



Latin American tax scenario resulting from the pandemic: effects and provisions that may endure

December 10, 2020

Agenda

- Welcome, introduction & agenda
- Macroeconomic figures references
- Economic sectors / effects
- Reasons to remain optimistic
- Regional digital economy taxation / current status and effect of Tier 1 &2
- Use of pandemic circumstance as a planning tool - case study
- Tax incentives
- Expected reforms
- DAC 6 provisions
- Outsourcing restrictions
- Tax audits and litigation

In memoriam



Francisco Botto

Head of Tax
DLA Piper Peru
1967 – 2020



Welcome

Macroeconomic reference

Argentina

Original Central Bank GDP Growth for
2020: -6%

Revised Central Bank GDP Growth for
2020: -13.6%

Chile

Original Central Bank GDP Growth for
2020: +0.5 – 1.5%

Revised Central Bank GDP Growth for
2020: -5.5 / -4.5%

Brazil

Original Central Bank GDP Growth for
2020: +2.3%

Revised Central Bank GDP Growth for
2020: -4.5%

Colombia

Original Central Bank GDP Growth for
2020: TBD%

Revised Central Bank GDP Growth for
2020: -TBD%

Mexico

Original Central Bank GDP Growth for
2020: +2%

Revised Central Bank GDP Growth for
2020: -3% (IMF -9%)

Peru

Original Central Bank GDP Growth for
2020: +3.8%

Revised Central Bank GDP Growth for
2020: -12.7%

Reasons to remain optimistic

Population profile

- Fundamentals remain (commodities/natural resources/low labor cost)
- Professional profile of the overall population in the recent decade

Near-shoring opportunities for LATAM resulting from:

- PRC/US trade environment and continuous IP rights violation
- Strategic manufacturing/supply needs – (eg, personal protective equipment; pharma; e-components)

Challenges

President Elect Biden's possible on-shoring policies:

- US employment generation incentives
- Surtax to US manufacturing/services subs tending to the US market

Effects of COVID-19 pandemic on poverty/misery levels (back to 2000 indexes...)

Reasons to remain optimistic

Challenge overcoming factors:

- US economy not equipped for labor intensive manufacturing processes
- US FTA network with the region
- Access to proven strategic:
 - Heavy-duty manufacturing (MEX)
 - Biomed manufacturing processing areas (CR FTZ)
 - Logistics hubs (PANAMA FTZ)
 - Pharma record (Puerto Rico)
 - Experience professional consulting force (ARG)
 - Holding legislation (COL)
 - Multinational headquarter regime (PAN)
 - “B” certified companies regime (URY) - triple impact: economic, social, environmental

Regional digital economy taxation /current status effect of Tier 1 &2

B2B follows general WHT and VAT reverse charge rules. B2C has new provisions:

Mexico

Applicable as of June 1, 2020
VAT @16%
NR registration and significant mandatory compliance requirement

On failure to register, IRS may instruct blocking website

Costa Rica

Applicable as of August 1, 2020.
VAT @13%
Payment intermediaries (credit card issuers and others) may be the collection agents at taxpayer's choice

Ecuador

Applicable as of September 15, 2020.
VAT @16%
Payment intermediaries (credit card issuers and others) may be the collection agents at taxpayer's choice

Chile

Applicable as of June 1, 2020
VAT @19%
NR registration and compliance requirements are mandatory. On failure to register, IRS may instruct payment intermediaries to collect.

Argentina

Applicable
As of July 1, 2018 VAT @21%
and as of January 1, 2019 PAIS tax @8%
and as of September 1, 2020 35% personal income tax prepayment
and as of January 1, 2021 provincial turnover tax up to 2% to 3%
All on certain digital services (enacted but to be implemented).
Payment Intermediaries (credit card issuers and other) are the collection agents

Colombia

Applicable as of April 19, 2019.
VAT @19% on certain digital services
NR registration and compliance requirements are mandatory. Payment intermediaries (credit card issuers and others) collection option has not become available yet

Brazil

Proposed Bill under discussion creating a DST (CIDE-Digital) @1.3% and 5% on gross revenue from determined digital service income (advertising; sales to residents platform; and transmissions of residents personal data)
State level - ICMS (VAT) Withholding
Legislation has been introduced in Rio and Sao Paulo states to have ICMS withheld and collected on certain B2C services. Rio appoints payments intermediaries to collect, but regulations are pending. Sao Paulo has not designated a collection agent

Paraguay

Applicable as of January 1, 2021
VAT @ 10%
and WHT 4.5% on certain digital services
Payment intermediaries (credit card issuers and other) may be the collection agents at taxpayer's choice

Uruguay

Applicable as of July 1, 2018
VAT @19% +WHT at 12.50% on certain digital services
and NR registration and compliance requirements are mandatory

Next in line

Canada

Proposal to extend GST/HST to sales of digital products and services by foreign-based vendors and digital marketplace platforms

Peru

VAT @18%

Panama

VAT @ 7% [?]

Tier 1 & Tier 2

Not part of the regional legislative discussion yet



Use of pandemic circumstances as a planning tool: case study

Transfer pricing adjustments in LatAm

- MNE are evaluating different business model and changes to their transfer pricing policy in order to adapt to the new economic environment resulting from the crisis
 - The changes in their business model or supply chain process could trigger changes in their actual transfer pricing policies or creation of new intercompany transactions and
 - A significant number of Latin America countries have included regulations that could trigger tax adjustments, if there is a change in their transfer pricing policy due to changes in their function, risk and assets.
- The COVID-19 pandemic has allowed us to revise existing business/operation models and align them to the current macro-economic reality. Adjustments have not focused on changes to the TP methodology or on transferring function, risk and/or assets, thus reducing exposure to potential assessments or mandatory reporting obligations

Example of technical TP considerations

- The transfer pricing usually include a transfer pricing formula or guidance on how it is calculated (eg, it can be based on cost plus, resale minus or third-party prices)
- In certain circumstances, a transfer pricing adjustment can be only considered as a change of price that isn't implied by a change in function, risk and assets
- The technical analysis usually requires a detail review of:
 - Global business model
 - Specific circumstances of the subsidiary and its economic environment
 - Existing intercompany agreement or key terms of negotiation
 - Explicit or implicit intercompany policy
 - Existing transfer pricing documentation and how the entity or transaction is characterized
 - Detail on how intercompany prices are established (operational transfer pricing)
- Arms length behavior in the execution of the transfer pricing adjustment



Regional forum

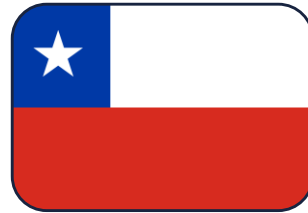
Tax incentives



Tax amnesty
Regularization plans
Extension of deadlines



Special depreciation rules
Decrease of income tax payments
Reduction of compensatory interest to tax debt
Carry-forward for losses



Reduction of CIT to 10% for small and medium sized taxpayers (2.8 gross income)
Refund of accumulated VAT credit

Instant depreciation of tangible and intangible goods



Loans to small businesses
Limited deferral and reductions on fines for social security contributions

Some states reduction in local taxes, such as payroll tax, property taxes, and real estate transfer tax.



Customs reduction and clearance simplification process for COVID drugs and medical equipment
Tax deferrals for federal taxes (CIT, Gross Revenues and Payroll Taxes)

Temporary 50% reduction of so-called S system contributions

Zero rate to IOF credit and loan transactions entered into between April 3, 2020 and November 26, 2020

Labor law flexibility – reduction in work hours and salaries

Expected reforms

Argentina

Equity tax for individuals...
Will it expand to corporations?

Brazil

Digital service tax
Unification of PIS and COFINS (federal VAT)
Comprehensive tax reform (one VAT)
Corporate income tax (depart from IFRS)
New amnesty program (?)

Chile

2019 reform came into force in April 2020, so only regulations expected at this time

Colombia

Elimination of tax incentives and other tax benefits
VAT tax rate unification
Elimination of special tax treatments on exempted products and services
Increase of income tax rates for individuals
Renewal of the wealth tax
Increase of the tax rate applicable to inheritances

Mexico

Outsourcing
Increase of compliance
Digital freeze
Expansion of accounting records definition
Criminal procedures

Peru

Digital tax VAT

DAC 6 type provisions / mandatory disclosure rules

Argentina	Mexico
<ul style="list-style-type: none">• Enacted October 2019• Applicable for planning implemented from January 1, 2019. Planning implemented to October 19, 2020 or implemented prior to January 1, 2019 that remains in effect must be reported before January 29, 2021• “Tax planning” includes structures implemented to avoid the compliance of any information or reporting regimes, whether there is a tax advantage or not• [Mandatory reporting at the level of advisors and taxpayers (both individuals or corporations)• National planning informed by the last day of the month following the closing of fiscal period of implementation. International planning informed within 10 days of implementation starts• Failure to comply with these obligations may give rise to penalties of AR\$5,000 to AR\$450,000 (US\$61- 5,500)	<ul style="list-style-type: none">• Enacted on December 9, 2019, Reporting guidelines issued on November 18, 2020• Applicable as of 2020, but reporting for 2020 transactions and prior years, must be made by February 15, 2021• General rule to report within 30 days after first act of reportable transaction is carried out• Mandatory reporting at the level of advisors and taxpayers (individuals or corporations)• 14 categories of activities are considered “reportable transactions” & refer to the avoidance of exchange of financial or tax information; creation of a PE, not applying withholding taxes on dividends, transactions where accounting and tax amounts differ by more than 20%, inappropriate transfer of tax losses, application of tax treaty benefits, transfer pricing considerations• Non-compliance penalties of 50% to 75% over tax benefit; and tax advisors could be subject to potential penalty of US\$1 million

Outsourcing restrictions

- Mexican President Andres Manuel Lopez Obrador presented a bill on November 12 that will affect how most multinational companies (MNCs) have been operating in Mexico. Discussion has been officially postponed to February 2021
- When starting operations in Mexico, MNCs normally set up a profit generating subsidiary (OpCo) and an employee-housing brother/sister subsidiary (insourcing). Insourcing typically houses the employees and charge services to Opco on a cost-plus basis, thus allowing to minimize impact of mandatory profit sharing rules. In other instances Opco would just hire services from a *bona fide* third party outsourcing company (Outsourcing) with a similar mandatory profit sharing impact
- The purpose of the proposed bill is to limit the ability for OpCos to insource or outsource personnel. The provisions as they currently stand provide for changes to the Federal Employment Law; Social Security and Public Housing Law; Federal Tax Code; and Income Tax and VAT laws
- The changes are geared toward limiting the deductibility of insourcing and outsourcing related expenses and further restrict the ability to claim VAT credits related thereto. Any structure deemed to be implemented to circumvent these new restrictions may, in some cases, be deemed to be tax fraud



Tax audits and litigation

Tax controversy environment in Latin America region

General

Current trends

Expected future trends

Key actions to take

Countries are extremely formalistic

Significant and increasing activity in tax audits

Extensive documentation required

Active involvement in discovery
Digital data

Business purpose and substance proof

Aggressive audits
Large assessments

Cross-border payments, supply chain restructuring

PE risks for non-resident activities

Transfer pricing audits

Inclusion of GAAR provisions

Mandatory Disclosure Rules

Most active jurisdictions

Mexico
Brazil
Argentina
Colombia
Peru

Increase tax controversy compliance

Severe fines increase

Importance of criminal procedures

Preparation for future law changes

Frequent health checks

Closely monitor GAAR application in practice

Proactive controversy management needed

Be aware of "Fully Transparent Taxpayer"

Keep documentation and defense files current

Hot topics



Argentina

Federal

- Intercompany cross-border operations and transfer prices. Intercompany debt and interests deductions
- Use of metadata and microdata to detect differences between different parameters (eg, reported sales vs. credits in bank accounts). Any tax returns inconsistencies may cause audits
- Attempt to tax digital economy. Project of new sourcing rules

State and Local

- Withholding agents of Turnover Tax are being hefty audited
- The number of criminal tax cases in connection with Turnover Tax is increasing
- Turnover tax on digital services starts collection on January 2021

FY 2020 closing tips; inflation adjustment and FX variations

- Inflation adjustment. Litigation opportunities. Updated inventory of goods and assets is absolutely necessary
- Debt of the local entities nominated in foreign currency could undermine the equity of local entities if devaluation is increased
- Conversion of financial debt in capital injection. Check tax effects. Potential challenge of deduction of interests and FX variations
- Personal Assets Tax and new Equity Tax (threshold US\$2.2M – AR\$200M). Litigation opportunities

Hot topics – tax audits and litigation



Brazil

Federal

Goodwill amortization

IOF on intercompany agreements

Stock options (withholding income tax and social security contributions)

Reverse merger transactions and NOL utilization

Inclusion of officers as co-responsible in tax assessments

Tie break at Administrative Tax Court (CARF) now ruled in favor of taxpayer

State and local

State VAT (ICMS): intercompany transactions below cost; lack of ICMS differential

Service Tax (ISS) on Exportation of Services (where the results of the services are verified)

Software licenses: ISS or ICMS

Inclusion of officers as co-responsible in tax assessments

Superior Court of Justice (STJ) ruled that ICMS declared and non-paid constitutes crime

Tax litigation opportunities

Substitution of judicial deposits in cash (eg, bank guarantee, insurance guarantee, real estate)

Expedite credit analysis and refund requests

Discussions about constitutionality and legality of certain laws and regulations

Hot topics – opportunities



Brazil

Intercompany debts and ideas to mitigate FX losses

- Capitalization
- Forgiveness
- Debit to shareholder's account

Excess cash / repatriation options

- Return of Capital (tax free provided certain requirements are met)
- Interest on Net Equity
- Dividends (tax free)
- Loans from Brazil (subject to IOF and TP rules – minimum interest rate)

Other opportunities

- Review PIS and COFINS credits: court precedents more favorable to taxpayers
- Cost-sharing arrangements for back-office activities
- Sales and marketing structures (no PE – BEPS Action 7 not introduced)
- Revision of tax procedures for large consumers of electricity to mitigate tax risks
- Supporting documentation for taxes could be digitalized (no originals need to be maintained)
- Corporate simplification: only one shareholder for a Limited Liability Company needed

Hot topics



Colombia

- Transfer pricing regime was enacted in Colombia back in 2002
- For 10 years, principal judicial decisions were adopted by the Constitutional Court. The first ruling was adopted in 2003.
- Currently, there are around 50 judicial pronouncements adopted by the Council of State on transfer pricing matters. Most of them related to formal and procedural issues, and others related to non-compliance penalties
- The technical and substantial controversies are related to the following issues:
 - ✓ Selection of tested party
 - ✓ Selection financial information
 - ✓ Comps. search
 - ✓ Selection of PLIs
 - ✓ Comparability adjustments
- The Tax Authority has grown more sophisticated in its arguments and investigations. Therefore, prudent companies take care with transfer pricing analysis and gathering all the supporting documentation that proves the application of the arm's length principle to those operations executed between related parties

Hot topics



Mexico

- Auditing activity is ongoing even in the COVID-19 environment. The current general areas of focus are:
 - Transfer pricing audits
 - Adjustment of profit margins; TP methodology and compliance; support documentation of payments and TP documentation
 - Cross-border payments
 - Deductibility requirements: compliance with formal requirements; documentation of actual rendering of services and delivery of goods (*“materialidad”*) and business reason/need (*“strictly indispensable”*) analysis
 - Tax treaty benefits: applicability of treaty withholding tax rates and formal compliance requirements
 - Tax authorities are using available digital information to verify taxpayers compliance, identify inconsistencies or an incorrect analysis of the data findings have resulted in cancellation of the taxpayers ID, suspension of the electronic signature, cancellation of the importers registry or even the seizure of bank accounts
- Expected future trends:
 - VAT on digital services
 - MDR compliance and application of GAAR in practice
 - Even more comprehensive documentation requirements and increased administrative burden
 - Limitation of interest expense, payments to low-tax jurisdictions and anti-hybrid rules
 - Expanded definition of Permanent Establishment
 - Increased importance of criminal procedures regarding tax matters



Q&A

Thank you for joining us.



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