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Interaction between BEPS Plan and LATAM Recent Tax Developments

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This contribution is aimed at surveying the interaction and reciprocal influence between the OECD-G20 BEPS Action Plan (the BEPS Plan), on one hand, and contemporary tax developments occurred in the Latin American (LATAM) region, particularly those geared to counteract base eroding and profit shifting moves by multinational enterprises (MNEs), on the other.

At first glance, the interaction may take place in both directions: (i) BEPS Plan's initiatives that impact or influence LATAM recent tax legislative developments, and (ii) in the opposite direction, prior domestic tax developments in LATAM that are taken by OECD CFA and/or the working groups to provide a widespread recommendation or solution to a detected issue under the BEPS Plan. In addition, there is a third interesting angle, consisting on what I have labeled the misuse of the BEPS brand by national tax agencies in the region; I will further elaborate on this concept while addressing the issue below.

Against all odds, the first mentioned trend in the preceding paragraph (inbound influence) has not actually materialized to a significant extent in the LATAM domestic legislation, through recent tax amendments in the region concerning MNEs are somehow BEPS-flavored, and were addressed to counteract longstanding base erosion or shifting issues.

For instance, even though Chile is an OECD full member country, none of the 2014 Chilean tax amendments is traced back to the BEPS Plan's proposals or suggestions. However, some long awaiting substance related domestic changes (e.g., introduction of general anti-avoidance rules –GAAR–, a newly created CFC regime, thin-cap rules, and indirect capital gain taxation) are similarly oriented at avoiding the erosion of the national tax basis and the shifting of income overseas.

The same can be said on the “substance over form” and “business purpose test” heavily applied in Brazil by the Receita and the courts, on the basis of a (not yet regulated by law) sham rule contained in the Tax Code; although the lack of a specific regulation allows the tax agency to act with an ample discretion which, at instances, generates uncertainty and unpredictability, it is a fact that application of those principles shows a migration from a traditional purely legalistic approach to widespread concepts of interpretation in the tax field.

Along the same line, Argentina has intensified the application of its longstanding GAAR to cross-border business deals (particularly to intra-group deals), as well as business deals under a treaty

setting, either to re-characterize income and/or reassign it to the ultimate beneficiary. Moreover, application of domestic GAAR under a treaty umbrella is even expressly contemplated in recent tax conventions, as for example in the memorandum of understanding annexed to the treaty in force with Spain.

The Colombian SAAR (an overreaching thin-cap rule) introduced in 2013, and the Peruvian 2012 reform which included inter alia, a deemed or constructive dividend distribution upon the reduction of capital, new GAAR not yet fully implemented, and indirect capital gains taxation (a rule enacted in 2011), are also vernacular (rather than BEPS influenced) responses to base eroding gambles.

In the same direction, the 2014 Mexican Tax Reform included anti-erosion rules aimed at protecting the tax basis in particular settings, including, inter alia: (i) a defensive rule against double deduction of outbound payments from Mexican corporations to their foreign controlling parents; (ii) a denial of the deduction of interest, royalties and technical assistance paid to foreign beneficiaries which are non-taxable on the income received in their home jurisdictions; and (iii) a subject-to-tax rule that conditions the granting of benefits to treaty-partner residents.

It is difficult to ascertain whether LATAM tax reforms are motivated by the BEPS Plan. Notwithstanding the foregoing, I am persuaded that since LATAM countries have always been capital importing countries whose economies are mostly dependable on MNEs operating in the region, BEPS' scope of action has, some way or another, already received attention in the region, and new unilateral legislative tools aimed at protecting the national tax basis against base eroding and shifting schemes by MNEs are part of a modernization trend in the region which is somehow independent from the BEPS Plan. For the same reason, that trend will be kept in LATAM policy-makers' agenda even after the BEPS mood passes in the central economies.

There is, however, a BEPS motivated potential change in treaty law (inclusion of limitation of benefits clauses –LoBs– under Action 6) which might sharply affects investment patterns in the region. This is so because, thus far, except for the Mexican treaty network, LATAM treaties are largely free from LoBs clauses, thus allowing the use of regional holding companies organized in suitable treaty-partner countries. If LoBs clauses are adopted in the LATAM treaty network, regional treaty holdings will be no longer available as an investment vehicle, simply because they will not comply with the condition that more than 50% of the capital belongs to residents in the same treaty-partner country (it is common place that the parent be organized in a third country).

As regards the LATAM tax legislation's potential or actual influence on BEPS outcomes (outbound influence), the issue may be addressed under two different perspectives.

Firstly, there are many aspects on which LATAM tax legislation may influence at least indirectly BEPS outcomes, particularly concerning outbound payments by MNEs. The region has long contained a variety of defensive source rules concerning interest, IP royalties, dividends, technical assistance, and service fees in general, deduction limitations or exclusions concerning the same type of payments made intra-group, and application of GAAR and SAAR in an international context to re-characterize inter-company agreements and/or payments, or to redefine the beneficiary, including in a treaty setting.

Secondly, there are some particular concerns where the BEPS Plan is literally copying previously developed LATAM solutions, namely (i) the adoption of the so-called Sixth Method to value commodity export transactions (Action 8), and (ii) the adoption of indirect capital gain taxation to

cope with loss of revenue in low-income countries (Report on the Impact of BEPS in low income countries). Fortunately, the recently issued Discussion Draft on CFCs (Action 3) appears to have left as a remote possibility the adoption of a full-income inclusion system similar to the catch-all Brazilian CFC regime.

Finally, as anticipated, one indirect impact of the BEPS discussions comes from the misuse of the BEPS brand by national tax agencies that unduly jeopardize the BEPS brand and its goals by reducing BEPS to a new tool to be used in a witch hunt against MNEs. Reference is made to the increasing use of the BEPS Brand to articulate and justify over-aggressive press-oriented interim measures, criminal tax accusations, and auditing against MNEs, which cause a huge reputational damage to the affected taxpayer, have a significant demonstrative effect on taxpayers at large –acting as a deterrent on those tempting to take similarly aggressive tax paths– but at times end up being a tax nothing, i.e., there is no direct meaningful revenue effect. In certain cases this practice also leads to litigation that should have been avoided.

In Argentina, there have been lately at least three noteworthy cases: Despegar, Procter & Gamble, and HSBC; the first two cases were presented as large tax scandals which quickly became diluted into tax technical discussions. In the HSBC case, the tax agency pressed criminal charges against around 4,000 residents having undisclosed foreign accounts, an announced a billionaire potential collection concerning tax years which, for the most part, were later admitted to be covered by the statute of limitations.

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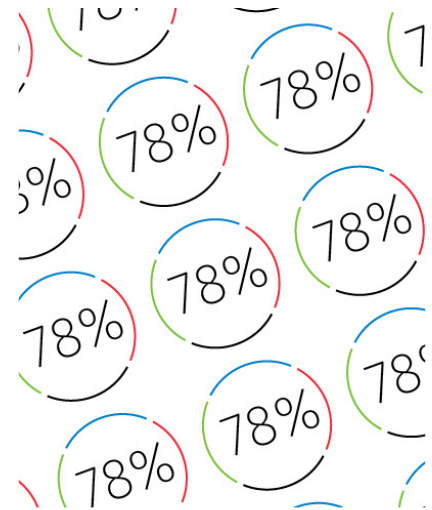
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