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## I. INTRODUCTION

Argentine tax authorities, aware of the implications of an increasing economic globalization, faced income tax reform, in order to restrict the action of multinational companies in respect of the use of techniques, through tax planning, which would cause the erosion of national tax bases. At the same time, Argentine tax authorities were also worried about the existence of tax havens, inasmuch as they offer adequate room for tax evasion.

Besides, the existence of them encourage money laundering and crime.

In consequence, in December 1999, important reforms were introduced to Income Tax Law, by which transfer pricing rules were reinforced.

In this respect, the new legal rules stated that any transaction between permanent establishments, corporations or partnerships residing in Argentina and individuals and companies residing in jurisdiction with low or no taxation regimes are deemed, not to have been concluded at arms' length.

We can see that in this situation there is a reversal in the burden of proof and in consequence taxpayers must present to tax authorities evidences that those transactions have taken place on normal open market commercial terms.

At the same time, new legal rules introduced the definition of controlled foreign corporation (CFC), as those organized or residing in jurisdictions with low or no taxation regimes, and obtaining their income wholly or partially from passive investments.

As we can see, it is necessary to define the concept of jurisdictions with low or no taxation regimes, which will be included, in accordance with mandatory legal rules, in a list with an enumeration of them, to be introduced to income tax regulations. At present, new regulations have not appeared, but they will do soon.

Before tax reform, Federal Tax Bureau had stated, through administrative rules, a general definition of low or no tax jurisdictions, in connection with information on transfer pricing to be supplied by taxpayers engaged in transactions with companies or individuals residing in those jurisdictions.

Tax authorities took into account, to state that definition, not only tax conditions, but also the existence of other circumstances, such as banking, financial and stock-exchange secrecy and ring-fencing. That general definition will be overridden, at being replaced by the aforesaid list.

In respect of thin capitalization, legal rules are, as we will see later, incidentally tied to the use of low or no taxation regimes. In this regard, it must be considered that those rules were introduced to Income Tax Law little before the introduction of the aforementioned provisions.

## II. IDENTIFICATION OF LOW TAX REGIMES.

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<sup>1</sup> Published in Cahiers de Droit Fiscal International 2001. Kluwer Editors – Amsterdam.

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In accordance with last mentioned reforms introduced to Income Tax Law during 1999, the concept of low tax regime is mainly applicable to transfer pricing. In this respect, article 15 of the mentioned legal statute, states that any transaction or operation between a permanent establishment situated in Argentina, or any resident corporation or partnership and individuals or companies situated in countries with low or no taxation, will not be considered, for tax purposes, as concluded at arm's length.

At the same time, the above mentioned legal rule states that the regulatory decree, must include a list with the enumeration of countries where there are low or no taxation regimes (designated jurisdictional approach).

At present, the regulatory rules are being elaborated and it is reasonable to think they will appear in a short time.

On October 12<sup>th</sup>, 1999, the Federal Tax Bureau stated administrative rules in order to collect information from taxpayers referring to transfer pricing.

In relation with the above mentioned provision of Article 15 of Income Tax Law, one of these administrative rules requires the supply of information about transactions concluded between resident taxpayers and legal entities or individuals residing in jurisdictions with low tax regimes (tax havens). This administrative rule includes a definition of this last concept.

Thus, it will be considered as a jurisdiction with low tax regimes, those countries or territories where income obtained by individuals or legal entities is not taxed or is subject to low taxation. The concept includes tax privileges granted to companies involved in specific activities, provided for by the commercial law or tax law of the country.

Besides, in the definition of a country with a low tax regime, one of the following circumstances must be taken into account:

- a) There is no access of tax authorities to information about banking, financial or stock exchange operations.
- b) Tax privileges granted to non-residents are not available for residents (ring fencing).
- c) Very simple legal requirements to form a corporation and lack of legal control over its operations.
- d) Lack of requirements about registration of shares in an approved stock exchange.
- e) Lack of accounting and auditing rules referred to the balance sheet of legal entities.
- f) Dividends, royalties, interest and other kinds of income paid to beneficial owners residing abroad are not subject to withholding tax.
- g) Discretionary granting of tax privileges by tax authorities.

It is remarkable that some of the above mentioned provisions are in line with those taken into account by the OECD in its papers referring to global tax co-operation (2000) and harmful tax competition (1998).

As aforesaid, this definition will be overridden at being replaced by the list to be included in Income Tax regulations.

It is important to remark that the mentioned list will contain only an enumeration of low or no taxation jurisdictions and not a general definition of them, and that it will be published, as all legal rules, in the Official Bulletin.

### III. DOMESTIC TAX PROVISIONS

#### **A) General anti-avoidance legal rules.**

As aforesaid, any transaction between permanent establishments situated in Argentina or resident companies or trusts and companies or individuals residing in jurisdictions with low or

no tax regimes, will not be considered as concluded at arm's length, in accordance with legal provisions contained in article 15 of Income Tax Law. The burden of proof to overcome this legal presumption is charged to the opposing party, in this case the taxpayer.

We have already stated that the described rules are mainly applied in transfer pricing. In this matter, administrative rules stated by Federal Tax Bureau impose on multinational enterprises the supply of information, every six-month, referring to transfer pricing.

As a general rule, article 14 of Income Tax Law states that any transaction or operation concluded between resident enterprises and associated enterprises residing abroad will be deemed as concluded between independent parties when the conditions of the transaction do not differ from those emerging from similar agreements concluded by not associated enterprises, on normal open market commercial terms. These provisions, as we can see, imply the application of the arm's length principle, which underlay this article.

If an adjustment of profits is necessary, when transfers have been made on other than arm's length terms, then the aforementioned provisions included in Article 15 of Income Tax Law, referring to transfer pricing will become applicable, to re-write the transaction.

Besides we must mention, that there are two main principles to be specially observed in the interpretation of tax rules which are consecrated for this purpose by Articles 1 and 2 of Procedural Tax Act.

Rules contained in the first mentioned article can be seen, up to a certain extent, as consecrating for tax law an important degree of autonomy in respect of common law. Principles provided for by this last assume an auxiliary character in respect of interpretation of tax law.

In accordance with the aforementioned Article 1 "legal tax provision must be interpreted according to their purpose and economic meaning. When it is not possible to state the meaning and scope of application of a tax legal rule by means of its wording and spirit, then interpretation must be made according to rules, concepts and wording of common law."

Provisions contained in Article 2 of Procedural Tax Act can be seen as legal barriers established against tax avoidance by taxpayers, similar to "substance versus form" or "abuse" rules consecrated in other countries' legislation.

According to this article, in the interpretation of tax law, competent authorities must pay special attention to economic purposes pursued by taxpayers and to economic links established between them. Special provisions must be applied when taxpayers, in concluding any agreement, use some legal structure or formula provided by common law, which is not the most convenient to express their real economic intentions. In those cases, in determining the taxpayer's fiscal situation, authorities or courts, as the case may be, can take into account, to solve the case, the most adequate legal structure or formula which would more properly fit to the real economic intention of the parties (disregard of legal form).

In our opinion, our courts would not hesitate in applying all the aforementioned provisions and principles to the solution of some case submitted to its jurisdiction related to operations made with parties residing in countries with low or no taxation regimes, or to the use of those regimes by multinational enterprises.

In an interesting case law "Treas S.A." on 9/14/93, the Federal Supreme Court decided that in the absence of legal provisions referred to income obtained in tax havens, in this case the Principality of Liechtenstein, there were no reasons to support the position of Federal Tax Bureau in considering that income as emerging from sources within Argentina. The Court also decided that was illogical to impose on the taxpayer the burden of proof related to the origin of income, to overcome the tax administration's presumptions.<sup>2</sup>

In other situations, the Court of Appeal arrived at similar conclusions in cases submitted to its jurisdiction (Daglio, Eduardo Alfredo, 12/28/87, Lacasa, Federico A. 10/01/92).

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<sup>2</sup> El impacto de la Tributación sobre las Operaciones Internacionales - Campagnale, Catinot y Parrondo, Ed. La Ley, Bs.As. 1999, pag 297

We must observe that at the time of these courts' decisions, there were no legal provisions referring to countries with low or no taxation regimes, as those introduced to Income Tax Law in 1999.

## **B) Specific rules dealing with the use of low-tax regimes.**

### *Controlled Foreign Corporations (CFCs) rules*

In accordance with reforms introduced to Income Tax Law (article 133 item a)) in December 1999, income arising in passive investments, obtained by corporations organized or residing in jurisdictions with low or no taxation regimes, will be computed as taxable income by resident shareholders, regardless of their distribution as dividends.

We can assure that the general policy objectives pursued by tax reform were to prevent the diversion of passive income to CFCs organized in tax havens and to avoid the accumulation of such income in them. Besides, legal rules could be useful in deterring companies from operating through tax havens.

As we can see, only foreign corporations are subject to CFC rules and for identification of jurisdictions with low or no taxation regimes, the same list aforementioned must be used (designated jurisdiction approach).

In November 2000 income tax regulations set forth additional rules referring to CFCs. Both in Income Tax Law and subsequent regulations there is not a definition of a controlled foreign corporation. So, any resident shareholder must include tainted income as taxable in his income tax assessment, regardless of their capital or voting power in the CFC.

Indirect ownership rules have also been stated by regulations, in accordance with which rules on CFC will be applicable not only to direct investment made by resident shareholders, but also to indirect investments made by those CFCs in other companies residing in low or no taxation jurisdictions.

CFC rules state that only tainted income will be attributed to resident shareholders (tainted income approach).

Tainted income, as defined by law and regulatory rules, include rents (with the exception of companies engaged in immovable property), royalties, dividends, interest from lending and public bonds, interest arising from deposits in banks and investment companies, interest from derivatives not covering any kind of risks and profits emerging from the sales of shares.

It must be remarked that in accordance with new regulations, rules on CFCs will not be applicable if more than 50% of their gross profits are arising from business activities of any kind (commercial, industrial, agricultural activities).

It is highly probable that this statement will bring about some interpretative doubts. For instance, regulations do not state if the limit of 50% of gross profits must be reached year by year or through a period of time, which would be much more reasonable.

In respect of losses, if tainted income includes profits emerging from the sale of shares, losses having the same origin would only be attributed to those profits. Not compensated losses can be carried forward for a period of five years. No other foreign source losses can be attributed to shareholders residing in Argentina.

Under general provisions included in Income Tax Law, a tax credit should be granted to shareholders in respect of foreign income tax paid by the CFC.

Finally, dividends distributed out of passive income attributed to shareholders will not be included in global income of this last, in accordance with proceedings to be stated by tax administration.

### CHART OF RULES ON CFCs

Policy objectives	<ol style="list-style-type: none"> <li>1) To prevent the diversion of passive income to CFC's organized in tax havens.</li> <li>2) To prevent the accumulation of such income in CFCs in tax havens</li> <li>3) to deter companies from operating through tax havens.</li> </ol>
Definition of tax haven	Statutory black list of tax heavens
Definition of controlled foreign corporation (CFC)	<ol style="list-style-type: none"> <li>1) No minimum ownership requirement.</li> <li>2) Indirect ownership rules. Rules on CFCs are applicable not only to direct investments made by resident shareholders but also to indirect investments made by these CFCs in other companies residing in low or no taxation countries. No minimum ownership requirements for indirect investments.</li> </ol>
Attributed income	<p>Transactional approach. Tainted income includes rents (with the exception of companies engaged in immovable property), royalties, dividends, interest from lending and public bonds, interest arising from deposits in banks and investment companies, interest from derivatives not covering any kind of risks, profits emerging from the sale of shares.</p> <p>Rules on CFCs do not apply if more than 50% of gross profits obtained by the company are arising from business activities of any kind (commercial, industrial, agricultural activities).</p>
Domestic taxpayer to whom income of CFC is attributed	Incomes of CFCs are attributed to any shareholder regardless of their direct or indirect interest in the CFC.

#### Exemptions

1) For distributions	Dividends distributed out of passive income attributed to shareholders, in accordance with administrative rules to be stated by Federal Tax Bureau.
2) Industrial and commercial activity	Amounts of dividends exceeding passive income are taxable when they are paid to shareholders.
3) Motive exemption	To avoid double taxation on dividends paid out of passive income, as these last were included for tax assessment by shareholders on accrued basis.
4) Exemption for publicly traded CFC	N/A
5) de minimis exemption	None
6) Domestic taxpayers to whom income of CFC is attributed	Constructive ownership rules. Any shareholders regardless of his capital or voting power.

#### Relief provisions

1) Foreign taxes	Tax credit granted for foreign taxes paid by CFC
2) Losses	Only losses arising in the sale of shares are deducted from profits of the same origin. Not compensated losses of the same origin can be carried forward for five years. No losses can be deducted from tainted income attributable to shareholders.
3) Subsequent dividends	Not taxable.
4) Subsequent capital gain	No relief.
5) Income taxed under another country's CFC measures	No relief.

### *Deduction of expenses*

Under Argentine legal provisions, tax is charged on net income, both if the taxpayer is a resident or not. Net income derived by Argentine residents is assessed on actual basis, while Argentine net income derived by non-residents is presumed according to statutory rules in most cases.

In determining net income, residents are allowed the deduction of every expense incurred to obtain, maintain and preserve taxable income, which shall be identified with a class of gross income on the basis of factual relationship between the gross income and the expense and be allocated to it accordingly (Income Tax Law, article 80).

Where expenses are incurred to obtain taxable and not taxable income, thus being jointly related to the taxpayer's all income, they shall be apportioned, and will only be allowed the deduction of the proportion which is related to taxable income.

There are no legal rules expressly tied to payments made in favor of entities or persons, which benefit abroad from a low tax regime.

It is highly probable that, in auditing the assessment of taxable income by taxpayers, fiscal authorities are more accurate in their proceedings, in this respect.

### *Administrative provisions relating to declarative obligations.*

We have already mentioned that the Federal Tax Bureau stated administrative rules to collect information on transfer pricing, and imposed the obligation of supplying such information on multinational enterprises (associated enterprises).

Besides, all companies, and trusts residing in Argentina and engaged in transactions with persons or companies residing in jurisdictions with low or no taxation are bound to supply information about those operations to tax administration. As aforementioned these operations will be deemed as not concluded at arm's length.

Transfer pricing rules apply in respect of the last mentioned operations, and companies should reassess their tax declarations, if they cannot prove the operations were concluded at arm's length.

Perhaps the obligation imposed on companies could have some usefulness in deterring companies from concluding operations related to countries with low or no taxation regimes. Besides, tax administration can generate a database for auditing proceedings, as useful as it can reveal the complexity of transactions in a globalize economy.

The above referred declarative obligations, (which are tied only to operations in connection with foreign countries), have a complementary character in relation to the assessment of the taxable net income of taxpayers.



There are no special sanctions provided for by the Procedural Tax Act in this respect. Penalties for formal infractions may be imposed on the taxpayer in the case of unfulfillment in the supply of information on their international operations.

### **C) Rules incidentally tied to low tax regime.**

In 1999, some legal rules were introduced to Income Tax Act, referring to the allowance for the deduction of interest in the case of companies, which could be considered as incidentally tied to the use of a low tax regime.

In accordance with those rules, 40% of interest emerging from financial liabilities are considered to be deductible in the assessment of taxable net income, while the deduction of 60% of its amount is subject to the fulfillment of two conditions, which must be taken jointly into account.

First, the debt to equity ratio must not exceed 2.5 (safe haven). Second, the amount of interest emerging from financial operations must not exceed 50% of taxable net income assessed before the deduction of interest.

In accordance with these rules, interest will not be deductible in the proportion attributable to the higher amount exceeding the referred limitations.

Due regard must be given to the fact that the referred limitations are applicable to debt-claims of any kind, even in the case the creditor is not an associated enterprise.

In connection with the aforementioned legal rules, some modifications were introduced in respect of the withholding tax to be imposed on payments of interest to financial entities residing abroad.

When those entities are residing in countries which central banks fulfil the standards for bank controlling stated by the Banks Committee of Basilea, the effective withholding tax is 15.03%.

If the central banks of the country of residence of the creditor do not observe those standards, the effective tax rate charged on interest is 35%.

The income tax regulations include a list enumerating the countries which central banks have adopted those standards, This list can be updated by the Ministry of Economy.

As we can regard, the referred legal rules have some connection with the probable existence of low tax regimes in the country of residence of the creditor.

## **IV. DOUBLE TAX CONVENTIONS**

Argentina has entered into conventions for the avoidance of double taxation with several countries, mainly with those which are State members of the OECD.

Our country has followed, in negotiating tax treaties, as a primary guide, the OECD Model Convention.

We can arrive at the conclusion in regarding the policy adopted by our country in respect of the negotiation of tax treaties with countries considered as tax havens, that tax authorities have refused to conclude tax conventions with them.

### *Entitlement to treaty benefits*

Our country, in negotiating treaties for the avoidance of double taxation, mainly in conventions recently concluded, agreed with the other Contracting States to insert a general provision restricting access to benefits of the treaty only to the beneficial owners of the payments.

In 1992, the Federal Tax Bureau stated administrative rules, binding to taxpayers, by which any person or entity with the intention of qualifying for a treaty benefits, has to prove to be a resident of the other contracting state. For this purpose, they have to obtain from the tax authorities of the State of residence a certificate in which that circumstance is formally attested.

There are other limitations to qualify for the benefits of Conventions Argentina have entered into, most of which have a general character.

For instance, in most Conventions, a reduced tax is charged on dividends, when the beneficial owner of them is a company holding at least 25% of the equity stock of the corporation paying the dividends. This provision is similar to that provided for by article 10 of OECD MC.

Other limitations take into account special rules provided for by the legislation of the Contracting States.

Thus, in convention with the United Kingdom, when one of the Contracting States grants reductions or exemptions of taxes for certain kinds of income, and taxation in the other contracting State is subject to the effective remittance of that income (tax deferral), the aforesaid reduction or exemption is only applicable to this last.

In Convention with Denmark, when profits attributable to a permanent establishment situated in Argentina are subject to reduced taxation or exempted of tax, Denmark grants full credit on those profits as if those exemptions or reductions would not have been applied (tax sparing). This clause is applied if the permanent establishment carries on effective business activities in Argentina and no more than 25% of those profits have origin in interest, sale of shares or in activities carried on in third countries.

In other treaties, Argentina entered into some territories under the sovereignty of the other contracting state, are not included in the territorial definition of that state (Ex. Groenland in the case of Denmark) as they are considered low or no tax jurisdictions.

As the principle of legality is consecrated in Article 19 of the National Constitution, and international treaties have to be passed by the National Congress, the aforesaid limitations are always included in the sections of the treaties.

#### *Tax Incentive Relives*

In respect of low-tax regimes in high-tax countries, we must remark that in last Double Taxation Conventions Argentina has entered into, tax incentive relief granted to taxpayers to encourage industrial or other kinds of economic activities consisting in the reduction or exemption of tax, are taken into account by the other Contracting States.

So in conventions with Denmark, Finland, Canada and the United Kingdom, tax credit is granted to taxpayers residing in those countries, in respect of the Argentine tax that would have been paid in case the referred reductions or exemptions would have not been applied.

This benefit has usually temporary limitations of about ten years.

#### *Administrative cooperation*

As Argentina has taken, in negotiation tax treaties, as a general guide, the OECD MC rules referring to exchange of information, as provided for by article 25 of that Model are included in them.

In fact, the exchange of information with the other contracting States has proved to be fluent, and is in charge of competent authorities (Secretary of Treasury). This exchange is mainly directed to prevent tax evasion and to avoid treaty shopping.

At present, tax authorities are engaged in encouraging this exchange of information, and are generally willing to negotiate tax treaties under these issues.

#### *Relationship between double tax conventions and domestic anti-avoidance rules.*



In accordance with article 75 (22) of the Constitution of the Argentine Nation, after the reforms introduced to it in 1994, international treaties take precedence over internal law.

On July 7<sup>th</sup>, 1992, the Federal Supreme Court, in case law “Ekmekdjian, v. Sofovich, Gerardo”, stated that all the branches of the State must give supremacy to an international treaty over any rule of our internal law in conflict with it.

In our country controversial situations arisen in the interpretation of tax treaties must be submitted to be solved to the jurisdiction of federal courts, including the Federal Supreme Court. In accordance with article 108 of National Constitution Federal courts are not limited at all in their ability to interpret tax treaties.

In 1937, the federal Supreme Court in case law “Scarcella v. Excise Tax Bureau” decided that tax rules had not be necessarily interpreted in the most restrictive sense allowed by the wording of legal statutes, but in the sense of making it possible to fulfill the purpose and object of the rule, due regard being made to the principles of a reasonable interpretation. These principles were repeated later in other decisions of our courts and became classic in the interpretation of tax rules.

We have already mentioned that articles 1 and 2 of Procedural Tax Act consecrate for tax law an important degree of autonomy in respect of common law, and that provisions contained in Article 2 of Procedural Tax Act can be seen as legal barriers stated against tax avoidance by the taxpayers, similar to “substance versus form” or “abuse” rules consecrated in other countries’ legislation.

All the aforesaid principles can be used in the interpretation of tax treaties, because even as they take precedence over internal law, their rules are incorporated to this last.

Anyway, no conflicts have arisen in the application or interpretation of tax treaties in respect of anti-avoidance rules provided for by law.

Perhaps, we can find the reason of this in the fact that domestic anti-avoidance provisions are in line with those included in tax treaties, as that provided for by article 9 of OECD MC, which was taken as a guide for negotiation.

As a general approach we could state that anti-avoidance rules are a complement of those included in tax treaties and not conflicting with them.

Thus we could remark that, in some treaties (ex. Finland, Denmark), the adjustment proceedings provided for by article 9(2) of OECD MC, similarly included in these treaties, will not be applicable in cases of fraud, neglect or guilty omission.

In similar sense, in tax convention with Netherlands, each state makes reservations for the application of its domestic rules about thin capitalization.

As a proof of our assertions, there have not been case law in connection with this matter.

## V. OECD AND EU INITIATIVES AGAINST HARMFUL TAX COMPETITION

Argentina tax authorities agree with the purposes of the State Members of the OECD in countering harmful tax practices.

We must remark that Argentina tax authorities are in permanent contact with the OECD Committee on Fiscal Affairs, and perhaps they will try to be brought into a dialogue with the Forum on Harmful Tax Practices.

The authorities are also aware of the distortions caused in the global environment by harmful tax competition and by the existence of tax havens, and at the same time, the erosion in national tax bases caused by the existence of these last.

Besides, national authorities are far interested in the cooperation of these countries in disclosing and punishing criminal practices, and in avoiding money-laundering coming from those practices (ex. Narcotics trafficking).

In a general sense, the OECD issues on harmful tax competition were, among others, an important element to be taken into account in introducing legal reforms to Income Tax Law at the end of 1999.

Thus, there it has been included the concept of low or no taxation regimes and of controlled foreign companies (CFC). At the same time, tax authorities are making a list of tax havens.

It is highly probable that our country will improve new rules to reinforce those above commented.



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