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Non-discrimination on the Basis of Nationality in Latin American Countries

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The DTT's signed by the LATAM countries generally follow the rule included both in the OECD and UN Tax-Convention Models. Article 24 Section 1 states that "nationals of a contracting state shall not be subjected in the other contracting state to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other state in the same circumstances, in particular with respect to residence, are or may be subjected". Almost all the treaties also consider this provision as applying to "persons who are not residents of one or both of the contracting states."

Derived from this rule, there are certain cases in Latin America to be considered. For example, Colombia has a provision stating that the withholding-tax system for overseas payments – which comprises a range of withholding taxes that in some cases can reach 33% of the gross payment – is only applicable to foreign, non-Colombian residents in the case of individuals (1). If we interpret Article 24.1 in the sense that it also considers nationals of an "X" state having a DTT with Colombia, who are non-residents in Colombia, the discrimination is clear. In fact, Colombian nationals who are non-Colombian residents are not subject to such a system; on the contrary, they are subject to far lower withholding taxes. The discrimination against a national of an "X" state who is non-resident in Colombia is, therefore, evident. However, it is important to mention that the OECD would take a different approach to this case (2).

The exclusion of Residency from the general non-discrimination rule based upon Nationality according to Article 24.1 is based upon the fact that the majority of states use residence as the criterion to determine income-tax liability, as residents are usually subject to tax on their worldwide income. In other words, a person who is not resident in a state can be, in principle, discriminated against, bearing in mind that they are only liable to tax with respect to certain types of income and, in general, on income sourced in that state (3). This premise has also been recognised in Latin American case law, as shown, amongst others, in some Mexican and Argentinian decisions (4). However, Brazil is one case for study since, in some judgements, it is suggested that Article 24.1 implies the prohibition from discriminating also on the basis of Residency. In fact, there is an interesting case in Brazil which involves the DTT between that country and Sweden, in which the point of debate is the possibility for Brazil to apply withholding taxes on dividends to Swedish non-Brazilian residents, taking into account the fact that such withholdings are not applicable to Brazilian residents. In all instances, the position of the different courts has been that this goes against Article 24.1. However, the final decision of the Supreme Court is still pending and perhaps that decision will completely change this view (5).

This Brazilian position, however, is not completely isolated (6) and opens an important discussion, particularly in countries in which withholding taxes for overseas payments are outrageously high and certainly exceed the notion of “income” which rules the “income-tax” system. If a foreigner, however referred to (non-resident, non-national, alien, etc.), is subject to taxes which certainly exceed their income, this situation should be a question to address under double-tax treaties if the country that exerts its power to tax considers a radically different approach to its own persons, whatever their category (residents, nationals, etc). This approach is based on the idea that one of the purposes behind avoiding double taxation is certainly to avoid an excess of taxation (if not, the prevention of double taxation would lack real meaning), but also because DTT’s should not, in our view, deviate from the general purposes of International Investment Agreements (IIA’s), a problem we will address in further articles. In addition, International Tax Law should not abandon the possibility of condemning potential situations of hidden discrimination which, in many cases, have been built on the basis of “national” considerations (7).

There are other cases of “hidden” (but clear) discrimination in which the debate on whether they fall under Article 24.1 or not is extremely controversial. Colombia has provisions regulating the so-called “presumptive income” which imply the assumption that taxpayers have a minimum income equal to 3% of their net worth in the previous year. In this sense, whenever the real income is less than such presumptive income, taxpayers still have to pay income tax over said presumptive income. However, the law also states that the presumptive-income taxable base can be reduced by the net-worth value of shares possessed in national entities, excluding the possibility of deducting the value of shares possessed in foreign entities. Some scholars consider that this provision is only “apparently” discriminatory as it is justified by the fact that national entities are also subject to the presumptive-income tax regime, this measure being a way of preventing the double-economic taxation that would occur if both the shareholder and the company were subject to a tax over the same taxable base. Nevertheless, this argument is very simplistic, as this deduction is given to all taxpayers who participate in Colombian entities, irrespective of whether or not they are subject to presumptive income tax or even regular income tax, amongst other considerations. There might be cases in which the company is not subject to tax at all and its shareholders can still use the prerogative of excluding the net-worth value of the shares they possess in it from the taxable base of their own presumptive income.

The above-mentioned case has been highly controversial in Colombia, although there is no official position on it. In principle, the discrimination implied in the domestic rule does not deal with Article 24.1, as it actually affects the taxation of Colombian-resident entities having investments abroad – a situation apparently not covered by the article. However, assuming a holistic approach, it is arguable that the discrimination also goes against nationals of the other contracting state, even if they are not taxpayers in Colombia. Ultimately, such residents are “subjected” to “requirements connected with taxation in Colombia” (following the wording of Article 24.1) as their wealth is directly incorporated within the tax base of a Colombian resident – something which would not otherwise occur if they were Colombian. From another perspective, DTT’s are also, in our view, an instrument to increase (not to decrease) and make feasible the economic flows between contracting states.

This latter case might be comparable to a decision taken by an Italian court stating that the denial of a tax credit to Italian residents investing in foreign companies (in this case, the United States) derived from dividends, was not only against Article 24.1 of the US-Italy Tax Treaty, but also against the fundamental freedoms of European Union law, bearing in mind that Italian residents investing in domestic companies were entitled to such a credit (8). Whatever the position over these two cases might be, they once again show the limited scope of Article 24.1.

Notes

(1) Some scholars think that this rule should be read, nowadays, as if it only referred to non-residents, irrespective of whether or not they are Colombian foreign individuals. However, there is no rule that has abrogated this provision and it can be considered as still being in force.
(2) Commentary Nº 8 to article 24 states that “Similarly, paragraph 1 does not apply where a national of a Contracting State (State R) who is also resident of State R is taxed less favourably on the other Contracting State (State S) than a national of state S residing in a third State… as the two persons are not in the same circumstances with respect to their residence”.
(3) See Sweden- Case HFD 2011 NOT. 99, 30 November, 2011; Netherlands- Case 088/01919, 20th November, 2009 (Supreme Court or Hoge Raad); Netherlands- Case 43.258, 7th of December 2007 (Hoge Raad); South Africa- Case Cohen Brothers Furniture (PTY) Ltd, Aliied Reinsurance Co (PTY) Ltd V. The Minister of Finance and the Commissioner for Inland Revenue, 23 March 1998 (Supreme Court of Appeal); Germany- Case 13 V 2774/03, 22 September 2003 (Finanzgericht München or Tax Court of first instance); New Zealand, Judgement of 16 July, 1973 (Court of Appeal, Wellington)
(4) See, for example in Mexico: Juicio de Nulidad Nº 12666/98-11_06-3/99-S2-06-02, Decision of 7 September 1999, Tribunal Fiscal de la Federación. See also in Argentina: case Hoechst A.G. v. DGI Rep. Argentina, regarding the DTT subscribed with Germany: Judgements of “Cámara Nacional Contencioso Administrativo Federal” (26.08.1993), and Supreme Court of Justice of Argentina (28.04.1998), case F-670. See also: case Astillero Ministro Manuel Domecq García S.A. also on a controversy derived from the Alemania- Argentina DTT. Tribunal Fiscal de la Nación, Sala C (07.11.1997).
(5) Currently, the case is before the Supreme Court. See: Supreme Court of Justice. RE 460320. Volvo do Brasil Veículos Ltda e outro. Case AC2436. The latest news on this trial is that on 30/09/14 it was suspended.
(6) Something similar occurred in Zimbabwe. See: British American Tobacco V. The Commissioner for Taxes, December 14 1994 (High Court of Zimbabwe).
(7) It is not difficult to demonstrate that taxation systems in developing countries are, in some cases, still based upon the idea of capital-export and capital-import countries. In my view, it is a consideration which is intrinsically a “national” idea.
(8) Corte di Cassazione, Case Nº 3119, 17 March, 2000.

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