INSTITUTE FOR INTERNATIONAL TAXATION
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Repatriating Profits from Latin America

At the U.S.-Latin America (LATAM) Tax Planning Strategies Conference held June 15-17, 2011 in Miami, one informative session dealt with "Repatriating Profits from Latin America" from various LATAM jurisdictions. The session was co-chaired by representatives from U.S. and Brazil, with five panelists from Brazil, Chile, Colombia, Mexico and Venezuela. Five other LATAM jurisdictions – i.e., Argentina, Ecuador, Panama, Peru, and Uruguay - were covered in several of the panelists' presentations.

The session covered in-bound corporate structures owned by U.S. investors that dominate LATAM jurisdictions; including excellent comparative reference charts of such traditional tax criteria as:

- **corporate & branch profit tax rates** ranging @ 35% in Argentina, 34% in Brazil, 20% in Chile, 33% in Colombia, 25% in Ecuador, 30% in Mexico, 30% in Peru, 34% in Venezuela
- **general absence in LATAM jurisdictions of domestic withholding tax on dividend distributions out of previously taxed profits** with two exceptions - i.e., imposed only by Peru @ 4.1% and Uruguay @ 7%; but notably high withholding tax rate barriers imposed on distributions in excess of previously taxed profit -i.e., ranging @ 35% in Argentina, 33% in Colombia, and in Venezuela @ 34% generally and 50% for oil companies or60% for mining companies
- **domestic withholding taxes on other payments to foreigners of**:
  - **interest** – ranging @ 35% in Argentina, 15-25% in Brazil, 35% in Chile, 0/1/14/33% in Colombia, 0% in Ecuador, 10/15/21/30% in Mexico, 30% in Peru, 32.3% in Venezuela; with specially reduced withholding tax rates on interest paid to financial institutions ranging @ 15.05% in Argentina, 4.0% in Chile, 4.9% in Mexico, 4.99% in Peru, 4.95% in Venezuela; and higher rates on interest paid to tax haven residents @ 25% in Brazil & 40% in Mexico)
  - **royalties** –ranging @ 21/28/31.5% in Argentina, 15-25% in Brazil, 30/15% in Chile, 33/26.4% in Colombia, 23.5% in Ecuador, 25% in Mexico, 30% in Peru, 30.6% in Venezuela
  - **technical assistance & information fees** –ranging @ 21/28% in Argentina, 15/25% in Brazil, 20/15% in Chile, 10% (Colombia), 25% in Ecuador, 25% in Mexico, 15/30% in Peru, 17/10.2% in Venezuela

- **capital gains** – ranging @ 35%/17.5% in Argentina, 34% in Brazil, 20/0% in Chile, 33% in Colombia, 0% in Ecuador, 25% in Mexico, 5%/30% in Peru, 34% in Venezuela

- **permanent establishment protection & reduced withholding tax rates under international bilateral double tax treaties (DTAs)** where applicable (i.e., depending on provisions of their DTA networks e.g.,:
  - **Argentina** – 18 DTA countries (notably exclude the U.S.); and including 3 DTAs in force within LATAM [i.e., Bolivia, Brazil, Chile]
  - **Brazil** – 34 DTA countries (notably exclude the U.S.); and including 8 DTAs within LATAM [i.e., Argentina, Barbados (under negotiation), Chile, Ecuador, Mexico, Paraguay (signed but not in force), Peru, Venezuela (signed but not in force)]
  - **Chile** – 27 DTA countries (including U.S., yet to be ratified); and including 7 DTAs within LATAM (i.e., Argentina, Brazil, Colombia, Ecuador, Mexico, Paraguay, Peru) – but no reductions of domestic dividend withholding tax rates under Chilean tax treaties
  - **Colombia** – 14 DTA countries (including U.S., under negotiation); and including 2 DTAs in force within LATAM [ie., Chile, Mexico (yet to be ratified)]
  - **Mexico** – 44 DTA countries (including U.S.); and including 7 DTAs within LATAM [i.e., Barbados, Brazil, Chile, Ecuador, Panama, Peru (yet to be ratified),Uruguay]
  - **Peru** –only 4 DTA countries (notably exclude the U.S.); and including 2 DTAs in force within LATAM [i.e., Brazil, Chile]
  - **Venezuela** – 31 DTA countries (including U.S.); and including 4 DTAs within LATAM [i.e., Barbados, Brazil (yet to be ratified), Cuba, Trinidad & Tobago]

Generally, the panelists covered the pitfalls of high withholding tax rates in the LATAM countries generally on dividends out of excess profits not previously taxed (versus no withholding taxes on dividends from after-tax earnings), on royalties and on fees for technical service and information; as the less desirable avenues for extraction of profits from LATAM companies.

The strategic planning alternatives highlighted covered were as follows:

- objectives/ constraints for multinational companies deploying cash from LATAM operations
- ideas for intercompany transactions to deal with LATAM jurisdictional issues
- optimization of deductions and repatriation among LATAM jurisdictions
- use of intermediary holding company structures
- legal, accounting versus taxation differences
- preferential methods of tax-free profit repatriation – dividends out of after-tax retained earnings, Brazil's interest on accounting equity as well as on debt, return of capital

Brazil – Distributions via Interest on Equity vs. Debt

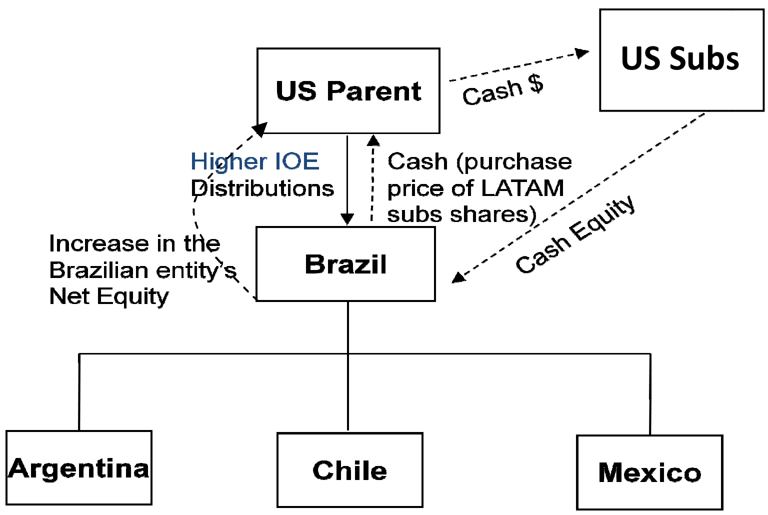
Most noteworthy were the alternatives in Brazil for the tax-efficient repatriation of profits to foreign investors via payment of interest on accounting equity ("IOE") as well as on debt ("IOD").

IOD paid to foreign lenders is typically constrained by Brazil's narrow thin capitalization rules that limit deductible interest based on a maximum debt:equity ratio of only 2:1 (reduced to 0.3:1 ratio for debt transactions with persons in a privileged tax regime or tax haven); whereas IOE paid to foreign investors is not subject to the thin capitalization limits. Accordingly, the recommended alternative for repatriating profits from Brazil was the payment of interest on equity that is over and above normal IOD; both of which are allowable deductions for Brazilian income tax purposes.

The allowable amount of IOE payable each year is based on up to 50% of current and retained earnings of a company's and its controlled subsidiaries accrued under Net Equity accounting rules allowed for Brazilian tax purposes. Both IOE as well as IOD paid to foreign investors are deductible at Brazil's corporate tax rate of 34%, but subject to Brazilian withholding tax of 15% (or 25% if paid to a tax haven resident) - i.e., generating a net after-tax saving benefit of 19% (or 9% if paid to tax haven residents). It was pointed out that where the recipient investor's jurisdiction treats IOE as eligible for a dividend participation exemption or at best an offsetting foreign tax credit, there should be no additional tax cost or, at least a lower overall net tax in investors hands.

Several planning strategies were suggested by the Brazilian panel members for optimization of IOE distributions. One such strategy was illustrated in the following schematic for structuring multi-national groups of LATAM subsidiaries under a single Brazilian holding company (and, in the restructuring process possibly extracting existing excess cash from a Brazilian subsidiary):

<u>PAYMENT of IOE</u>: Interest on Accounting Net Equity & Not subject to Thin Capitalization Limits



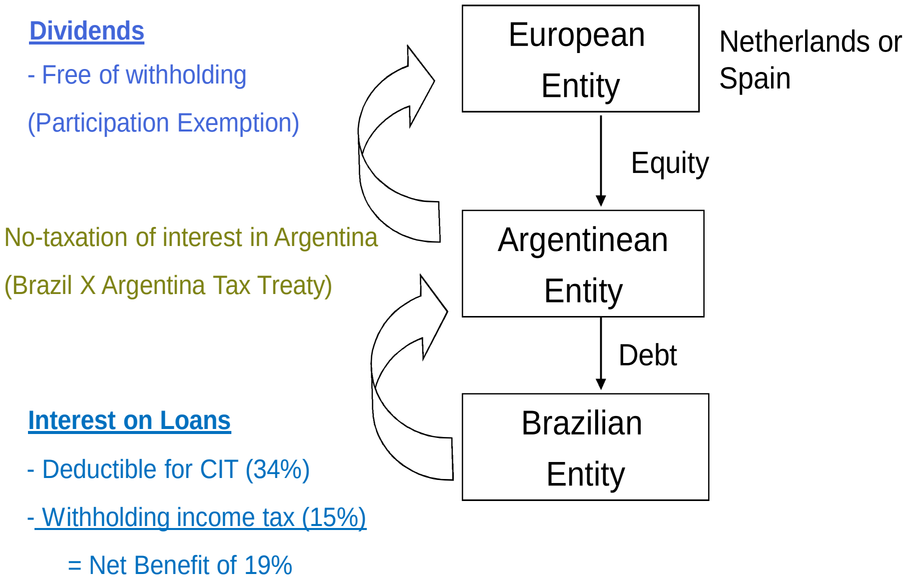
The above structure was presented to illustrate how cash dividend distributions to a U.S. parent can be accelerated via enhanced IOE distributions from the Brazil holding company. The Brazilian holding company's IOE earnings base would be boosted by recurring recognition of the underlying undistributed earnings of its other LATAM subsidiaries that can be accrued under the Net Equity accounting rules allowed for Brazilian IOE purposes. The higher IOE distributions (boosted by the group's consolidated current and retained earnings) would be fully deductible by the Brazil company @ 34% corporate income tax rate and not subject to limitations of the Brazilian thin-capitalization rules; but subject to Brazilian dividend withholding tax of 15% (no treaty reduction). For U. S. tax purposes, depending on the particular circumstances, the U.S. Parent may be able to claim that the IOE distribution should be considered as taxable dividend distributions, net of available foreign tax credits for any deemed paid Brazilian taxes.

At the same, Brazil's controlled foreign corporation (CFC) taxation rules would tax the Brazil company on its subsidiaries' annual earnings @ a corporate tax rate of 34%, net of tax credit for their underlying domestic income taxes paid for the year – i.e., taxed @ corporate income tax rate of 35% in Argentina, 20% in Chile and 30% in Mexico. If and when the other LATAM subsidiaries were to distribute their CFC tax-paid earnings by way of cash dividends, such intercompany dividend payments would be received tax-free by the Brazilian holding company. In the source countries, such cash dividends would be subject to relatively low withholding taxes given the dividend withholding tax rate on previously taxed earnings of 0% in both Argentina and Mexico, but effectively 15% in Chile under its integrated dividend withholding tax rate (i.e., 35% statutory withholding tax rate net of 20% corporate income tax creditable on dividends).

Where a group of LATAM subsidiaries presently exist as sister subsidiaries, there could be an additional cash extraction benefit from restructuring the group into the above structure with second tier subsidiaries under the Brazilian subsidiary serving as the group's holding company. Shares of the other LATAM subsidiaries would be transferred by the U.S. parent as a purchase for cash from the Brazilian subsidiary; utilizing either excess available cash in the Brazilian subsidiary or cash contributed down from other U.S. group subsidiaries into the Brazilian holding company for additional equity capital. Such re-structuring, however, would have to be carefully considered in the face of U.S. tax considerations, such as the possibility of triggering taxable deemed dividend distributions.

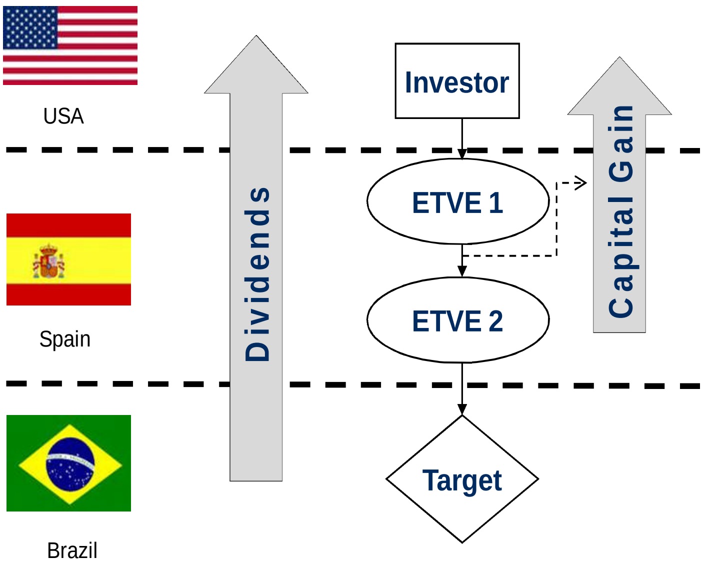
Also mentioned was that dividends from Argentina might be more ideally received if structured through an intermediary company in Spain or another European jurisdiction that adopts a dividend participation exemption; and where the dividend proceeds could be reinvested preferably on a more tax-effective basis rather than be distributed immediately to the U.S. parent. It was pointed out that use of a Spanish or other European intermediary is very common for U.S. Latin American structures.

Optimizing IOD deductions



The above structure was presented to illustrate use of an Argentinean entity as an intermediary to convert the Brazil entity's deductible IOD expense into preferential dividends for receipt by the European parent. The IOD paid to the Argentinean entity is deductible at Brazil's corporate tax rate of 34%, but subject to Brazilian withholding tax of 15% (or 25% if paid to a tax haven resident) - i.e., a net after-tax saving benefit of 19%. The IOD would be received tax-free by the intermediary entity in Argentina, where interest income is tax-exempt under a special provision of the Brazil-Argentina tax treaty. In turn, the tax-free interest income could be paid to the European parent by the Argentinean entity as a dividend out of after-tax earnings which is free of any dividend withholding tax in Argentina. The dividend income would be received in the European parent tax-free under a generic dividend participation exemption in such countries as the Netherlands or Spain. If this structure were used with a U.S. parent, then several factors would need to be analyzed, including possible future "Subpart F" taxable income considerations.

Brazil-Optimizing Capital Gains through Spain



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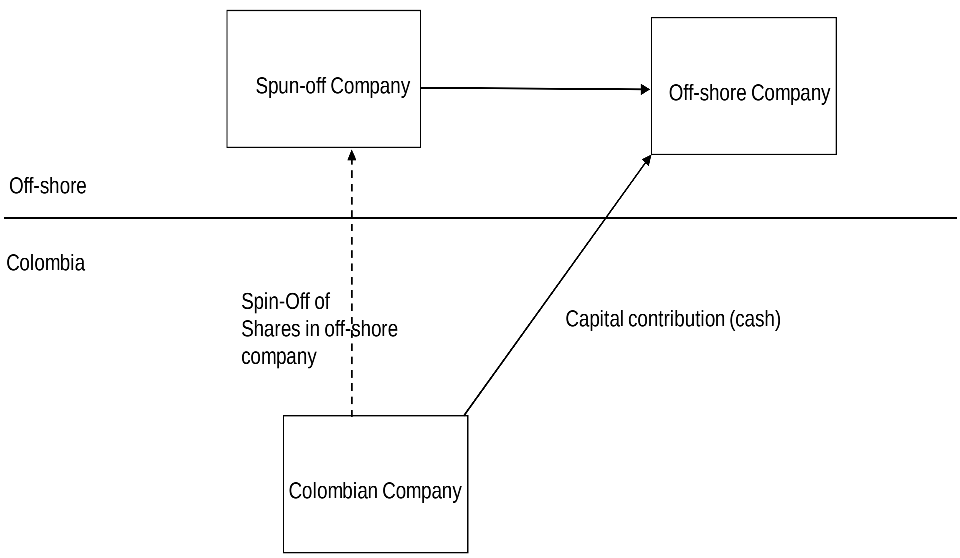
The above structure was presented to illustrate the advantages of utilizing Spanish ETVE companies as intermediaries to extract cash value of a Brazilian target company. An ETVE ("Entiidad de Tenencia de Valores Extranjeros") is a regular Spanish company subject to a 30% tax on its income including capital gains, but exempt from taxation on qualified foreign-source dividends and capital gains. Furthermore, outgoing dividends paid by an intermediary Spanish ETVE holding company to a parent corporation that is resident in a E.U. or treaty-partner country are free of withholding taxes in Spain, unless the parent corporation is in a jurisdiction where it will not pay corporate taxes equivalent to those levied in Spain. The ETVE must have an effective presence in Spain and must be an organization with substance and personnel (i.e. not be merely a brass plate company). Accordingly, the Spanish ETVE European holding company character, combined with Spain's broad tax treaty network with LATAM countries, make it an interesting vehicle for channeling inbound LATAM capital investments, as well as a tax-efficient exit route for repatriation of profits from LATAM countries.

In the above illustration, any realized capital gains from the direct sale of the Brazil target company shares would be subject to a 15% capital gains tax in Brazil. Alternatively, where the U.S. parent company's shareholdings of the Brazil target company can be structured to own the shares indirectly through a double-tiered Spanish ETVE holding companies structure (as illustrated above), taxable capital gains from selling the Brazilian target company shares can avoided. The capital gains value of the Brazilian target company would be effectively realized tax-free by causing the top-tier Spain ETVE holding company to sell its shareholdings of its subsidiary bottom-tier Spanish ETVE holding company (not the Brazilian target company itself). The top-tier Spanish ETVE holding company would realize the capital gains tax-free and be able to distribute the proceeds as a dividend free of withholding tax to the U.S. parent under Spain's domestic ETVE legislation. Income tax treatment in the U.S. would depend on a number of factors, such as whether "check-the-box" elections were made for any eligible entities in the structure.

Conceivably, such double-tiered holding company structures could be used in other intermediary jurisdictions, without the constraints of the Spanish ETVE rules, where capital gains are not taxed and foreign-source dividends can be received tax-free and distributed to foreign shareholders exempt from dividend withholding tax either under domestic tax law (eg., in Barbados), or otherwise via tax treaty.

Planning Idea – Spin-off Colombia



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The above illustration was presented as a recommended alternative to repatriate profits from Colombia tax-free to an offshore company. Cash would be contributed by the Colombian company to the offshore company in exchange for shares of the offshore company. In turn, the offshore company shares would be spun-off (e.g., via re-domiciliation) tax-free to the off-shore jurisdiction where the cash could be utilized in the offshore company (presumably tax-free) or extracted free of dividend withholding tax into the spun-off company. The spin-off of the offshore company shares is viewed as equivalent to a cash dividend which can be paid from Colombia free of withholding tax. If the spun-off company were a U.S. parent or an offshore company owned by a U.S. parent, then the transaction would need to be analyzed for taxable deemed dividend and other U.S. tax implications.

This document was not intended nor written to be used, and it cannot be used, for the purpose of avoiding penalties that may be imposed under U.S. Federal, State or local tax laws.

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