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Argentine treaty network: Will the schoppable treaty soon become an extinct species?

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Lessons to LatAm from recent developments of one of the oldest tax treaty networks in the region

The final outcome of Action 6, BEPS, posses the query of adopting the principal purpose test (PPT) standard, and/or adopting LoB clauses. By reviewing recent changes to the Argentine tax treaty network, this contribution is a call for LatAm countries to avoid a jump to the void by migrating from their own legal tradition in fighting treaty shopping to innovative, untested schemes that, as we all know, come with their own pros and cons.

Starting in June 2008, Argentina terminated unilaterally a number of treaties (DTTs) including the treaties with Austria, Spain, Switzerland and Chile. Reasons for termination vary, but allegedly perceived misuses of the DTTs by Argentine residents through round-trip schemes were at the basis of the DTT terminations with Austria, Spain and Chile.

In the case of Austria and Chile, a couple of administrative pronouncements from the Argentine Competent authority preceded or followed termination; the decisions set forth application parameters of the DTT based on domestic anti-avoidance rules (GAARs).(1) It is also true that the DTTs with Austria, Spain and Chile provided for benefits concerning the Argentine Personal Assets Tax (PAT) on the holding of shares in Argentine companies which were not reproduced in any other Argentine DTT and there was a decision to cut off this benefit altogether.

In fact, at the time of occurrence, the termination of the old Spanish DTT was highly unexpected; there had been neither rulings arguing against the benefits afforded under the DTT nor tax audits challenging them in a given particular case.(2)

Speculation behind the reasons for the termination included, *inter alia*, the Argentine government's reluctance to afford treaty benefits to Spanish holding companies (ETVEs – Entidad de Tenencia de Valores Extranjeros) that lacked substance, and to keep recognizing to Spanish residents (including ETVEs) the PAT exclusion on equity holdings in Argentine companies.(3) This last benefit under the previous DTT did not have, *per se*, great significance in revenue terms, but for the fact that such benefit had a contagious effect: Under the prevailing administrative interpretation until 2006, to the extent the benefit was afforded under a DTT, the same treatment was to be recognized to residents in Latin American states that were members of the Latin American Integration Association (ALADI).(4)

In the case of Switzerland the main reason for termination was a clause in the Additional Protocol to the DTT which, by equaling the treatment of royalties to that afforded under Swiss law, in practice implied that Argentine-source royalties went fully untaxed, an unparalleled treatment in the Argentine treaty network. Additionally, Argentina wished to correct the treatment afforded to the insurance business, and to introduce a wide (OECD last version) exchange of information clause.

Today Argentina has new DTTs in force with Spain(5) and Switzerland(6), and new DTTs have already been signed with Chile (replacing the old one) and Mexico. The old Austrian DTT has not been replaced yet.

In this context, it is worth wondering whether new anti-treaty shopping provisions have made these DTTs (or other available options, such as the Dutch treaty) fully unshoppable, or simply set forth internationally accepted standards to avoid treaty abuse.

Section I (persons covered) of the Spain DTT remains unchanged, so the new DTT keeps applying to residents of one or both treaty-partner countries (whether individuals or legal entities) without further qualifications. The DTT application is therefore not conditioned upon the resident being taxable or taxed in its country of residency; thus, Spanish holding companies (ETVEs) are not subjectively excluded from the treaty's scope of application.

But, in connection therewith, two clauses in the accompanying Memorandum of Understanding (MoU) are worth mentioning: Clause A, which allows a treaty partner (for example Argentina) to apply domestic rules to prevent tax avoidance or evasion (that is, domestic GAARs requiring economic as well as legal substance), and Clause B, which provides for the application of the beneficial ownership requirement not only in connection with dividends, interest and royalties (Sections 10, 11 and 12), but also in connection with income of any nature received by a treaty-partner beneficiary.

Argentine treaties has been traditionally silent on the application of domestic GAARs under the umbrella of the DTT, so that the innovation arising from the new Spanish DTT is the express treaty reference to the application of GAARs, a domestic rule to which the argentine tax authorities has resorted to widely anyway in the past to recharacterize income or redefine the beneficiary under a treaty.

Additionally, Sections C and D of the MoU annexed to the Spanish DTT further provide that the DTT will not disallow the application of domestic rules of fiscal transparency (controlled foreign corporation regimes) or thin capitalization rules, and that sections 10, 11, 12 and 13 (dividends, interest, royalties and capital gain provisions) will not apply whenever the primary purpose or one of the primary purposes of a person related to the origination or assignment of shares or other dividend-generating rights, the origination or assignment of an interest-bearing credit, or the origination or assignment of a royalty-generating right, is to obtain the benefits of such sections. This last rule is in line with already existing OECD MC Commentaries, and might also be viewed as an early predecessor of BEPS Action 6, PPT (principal purpose test).(7)

As regards net worth taxes (Section 22), the new DTT eliminates subsection 4 of the same section in the old DTT, according to which the net worth represented by shares or participation in the capital or net worth of a company might only be taxed in the contracting state of which the owner is a resident (*e.g.* Spain). By eliminating that subsection, participations may also be taxed in the

State where the participated entity is a resident (*e.g.* Argentina). As a result, the holding (for instance by a Spanish ETVE) of shares or other equity interest in an Argentine company is subject to PAT.

Section 28 (Entry into force) provides that the Convention would enter into force upon the exchange of ratification instruments, and its provisions would have retrospective effect: (i) in connection with taxes withheld at source on payment made to non-residents as from January 1, 2013; (ii) in connection with other taxes, as from fiscal years commencing on or after January 1, 2013. As a result, taking into account the DTT effective date (December 27, 2013) there was a continuity of effects –perfect matching– between the old and the new Spanish DTT.

Section 12 of the new Swiss DTT empowers Argentina to apply withholdings on Argentine-source royalty payments to Swiss resident companies, at rates varying from 3% to 15%, depending on the type of licensed IP, and allows the application of PAT on shares and other equity participations in Argentine companies.

In accordance with recent domestic tax changes, Section 10 allows taxing PEs as resident companies, plus an additional 10% on profit remittances to the foreign head office.

The new DTT also eliminates the most favored nation clause which indirectly benefitted insurance companies under the old one, and set forth a general anti-abuse rule so that residents of third countries may not take advantage of the benefits of the DTT by structuring abusive tax planning that lead to double non-taxation.

Finally, the Swiss DTT provides for an exchange of information upon request in accordance with OECD latest (and widest) standard.

The new DTT with Chile(8) is basically aimed at overcoming double non-taxation situations coming from a combination of a source-based treaty patterned after the Andean Pact Model, with a Chilean holding company regime, widely used by Argentine corporate residents to avoid the impact of Argentine corporate income tax (CIT) on dividends received from and originating in second-tier operating subsidiaries located in third (non-treaty) countries. The new DTT abandons the old design, follows the OECD-UN structure, and sets forth strict rules to avoid round trip treaty shopping schemes.

Traditionally, as anticipated, Argentina has fought treaty shopping against by resorting to domestic GAARs, even without a treaty express authorization. As a progress, these domestic principles were given treaty status in the DTT with Spain.

Until now, however, no LoB provisions have been provided for in the Argentine treaty network. The new development is that, for the first time, perhaps influenced not only by the BEPS mood and the outcome of Action 6, but also by the unexpected results under the old DTT, article 24, paragraph 6, of the new DTT with Chile contains the most detailed LoB provision available, combined with a PPT standard patterned after Action 6, BEPS

Whether this is the start of a new policy against treaty shopping that would spread over future DTTs it is difficult to foresee. I would rather believe that this move is basically predicated on the basis of the particular situation created under the old DTT with Chile, and would not become a policy trend in Argentina. Moreover, I am persuaded that it is in the LatAm countries (including Argentina) best interest to keep preventing treaty shopping onward in accordance with their own

legal traditions and, hence, countries applying so far domestic GAAR should be inclined to apply the PPT which is precisely the corresponding treaty equivalent standard, and resisting the temptation to migrate to highly complex, mechanical, and domestically untested LoB clauses.(9)

For EU companies the Dutch and Spanish treaties still are the most suitable channels to trade with and invest into Argentina. These treaties are available, however, as long as legal and economic substance can be evidenced in the treaty holding intermediary vehicle.

It has been usual for the global company to invest in the LatAm region through a holding company organized in an extra-zone country having treaties with the LatAm jurisdictions where the operating subsidiaries are going to be established (*e.g.*, through a Dutch or Spanish holding). As mentioned, these schemes have been allowed in the past, as long as the holding evidences economic as well as legal substance. This is going to be the case in Argentina for the time being, but to the extent LoB clauses of the type included in the Chilean treaty proliferate over the region, this practice would be sharply curtailed without a meaningful revenue purpose; and this is so because under an LoB scrutiny, the sole fact that the controlling shareholder is a resident of a third country would prevent the entity to benefit from the DTT, unless the shares are listed in a recognized stock exchange in the same country, which might or might not be the case.

So far, LatAm has been a LoB free area but for Mexico which had been using LoB in its treaties for a long time, and personally I would be inclined to suggest countries in the region to keep the use of domestic GAARs or the treaty PPT equivalent as an efficient and much more tailored-made tool to fight treaty shopping in line with the legal tradition in the corresponding jurisdiction.

(1) DNI Memorandum 64/09, use of an Austrian intermediary (shell) holding company without any economic substance; and DNI Memorandum 799/10, double non-taxation obtained by using an interposed Chilean holding company (Chilean Platform regime). This last approach was later endorsed by the Argentine Tax Court, *in re* Molinos Rio de la Plata, August 14th, 2013, decision appealed and pending before the Federal Court of Claims.

(2) But tax audits on Spanish holding companies did follow termination of the DTT subjecting ETVEs to a strict substance scrutiny

(3) Section 22, 4 of the old Spanish DTT.

(4) Memorandum (DNI) 1000/2002, October 15, 2002; cfr. General Attorney Office (PTN)'s opinion 172/2006, June 30, 2006 and AFIP External Note 5/2008, July 31, 2008.

(5) Argentina and Spain signed the new DTT on March 11, 2013, and the treaty is in force as from December 27, 2013.

(6) The new DTT with Switzerland is effective as from November 27th, 2015.

(7) See, Teijeiro, *LoB Clauses, PPT Standard, and the Latin American Treaty Network Choices*, Kluwer international Tax Blog, June 5, 2015

(8) Signed on May 15, 2015, and not yet in force.

(9) The DTT with Mexico was signed on November 4, 2015, and in line with the most recent treaties, rules are provided to avoid double non-taxation situations and treaty shopping.

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