is possible that the termination will have a significant negative impact on future financings coming out of Germany for the purchase of industrial equipment, industrial sites and public works by Brazilian companies.

Matching Credits. As long as the DTT still exists, German tax residents may register a "matching credit" of 20% with the German tax authorities, even if the effective tax rate in Brazil upon interest is 15% or even less. This benefit, granted by Germany to subsidize investments in Brazil by German tax residents, will no longer exist if the DTT is terminated.

Royalties (Article 12 of the DTT)

There would be no immediate consequences regarding royalties, as the domestic withholding tax rate on royalties (15%) is equal or even lower than the maximum rate established under the DTT. As with dividend and interest income, the main effect of the termination of the DTT upon royalties is that both Brazil and Germany are free to change this tax treatment in the future.

Matching Credits. For the same reasons as noted regarding interest income, a matching credit will no longer be allowed in Germany in relation to royalty income.

The termination of the DTT would have a very important negative effect on certain interest payments made by Brazilian residents to German residents.

Tax Credits for Brazilian Resident Individuals

Brazilian resident individuals are only allowed to offset taxes paid abroad on their worldwide income subject to tax in Brazil (i) if there is a DTT signed between Brazil and the country where the taxes were paid or (ii) if the Brazilian beneficiary of the income proves that there is reciprocity of tax treatment between both countries.

The termination of the DTT would thus require that Brazilian resident individuals earning income subject to tax in Germany demonstrate that under German domestic tax law a tax credit would be granted for the tax paid in Brazil in relation to the income earned by a German individual investing in Brazil. In short, it must be shown that the Brazilian withholding tax can be offset in Germany for the type of income under analysis.

After the termination of the DTT this "reciprocity test" will have to be complied with on a case by case basis, unless the Brazilian au-

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thorities recognize the reciprocity in a normative ruling applicable to all taxpayers receiving income from a given country, as it currently happens with the United Kingdom and the United States.

German Withholding Tax on Dividends, Interest and Royalties

It may be that the withholding tax rates in Germany on dividends, interest and royalties will increase in comparison to those established by the DTT. However, if the beneficiary of the income is a Brazilian legal entity, this may only affect the cash flow as Brazil grants tax credits for the tax paid in Germany, irrespectively of the existence of the DTT, up to the limit of the Brazilian corporate income taxes that apply on the same income at a combined rate of 34%.

The termination of the DTT is clearly bad news for Brazil's reputation with the international community, specially because the termination is partially motivated by the reluctance of the Brazilian authorities to apply the prevailing international position with respect to the interpretation of some treaty clauses.

On the other hand, if the beneficiary is an individual, the practical effect will depend on whether or not a tax credit will be granted by the Brazilian authorities based on the reciprocity test discussed above.

Final Comments

The termination of the DTT is clearly bad news for Brazil's reputation with the international community, specially because the termination is partially motivated by the reluctance of the Brazilian authorities to apply the prevailing international position with respect to the interpretation of some treaty clauses. As this issue is not exclusive of the DTT with Germany, other treaty countries may feel motivated to attack it by following the same route.

Although in practice the termination of the DTT tends not be disastrous as explained above, there are a number of issues (in particular cross border financing and transfer pricing) that will require careful analysis and investigation of alternatives to mitigate potential adverse impacts. ❑

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1. Such as the Contribution for the Intervention on the Economic Domain ("CIDE"); the Social Contributions on the Import of Goods and Services ("PIS-Importação" and "COFINS-Importação") and the Service tax on the Import of Services ("ISS-Importação").

2. Matching credits exist when one of the Contracting States of a DTT, usually the most developed (Germany in this case), grant a credit for the taxes paid in the other Contracting State (Brazil in this case) at a rate higher than the effective rate of taxation in the latter country. For instance, the maximum withholding income tax rate applicable under the DTT for interest paid by a Brazilian source to a German resident is 15%, but under the treaty Germany is required to grant a credit as if the tax had been withheld in Brazil applying the rate of 20%. The difference (20% less 15%) is a matching credit.

3. One of the main reasons for Brazil not having signed a DTT with the United States is the insistence of the Brazilian authorities in including a matching credit provision in the treaty, something which is not in line with the United States treaty policy.

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Latin American Project Developments

Argentine Incentives for Oil & Gas Drilling; Tax Increases on Mining in Chile; and Foreign Oil Companies in Ecuador

BY KEITH MARTIN (CHADBOURNE & PARKE)

Argentina

Argentina is expected to adopt incentives for new oil and gas drilling.

The government sent Congress a proposal in late May that would allow oil and gas companies to claim faster tax depreciation on assets used for new drilling—both at expansions of existing projects and at completely new projects. The measure would also exempt equipment imported for such drilling from import duties. Companies are also supposed to receive faster refunds of value added taxes paid on such equipment. The measure is expected to pass Congress easily.

There is a tradeoff. Companies will have to enter into some unspecified form of association with the state-run oil company, ENARSA.

Meanwhile, the province of Buenos Aires said in early June that it has secured court orders to seize wages of 41 executives of multinational companies who are delinquent in paying real estate and vehicle taxes. It has also commenced court proceedings against another 83 executives at such companies.

Bolivia

Bolivia is bracing itself for lawsuits after it increased government levies on oil and gas produced in the country from 18 percent to 50 percent and directed that exploration contracts signed with the government must be renegotiated. There is speculation that mining projects will be the next target.

The Bolivian president let stand in late May a new law, passed overwhelming by the Bolivian Congress, that would impose a 32 percent tax on oil and gas at the wellhead on top of an 18 percent royalty that the government already collects. The law also reinstates YPFB as the national petroleum company with ownership over reserves. The company had been reduced to only a regulatory role after Bolivia privatized the oil and gas sector in 1998. Exploration contracts with the government will have to be renegotiated within a 180-day transition period. Oil and gas companies have said they will sue for breach of contract and illegal confiscation. Any political risk insurance policies the companies possess could affect the claims they make in the lawsuits.

Meanwhile, there have been calls in Congress to impose a 10 percent royalty on mining. The country is expecting a sharp drop in the amount of foreign investment. Huge street demonstrations could lead to renationalization of hydrocarbons.

Chile

Chile imposed a new royalty tax on mining companies. The Chilean Congress passed the tax by a wide margin on May 18.

Ecuador is moving to collect $282 million in back taxes from 21 foreign oil companies.

It is a tax of as much as 5 percent on annual income from sales of ore from mines leased from the government. However, some costs of earning the income—like accelerated depreciation of mining equipment—that are deductible for purposes of calculating corporate income taxes would not be deductible against the tax base for the royalty tax.

The tax rate varies depending on annual sales. Companies that produce less than 12 metric tons of ore a year are exempted. The rates move from 0.5 percent to 4.5 percent as output increases from 12 to 50 metric tons. The tax rate for companies with more than 50 metric tons in annual output is 5 percent.

Larger mining companies will see their tax rates increase in Chile from 35 percent to 38.5 percent after the new tax is combined with the existing corporate income tax.

Ecuador

Ecuador is moving to collect $282 million in back taxes from 21 foreign oil companies.

The taxes are from the period 1998 through 2001. Among the companies being investigated are Occidental Petroleum, Repsol and EnCana. The move to collect taxes comes on the heels of an announcement that contracts with the state-

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owned oil company, Petroecuador, must be renegotiated. Petroecuador controls more than 60 percent of oil output in the country.

Peru

Peru will continue to collect new royalties on mining companies after a tribunal held they are constitutional.

Venezuela increased taxes on oil projects and is forcing some 22 companies to renegotiate their operating agreements with the government.

The tribunal said in early April that the new law calls for payment of royalties rather than "taxes." The decision could have implications for U.S. companies with mining operations in Peru, since foreign tax credits can be claimed in the United States only for overseas levies that are "taxes." What label a Peruvian tribunal chooses is not dispositive in the U.S.

The royalty rate in this case depends on the annual sales of the company. It is 1 percent for companies with gross sales of up to $60 million. It is 2 percent for gross sales between $60 million and $120 million, and 3 percent above that.

The government said it would continue to honor tax stabilization agreements signed with the government before mid-2004 when the new royalties went into effect. A tax stabilization agreement is a contract between a foreign investor and the government in which the government promises not to change the economics of a project by imposing new taxes, fees or other charges during the term of the agreement. Thus, the royalties only apply to companies that had not signed such agreements before last summer.

Venezuela

Venezuela increased taxes on oil projects and is forcing some 22 companies to renegotiate their operating agreements with the government. It is also seeking a total of $2 billion in back taxes from the companies. The moves are aimed at seizing a greater share of revenues from high oil prices.

In April, President Hugo Chavez increased the corporate tax rate on oil projects from 34 percent to 50 percent. In late May, the head of the national tax agency, SENIAT, told a parliamentary investigating committee that 90 percent of the 22 oil companies with operating agreements in the country have been reporting no income. A majority had agreed to pay back taxes on SENIAT's terms by the end of May, according to the tax agency.

The government has given the oil companies six months to agree to turn their operations into joint ventures with the government. It would take a 51 percent stake in each venture. ❑

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involved in import-export operations with independent parties must comply with, and

(ii) introduces significant amendments to the transfer pricing regime.

In the paragraphs that follow we will refer to the most relevant provisions contained in the Resolution.

Import-Export Operations Between Independent Parties

Section 8 of the ITL specifies that income earned in connection with the export of goods produced, manufactured, or acquired in the country is to be considered Argentine source income.[4]

The net income is to be computed by deducting from the sales price the cost of such goods, the transport price, insurance, sales commission and costs and expenses incurred in Argentina, whenever these expenses are considered 'necessary' to earn the taxable income.

On the other hand, the revenue earned by foreign exporters for selling their products in Argentina is deemed to be foreign source income. ITL Section 8, as amended by Law 25,784, provided for a reporting system for international transactions between unrelated parties to be subsequently implemented by the

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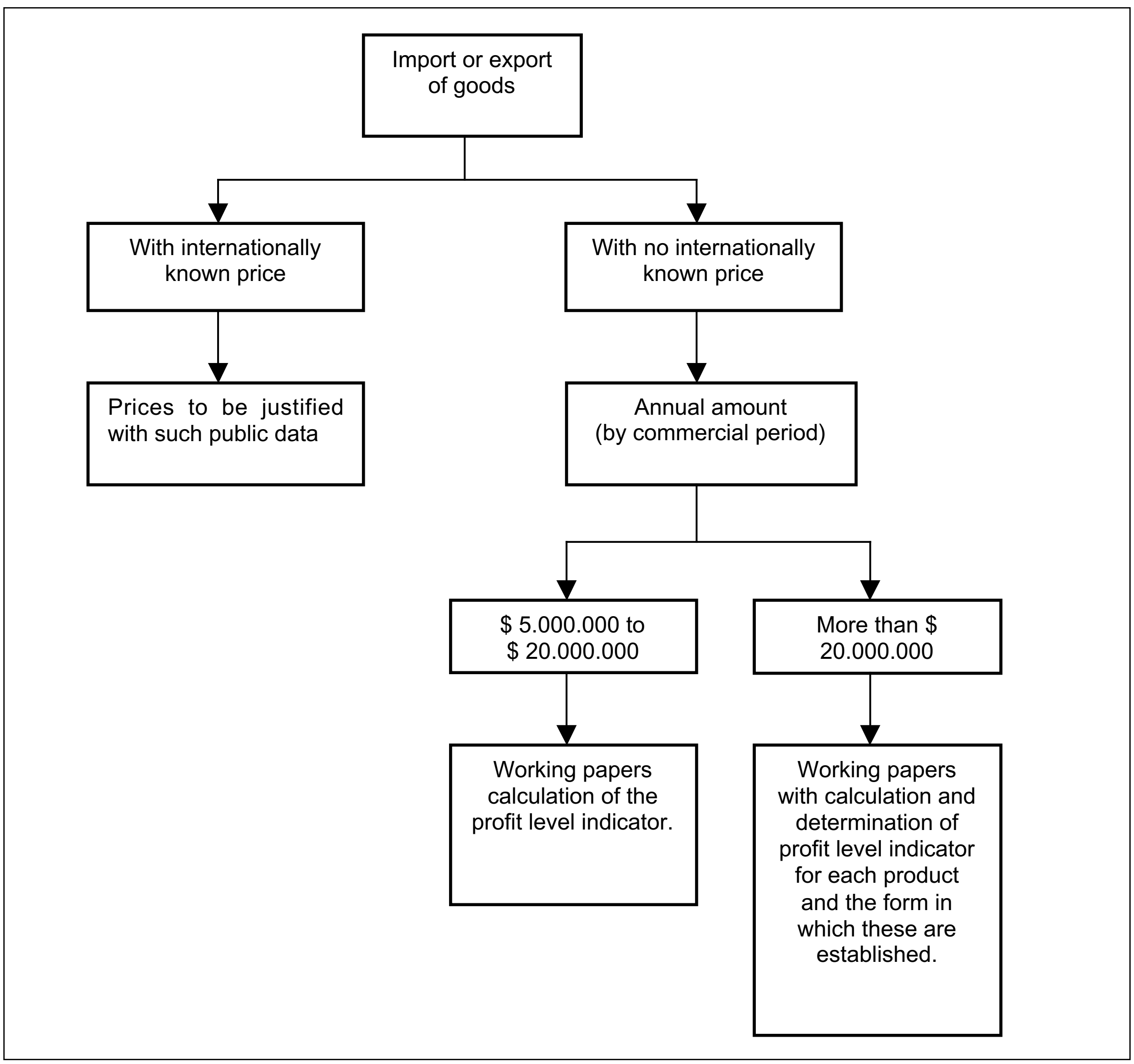
The special deadlines provided by the resolution will allow taxpayers to implement the new reporting requirements timely, though there is concern as to the adequacy of the AFIP software to receive and process all of the information.



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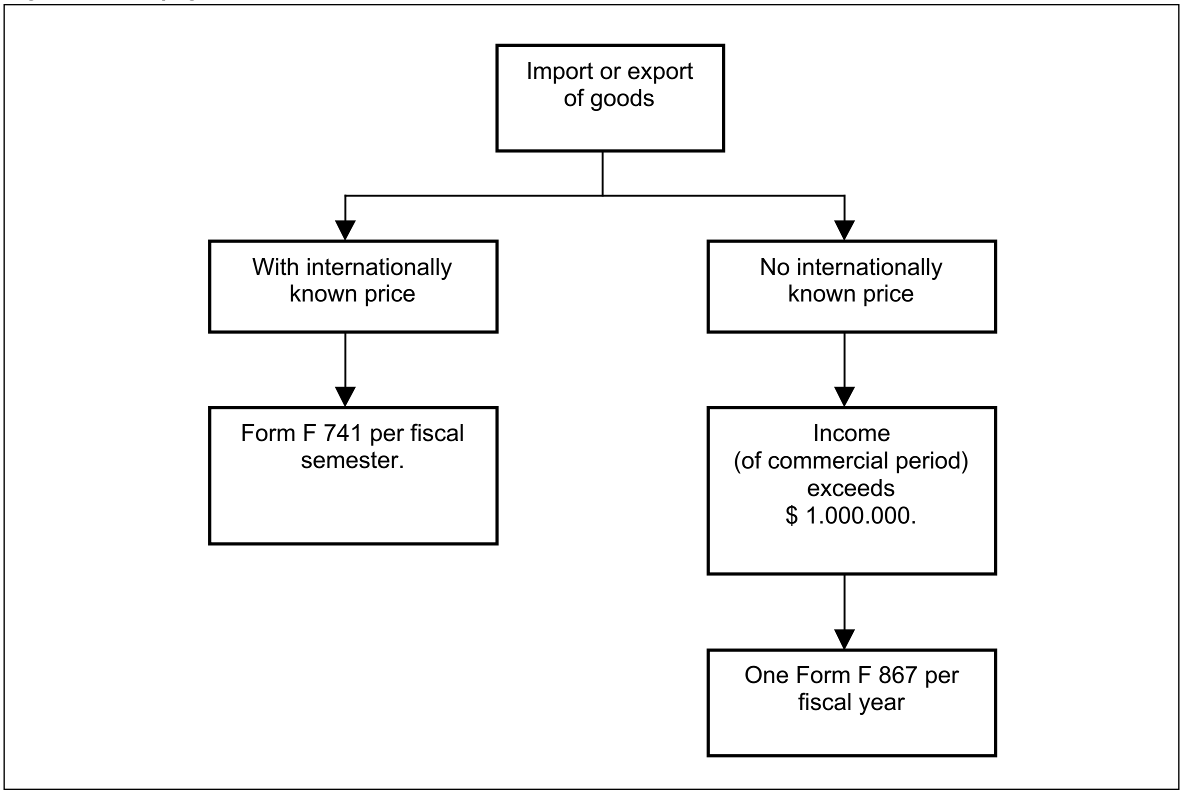

AFIP. Such a reporting regime is now implemented by General Resolution 1918.

Law 25.784 introduced significant amendments to the ITL. In effect, it:

i) eliminated comparison of the wholesale price in the place of origin or destination with prices agreed in import-export transactions as the basis for determining Argentine source income,[5] and

(ii) it eliminated application of transfer pricing norms whenever wholesale prices cannot be established.

The most important amendments are:

(i) that in import-export transactions with goods having an international price set in transparent markets, these prices must be used to determine Argentine source income, unless proof indicating other prices are applicable is submitted; and

(ii) in transactions in which no international price is available, the local party (importer, or exporter) must submit relevant information to the AFIP—cost contribution, utility margins and other data deemed necessary for inspection purposes, so that AFIP may determine whether the prices submitted are in line with market prices.

The documentation requirement set forth in (ii) only applies to export-import transactions exceeding a price annually set forth by the Executive Power. In 2005 such amount was set at AR$1,000,000 (approximately USD $330,000).

The Resolution sets forth that business entities located in Argentina (e.g. corporations, trusts incorporated in Argentina, closed investment funds, permanent establishments) carrying out import-export transactions with foreign unrelated parties must comply with certain requirements, namely:

1) Documentation requirements: These entities must keep backup information justifying prices agreed with independent parties. Documents must: (i) identify the local party and accurately describe the activities developed; (ii) identify the foreign party and describe the transaction amounts, bank account balances, etc. Such documentation must be complemented with certain elements: (see chart on page 19)

The documentation must be available at the time of filing the sworn statement on Form F. 741, corresponding to the first and second semesters of the fiscal period, and must be kept for the five years subsequent to the triggering of the statute of limitation.

2) Filing requirements: Taxpayers are to report data related to export-import transactions as follows: (see chart on page 20)

In order to determine the annual amount of import-export transactions, the Resolution sets forth that the amounts collected should be converted to Argentine pesos pursuant to the ITL.

As established in ITL Implementing Decree Section 97, transactions in foreign currency must be converted into pesos at the buyer/ seller exchange rate (as applicable) published by the Central Bank on the date the transaction has been closed and according to the norms and rulings applicable on such date.

Nonetheless, the Resolution does not define which value is to be adopted in determining the annual amount of import-export transactions taking place in the fiscal period under analysis.

In principle, it could be reasonably sustained that, in the case of exports, valuation should be based on a total FOB value, while imports should be valued on a CIF basis.

The information the taxpayer must submit to AFIP (thru tax return Form F 867) could ultimately be subject to scrutiny by the Customs Agency. Thus, extra care must be taken to avoid inconsistencies with customs valuations.

Sworn statement Forms F. 741 and F. 867 are generated electronically via the program "International Transactions - Version 2.0 - Release 0", which must be sent to the Revenue Service electronically (http:// www.afip.gov.ar).

When the size of the file impedes the electronic transfer of the document, the information (contained on a diskette/CD ROM) and the corresponding sworn statement form must be filed with the Revenue Service agency corresponding to the taxpayer. The same procedure is applicable whenever a system failure impedes electronic transmission of the material.

The overall goal of the new resolution is to enable the Tax Authorities to promote the timely filing of transfer pricing documentation.

General and Special Due Dates

The Resolution abolishes the provision contained in Section 3 of Resolution 1633, pursuant to which taxpayers engaging in import-export transactions of goods lacking a wholesale price in transparent markets with

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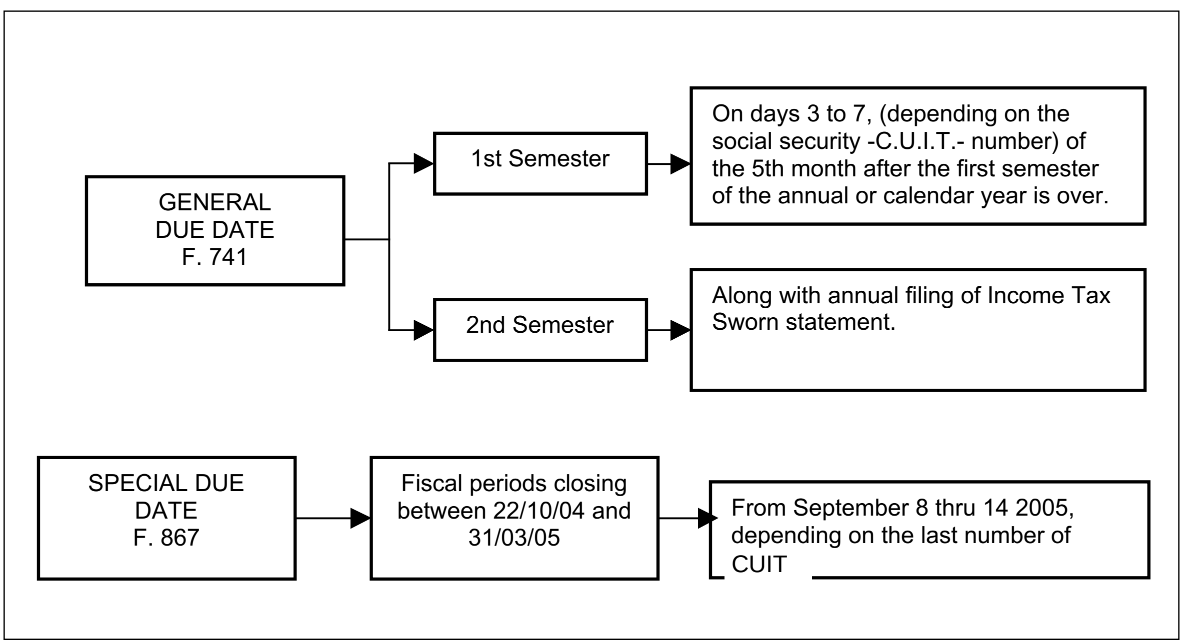

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independent parties were exempted from filing sworn statement forms F. 741 for due dates subsequent to November 2003 and until AFIP implemented the form, requirements and conditions in which said information was to be presented.

The exemption continues to apply to taxpayers which engaged int import-export transactions with independent parties during the fiscal years closed between October 22, 2003 and October 21, 2004.

The Resolution requires that the transfer pricing report and financial statements for the fiscal year which is reported and for the two previous fiscal years (whenever applicable) must be presented along with the complementary sworn statement Form F. 743.

Transactions Between Related Parties, Subject to Transfer Pricing Validation

The Resolution amends Section 16 of General Resolution 1122, setting forth that the transfer pricing report[6] and financial statements for the fiscal year which is reported and for the two previous fiscal years (whenever applicable) must be presented along with the complementary sworn statement Form F. 743. Changes to the regs seem to increase penalties when the full transfer pricing documentation is not timely filed.

Although Resolution 1126 also required taxpayers to present the transfer pricing report and the financial statements, it was a widespread local practice for taxpayers to submit the Form F. 743 without the report, for example when it was not possible to timely complete it.

Reference should be made to the fact that, although the lack of presentation of sworn statement Form F 743/or extemporary filing was subject to a formal penalty, the issue of whether such penalty could be extended to the lack of presentation of the transfer pricing report or the financial statements was doubtful.

The AFIP was aware that even when the taxpayer submitted sworn statement F. 743, lack of presentation of the transfer pricing report impeded an adequate control over international transactions between related parties or with parties incorporated in low tax jurisdictions to take place.

In such cases, the AFIP lacked elementary background information on the international transactions, such as information related to price determination and activities carried out. This is presumably the reason for which the Resolution incorporates a paragraph which states: *"lack of joint presentation of these documents will imply incompliance with the information requirement"*.

In relation to the penalty which could be imposed in the case of lack of joint presentation of the sworn statement Form F. 743, the transfer pricing report[7] and the taxpayers financial statements for the fiscal period declared and the 2 prior fiscal periods (whenever applicable), we understand that the penalty set forth in Section 38 bis of the Tax Procedure law (and mentioned above) cannot reasonably apply. Such provision sets forth that the lack of timely presentation of sworn statement Form F. 743 will be sanctioned, without warning, with a fine of AR$ 10.000, which is to be increased to AR$ 20.000 in the case of corporations, trusts, foundations or any other type of entities or permanent establishments belonging to foreign residents or corporations.

Since the Tax Procedure Law only refers to lack of submission of "sworn statement" (i.e., Form F 743), it would not be legally valid to extend the penalty to the lack of submission of the transfer price report.

This Federal Constitution states that for any punishable act or omission, both the punishable conduct and the penalty imposed must be specifically set forth by law, and could not be expanded by a Governmental regulation.

The issue then is whether the fine set forth in the first paragraph of Section 39 of the Tax Procedure Law (fines ranging from AR$ 150 to AR $ 2.500) or in the second paragraph would be applicable in such case (omitting relevant data required by AFIP for control of international operations is subject to a fine ranging from AR$ 150 to AR $ 45.000).

The debate is now undergoing discussion among transfer pricing specialists, not only as to the application or not of Section 39 but also as to the conditions for that penalty to apply.

Entry into Force

The amendments incorporated by the Resolution are enforceable as of fiscal periods closed on October 22, 2004 onwards.

The special deadlines provided by the Resolution, as mentioned above, will allow taxpayers to implement the new reporting requirements timely, though there is concern as to the adequacy of the IRS software to receive and process the whole information.

The overall goal of the Resolution is to provide the Tax Authorities with additional information on transactions between unrelated parties, as well as to promote the timely filing of transfer pricing documentation. ❑

(Footnotes)

[1] Official Gazette, October 31, 2001.

[2] Official Gazette, October 22, 2003.

[3] Official Gazette, July 23, 2004.

[4] For ITL purposes, "exports" are defined as the sending carried out by branches, representatives, sales agents, or other foreign entities.

[5] Pursuant to the legal text enforceable until then, in the case of exports with no agreed price or whenever the price agreed upon was less than the wholesale price applicable in the place of destination of the good, this last price was to be adopted, except proof indicating otherwise was submitted. Furthermore, the text indicated that AFIP could also determine the

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value of the goods on the basis of the wholesale price at the place of origin. However, if the export price was higher than the wholesale price at the place of origin, the first was the price to be taken into account.

In the case of imports, whenever the sales price to the buyer was higher than the wholesale price at the country of origin plus transport and insurance costs; than the difference between these two prices was to be deemed Argentine source income for the foreign exporter. AFIP could also determine the value of the goods on the basis of the wholesale price at destination. Nonetheless, when the effective import price was lower, this price will apply.

[6] The report that is to be filed along with the sworn statement must contain, at least, data and information included in Annex II of General Resolution 1.122 (as amended).

[7] The report that is to be filed along with the sworn statement must contain, at least, data and information included in Annex II of General Resolution 1.122 (as amended).

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