ARGENTINA - TAX REFORM

With the goal of promoting investments and competitiveness, and in line with the BEPs measures, Argentina has enacted a major Income Tax Reform in December 2017.

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I. INTRODUCTION

On December 29, 2017, a comprehensive income tax reform (the "Reform") was published in the Official Gazette.

The Reform includes amendments concerning a wide variety of topics such as the corporate income tax, tax on dividends and profits distributions, financial investments, indirect transfers of shares, thin capitalization rules, permanent establishment, transfer pricing regulations and tax transparency rules, among others.

Due to the relevance of these amendments, taxpayers conducting business or planning to invest in Argentina should be aware of the Reform and assess its impact. Below follows a summary of the most relevant income tax amendments.

II. CORPORATE INCOME TAX

The Argentine corporate income tax has been set at 35%. The Reform has established a gradual reduction:

- FY 2018 and 2019: 30%
- Starting from FY 2020: 25%

Regarding dividend distribution, the equalization tax applicable to the excess of accumulated earnings at the end of the previous fiscal year (35% applicable to profits not previously taxed) is replaced by a withholding tax applied to distributed dividends or profits accrued as from fiscal year 2018.

Profit payments and dividend distributions are subject to an 13% income tax withholding. This rate is reduced to 7% for profits accrued as from fiscal year 2020.

In cases where a tax treaty applies[1], the maximum rate of the equalization tax or the income tax on dividends may be limited according to the particular provisions of each such treaty.

III. INDIRECT TRANSFER OF SHARES

According to the Reform, the income obtained by foreign residents arising from the indirect transfer of assets located in Argentina by way of transfer of shares of a foreign entity can be considered Argentine sourced if a number of conditions are met:

- The market value of the transferred shares is based, upon the sale or during the previous 12 months, on at least 30% of one or more assets located in Argentina. Assets should be valued at their fair market value.
- The transferred shares represent, upon the sale or during the previous 12 months, at least 10% of the foreign entity's assets.

The transfer of the foreign entity's shares is not subject to this provision if:

- Such shares were owned before the Reform entered into force.

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[1] Argentina has executed tax treaties with Australia, Belgium, Bolivia, Brazil, Canada, Chile, Denmark, Finland, France, Germany, Italy, Mexico, Norway, the Netherlands, the United Kingdom, Russia, Spain, Sweden, Switzerland and Uruguay.

- The transfer is performed within the same economic group.

IV. THIN CAPITALIZATION RULES

The general principle is that all expenses necessary to keep, maintain and preserve the source of income are tax deductible. However, thin capitalization rules have been incorporated to disallow the funding of resident companies through debt by considering as a dividend the portion of the debtor's financial interest.

Thin capitalization rules limit the deduction of certain categories of financial interest paid by companies other than banks and financial institutions and by unincorporated businesses. The following categories are fully deductible:

- Financial interest paid to resident estates and individuals: and
- Financial interest paid to a foreign party that is subject to a 35% withholding tax.

In order for the financial interest to be fully deductible, the taxpayer must pass the following statutory thin capitalization test. The Reform replaces the 2:1 debt-to-equity ratio for a limit in the deductibility of interest arising from loans with related parties of up to 30% of the taxpayer's taxable income (before deducting interest and amortizations).

If the taxpayer fails to pass the test, the portion of interest accrued on the excess of the taxpayer's indebtedness giving rise to financial interest -other than loans generating financial interest in categories (i) and (ii)- which exceeds the test will be considered dividend and will not be deductible for income tax purposes.

Taxpayers are entitled to carry forward excess non-deductible interest for 5 years and unused deduction capacity for 3 years.

V. PERMANENT ESTABLISHMENT

The Reform defines a permanent establishment in line with OCDE's definition.

A foreign resident is deemed to have a permanent establishment in Argentina if, among other particular situations:

- It has a building site or construction or installation project or supervises the activities related to them in Argentina for more than 6 months;
- It renders services in Argentina for more than 6 months in a 12 month-term whether directly or through its personnel or any other personnel hired to such end; and
- It carries out its activities in Argentina through a dependent agent.

Please note that certain activities that have a preparatory or auxiliary nature are not deemed to create a permanent establishment.

Permanent establishments are subject to income tax at a rate of 30% on their net income determined on a worldwide basis. This tax rate will be reduced to 25% starting from fiscal year 2020.

VI. FOREIGN CONTROLLED CORPORATION RULES

According to the Argentine Income Tax Law, non-resident stock companies are considered separate taxable entities, while all other forms of business entities (including foreign permanent establishments of local residents) are disregarded for income tax purposes in Argentina.

In the case of foreign permanent establishments of local residents, net income is attributed to the Argentine headquarters, even if the permanent establishment has not remitted any profits.

The Reform incorporates rules applicable to controlled foreign companies, such as establishing that the net income of a foreign company is attributed to the Argentine owner at the end of the fiscal year in case of:

- A trust domiciled abroad controlled by Argentine residents which main purpose is assets management.

- Controlled Foreign companies, provided that:

  i. The profits obtained by the foreign company are not subject to a different section of the Income Tax Law;

  ii. The Argentine resident directly or indirectly owns more than 50% of the foreign company; or if at least 30% of the foreign company's income is generated from an Argentine source passive income that is exempt from income tax for foreign residents;

  iii. The foreign company does not have the material means to perform its activities, or more than 50% of the foreign company's income is "passive income", or it generates direct or indirectly deductible expenses for Argentine related parties; and

  iv. The effective income tax rate paid by the foreign company in the foreign jurisdiction is less than 75% of the income tax it would be required to pay under the Income Tax Law.

VII. NON-COOPERATIVE AND LOW OR ZERO TAX JURISDICTIONS

The Reform defines non-cooperative and low or zero tax jurisdictions:

- Non-cooperative jurisdictions: Countries or jurisdictions that have not entered into a tax information exchange agreement with Argentina or a tax treaty that includes a broad exchange of information.

- Zero-tax or low-tax jurisdictions: Countries, jurisdictions or special tax programs whose maximum corporate income tax rate is lower than 60% of the Argentine corporate income tax rate.

VIII. TRANSFER PRICING

The Reform includes a comment about International Intermediaries in the Transfer Pricing section and modified the so-called "Sixth Method".

1. International Intermediaries

Pursuant to the Reform, if an international intermediary is involved in an import-export operation, then it is necessary to evidence that the compensation paid to such intermediary is reasonable according to its functions and the assets and risks involved in the transaction.

This provision will only apply if:

- The international intermediary and the Argentine party are related parties, or
- The foreign counterparty and the Argentine party are related parties.

2. Sixth Method - Commodities

According to the Sixth Method, the price of an exportable commodity is determined, for transfer pricing purposes, according to the price in the transparent market on the shipment date, provided that such price is higher than the price agreed by the parties.

The Reform has limited the application of the Sixth Method to the export of commodities in which an international intermediary -as described in 1 or domiciled in a non-cooperative and low or zero tax jurisdiction- is involved. In those cases, the following requirements must be complied with:

- The substance of the international intermediary (e.g. the risks assumed, etc.) must be evidenced; and
- The agreement must be registered with the Argentine Tax Authorities.

If these requirements are not complied with, then the transaction price will be determined according to the price in the transparent market on the shipment date.

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If you have any question or comment regarding the foregoing, do not hesitate to contact us by calling at (54-11) 4326-7386, via fax to (54-11) 4326-7396 or via e-mail addressed to godoy@berettagodoy.com or balzano@berettagodoy.com.