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Challenges That Latin American Investors Face When Investing Into the United States

June 16, 2022

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The Panel

- **Co-Chairs**

  Fernando Camarena – Foley & Lardner México, S.C.

  Michael DiFronzo – PwC, Washington, DC.

- **Speakers**

  Ana Carolina Monguilod, i2a Legal, São Paulo

  Mauricio Piñeros Perdomo, Gómez Pinzón Abogados, Bogotá

  Michael Silva, McDermott Will & Emery, Miami, FL

  Rodrigo Stein, Cuatrecasas, Santiago

The Panel

Co-Chairs

Fernando Camarena -Fernando Camarena is a senior business and legal advisor on international and domestic tax issues in Mexico, providing both tax counseling and assistance with litigation. He represents small companies to Fortune 500, FTSE 100 and other global and brand name corporations in the energy, manufacturing, nutritional supplement, insurance and other industries.

Michael DiFronzo – US – Leads the Washington National Tax Practice for International Tax Services at PwC, formerly served as the Deputy Associate Chief Counsel (International-Technical) at IRS Chief Counsel.

The Panel

Speakers

Ana Carolina Monguilod – Brazil – head of tax of i2a Advogados, professor at Insper and director of ABDF (IFA Brazilian Branch).

Mauricio Piñeros – Colombia – Head of the tax law practice group of Gómez-Pinzón Abogados.

The Panel

Speakers

Michael Silva – US – Serves as Co-Head of the Latin America Affinity Group at McDermott Will & Emery, focuses his practice on international tax law, advises multinational corporations on establishing a business presence in the US.

Rodrigo Stein – Chile – Tax Partner at Cuatrecasas. Based in Santiago with extensive experience in corporate and international tax matters. Prior to joining the firm, he was the head of the tax & legal practice in Chile of one of the Big 4 accounting firms.

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1. U.S. Tax Challenges on inbound investment

U.S.A.

Latin American based multinationals – Current Significant Considerations

- Taxable business presence in the US in this new floating office environment - ECI, force-of-attraction, BPT
  - US sub vs. US branch
- Small treaty network between US and Latin America
  - In force: Mexico and Venezuela
  - Pending: Chile
    - Recent approval by the U.S. Senate Foreign Relations Committee - two reservations:
    - (i) BEAT on US residents or USPE; and (ii) relief of double taxation article (DRD as opposed to credits)
  - Negotiation in progress: Colombia
  - Rejected in the past: Brazil and Argentina

1. U.S. Tax Challenges on inbound investment

U.S.A.

- **Latin American based multinationals – Changes on the Horizon**

- Pillar 2: impact on inbounds, impact of the OECD

- Build Back Better: changes to the BEAT, secs. 163(j) and (n), sec. 7874

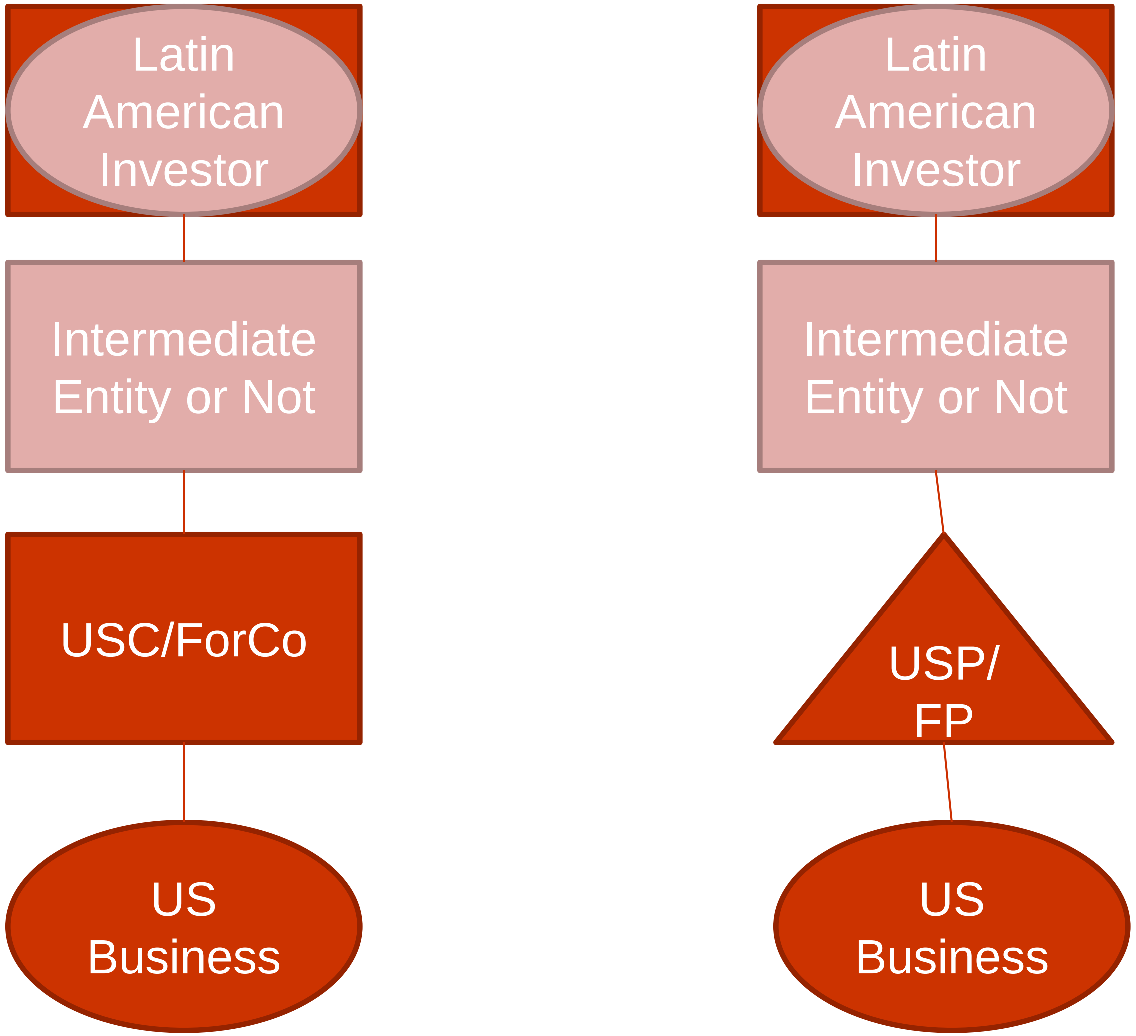
1. U.S. Tax Challenges on inbound investment

U.S.A.

Private Equity

- Fund structures - to block or not to block
  - To block: shield investors from ECI and UBTI, no WHT on capital gains, limit filing obligations, treaty considerations, AIVs/parallel funds/individual blockers for each investor, leveraged or not, sec. 385
    - blocker above or below the fund, parallel blocker
  - Not to block: single-level taxation, pass-through of character and losses, tax-free distribution of earnings, risk of ECI, BPT, UBTI, filing obligations
- Sovereign Wealth Funds and sec. 892
- Tax Exempt and UBTI
- Investment alternatives

1. U.S. Tax Challenges on inbound investment



1. U.S. Tax Challenges on inbound investment

Brazil

- **Summary of challenging issues**

- Lack of tax treaty with the US
- Very aggressive CFC rules
- Peculiar transfer pricing rules
- Limited Treaty Network

- **What can be taken from challenges:** tax systems asymmetries and lack of US-Brazil tax treaty tend to impair trading between these two countries. A perverse negative incentive. But with alternatives to work around it.

1. U.S. Tax Challenges on inbound investment

Chile

- US tax challenges for Chilean investors
  - No tax treaty with the US
  - Meet LOB test of US treaties when investing through another jurisdiction

1. U.S. Tax Challenges on inbound investment

Mexico

- Incentives for Mexican investors in the U.S.
  - Mexican corporate income tax rate vs U.S. Corporate income tax rate
  - Effects of the foreing-derived intangible income (FDII) in trading companies and share services companies established in the U.S.
  - U.S. Mexico Tax Treaty

2. Tax challenges Latam investors face in their residence countries on outbound investment

Double Taxation Relief

2. Tax challenges Latam investors face in their residence countries on outbound investment

Brazil

- **Foreign Tax Credits**
  - Direct and indirect foreign credits
  - With certain controversial points
  - Limited presumed credits (about to expire: 2022)

2. Tax challenges Latam investors face in their residence countries on outbound investment

Chile

- Double taxation relief - Foreign tax credit system (FTC)
  - Unilateral versus treaty-based relief
  - Direct FTC
  - Indirect or deemed credit
  - Individual and global limitations
  - Excess credit carry forward

2. Tax challenges Latam investors face in their residence countries on outbound investment

Colombia

- **Foreign Tax Credit**
  - Individuals residing in Colombia and Colombian companies who receive foreign source income subject to income tax in the country of origin, have the right to credit the income tax paid abroad for the payment of the Colombian income tax. The credit cannot exceed the amount of the Colombian income tax on the same income. For purposes of this limitation, the foreign source taxable income must be calculated allocating the corresponding costs and expenses.

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  - In the case of dividends distributed by foreign companies, Colombian tax law establishes a direct and an indirect tax credit. The Tax credit; however, is limited to the “effective tax rate” of the foreign tax. The “effective rate” is the percentage that results from dividing the value of the tax actually paid by the profits of the foreign company (before taxes). In order to credit the foreign income tax, it is necessary to evidence the payment of such foreign income tax

  - Only shares that constitute fixed assets of the Colombian taxpayer give right to the tax credit. Non-voting shares, portfolio investments and investments intended to speculate in stock markets do not give right to the foreign tax credit.

2. Tax challenges Latam investors face in their residence countries on outbound investment

Mexico

- Double Taxation Relief
- Relief under the U.S. – Mexico Tax Treaty
  - Article 24 provides general rules for domestic relief of double taxation
  - Provides reduced rates and elimination of tax
- Unilateral relief through the application of Foreign Tax Credit
  - Applicable to tax on dividends or profits
  - At least 10% ownership for the previous 6 months
  - Cannot exceed that tax that would have been paid in Mexico
  - Two tear ownership structures
  - Carry forward: 10 years
  - Credit not available if the dividend is a deductible expense (anti-hybrid rule)

2. Tax challenges Latam investors face in their residence countries on outbound investment

Tax Treaties

2. Tax challenges Latam investors face in their residence countries on outbound investment

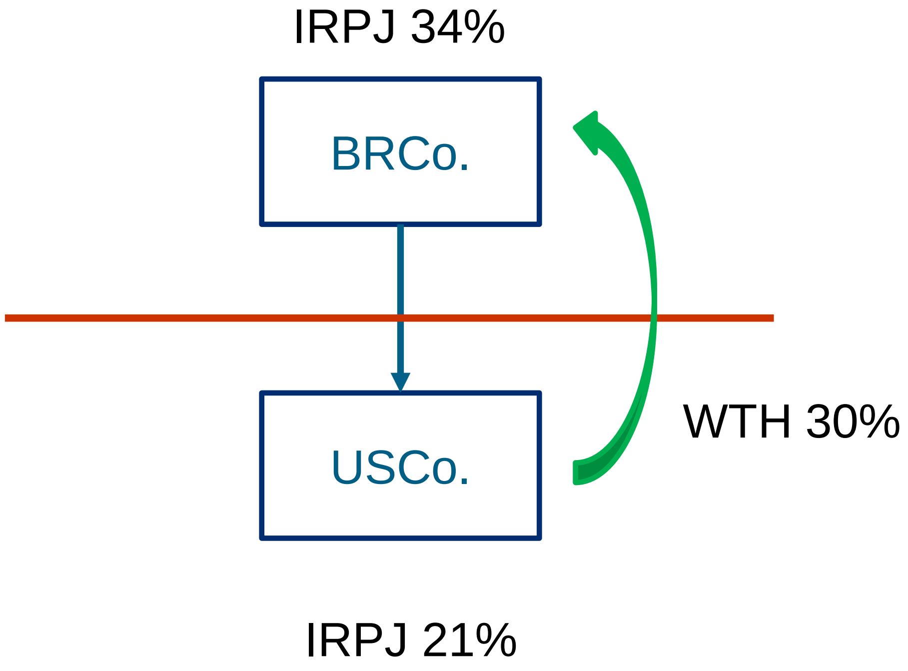
Brazil

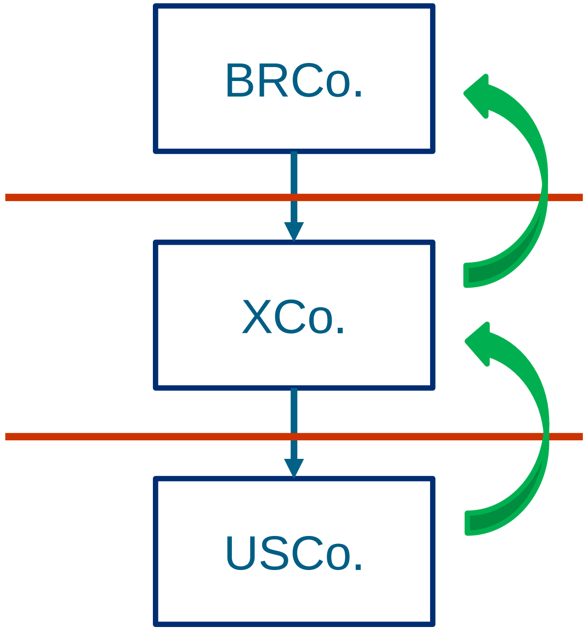
- Limited, but evolving, tax treaty network

2. Tax challenges Latam investors face in their residence countries on outbound investment

Brazil

- **A few interesting Treaty countries (to be used, of course, when there is substance etc.):** Austria, Luxemburg, the Netherlands…





2. Tax challenges Latam investors face in their residence countries on outbound investment

Chile

- Tax treaties
  - Treaty network
    - All Latam countries with few exceptions
    - Major European countries including Spain, UK, Ireland, Switzerland.
  - Dutch treaty signed in early 2021
  - US treaty pending ratification

2. Tax challenges Latam investors face in their residence countries on outbound investment

Mexico

- Mexico has an extensive network of treaties to avoid double taxation
- U.S. – Mexico Tax Treaty frequently applied by investors of both countries
- Based on the U.S. Model
- Mexico is frequently used as an “Investment bridge” as a result of the treaty (LOB provision)

2. Tax challenges Latam investors face in their residence countries on outbound investment

CFC Rules

2. Tax challenges Latam investors face in their residence countries on outbound investment

Brazil

- **Are the Brazilian CFC rules true CFC rules?**
- **Highlights**
  - Generally, 34% CIT rate
  - When does the CFC applies?
    - Controlled companies and specific affiliated companies *versus* other affiliated companies
  - Per entity approach
  - Limited consolidation possibilities (about to expire: 2022)

2. Tax challenges Latam investors face in their residence countries on outbound investment

Chile

- Anti-deferral: Controlled Foreign Corporation rules (CFC)
  - Concept of control
  - Low tax jurisdiction
  - Passive income
  - De minimis rules and safe harbors

2. Tax challenges Latam investors face in their residence countries on outbound investment

Colombia

- **CFC Rules**
  - CFCs are non-tax resident “entities” controlled by Colombian tax residents. (Includes companies, trusts, funds and private foundations, incorporated, operating or domiciled abroad, with or without legal entity

  - Colombian tax residents who have, directly or indirectly, a participation equal to or greater than 10% in the capital of CFC (or in its profits) will be subject to comply with the CFC regime

  - Passive taxable income is the result of adding all the passive revenue obtained by the CFC in the fiscal year, and subtracting the costs and deductions associated to said passive revenue

  - Passive income includes (i) Dividends, withdrawals and distributions (with certain exceptions) (ii) Interest (with certain exceptions) (iii) Income derived from the sale, use or exploitation of intangible assets, (iv) Income from the alienation of assets that generate passive income, (v) Income from the sale or lease of real estate, (vi) Income from the purchase or sale of tangible assets that meet certain conditions, and (vii) Income from technical services, technical assistance, administrative services, engineering, architectural o scientific services, between related parties, in a jurisdiction different from the residence or location of the CFC

  - Use of Colombian private equity funds to invest abroad

2. Tax challenges Latam investors face in their residence countries on outbound investment

Mexico

Control Foreign Corporation

- Anti deferral rules are applicable when investments are deemed to be in a low tax jurisdiction
- Mexico deems income to be subject to "low tax jurisdictions" when the corporate rate is not at least 75% of the Mexican income corporate rate. The current Mexican corporate rate is of 30%, thus the test to determine "low tax jurisdictions" in Mexico is of 22%
- U.S. federal and state income tax for purposes of the the low tax jurisdiction test
- Many specific rules and exemptions apply

2. Tax challenges Latam investors face in their residence countries on outbound investment

Use Of Offshore Jurisdictions

2. Tax challenges Latam investors face in their residence countries on outbound investment

Brazil

- Use of offshore jurisdictions
  - Tax implications: does not solve challenges and likely to make a bad scenario worse

2. Tax challenges Latam investors face in their residence countries on outbound investment

Chile

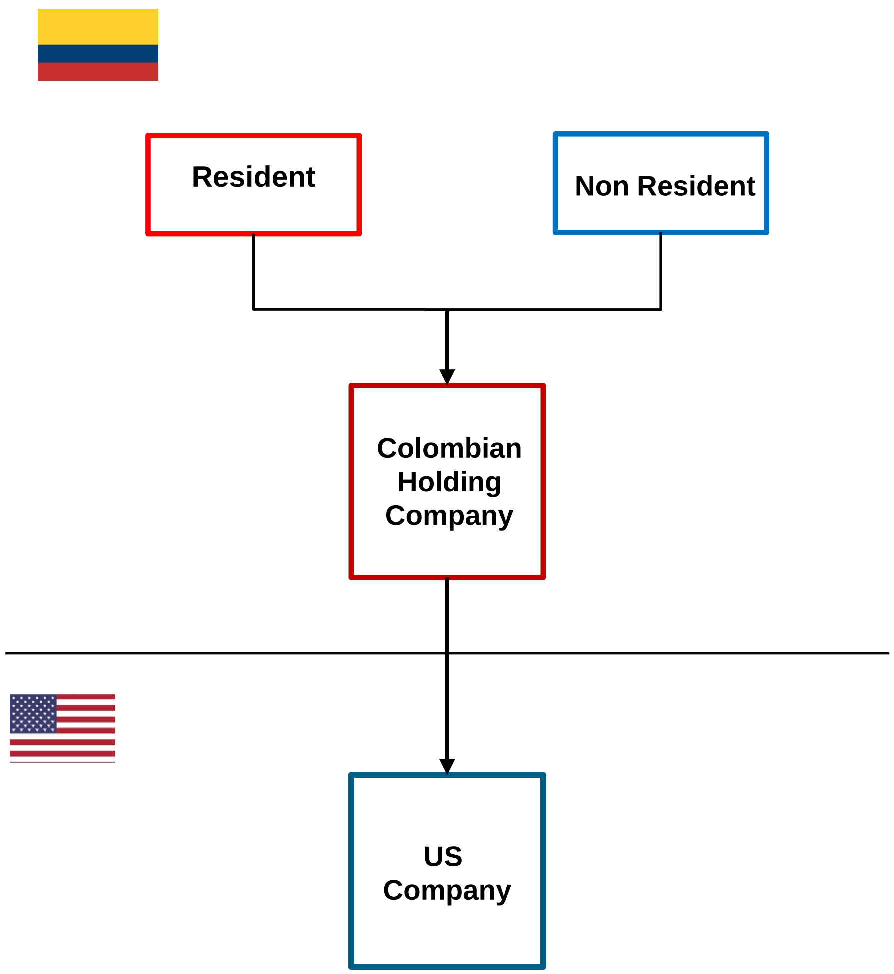
- Use of offshore jurisdictions
  - Definition of preferential tax system
  - Tax implications
    - Expense deductions
    - Transfer pricing
    - Thin capitalization
    - CFC

2. Tax challenges Latam investors face in their residence countries on outbound investment

Colombia

- **Investment through low-tax jurisdictions**
  - In Colombia, investment through companies located in low-tax jurisdictions does not generate adverse tax effects

2. Tax challenges Latam investors face in their residence countries on outbound



- **CHC Regimes**
  - CHCs are Colombian companies that have (i) Direct or indirect participation in at least 10% of the capital of two or more Colombian or foreign companies, for at least 12 months, and (ii) at least 3 employees, its own management in Colombia and can demonstrate that strategic decision-making regarding investments are adopted in Colombia.
  - Dividends paid by the US Company to the CHC are exempted in Colombia. Dividends distributed by a CHC to a non-resident shareholder are not subject to income tax in Colombia. Dividends distributed by a CHC to a resident in Colombia are subject to tax according to the general rules.
  - Capital gains obtained by the CHC and derived from the sale of the shares in a US company are not subject to tax in Colombia. Capital gains obtained by a non-resident shareholder of the CHC are not subject to tax in Colombia with respect to the portion of the sale attributable to the activities carried out by non-resident entities or the assets owned by non-resident entities.
  - CHC are considered Colombian residents for the purposes of the Tax Treaties signed by Colombia.

2. Tax challenges Latam investors face in their residence countries on outbound investment

Mexico

- Use of Offshore Juridictions
  - Many adverse consequences apply:
    - Reporting obligations
    - Application of anti deferral rules
    - Many rules to disallow deductible expenses paid to low tax jurisdictions

- Capital gains on the sale of entities of offshore jurisdictions are subject to a 25% rate on the gross of the purchase price

- Mexican withholding tax for source of wealth located in Mexico could be increased to a 40% rate

2. Tax challenges Latam investors face in their residence countries on outbound investment

Reporting Obligations

2. Tax challenges Latam investors face in their residence countries on outbound investment

Brazil

- Reporting Obligations
  - Many reports: very time consuming
  - Additional reports for subsidiaries abroad

2. Tax challenges Latam investors face in their residence countries on outbound investment

Chile

- Reporting Obligations
  - Central Bank
  - Registration of investment abroad with the SII
  - Annual reporting to the SII

2. Tax challenges Latam investors face in their residence countries on outbound investment

Colombia

- **Reporting and Compliance**

  - As a rule, taxpayers resident in Colombia are subject to file every year a report of the assets owned abroad, specifying the nature of each asset, it value and the jurisdiction in which is located

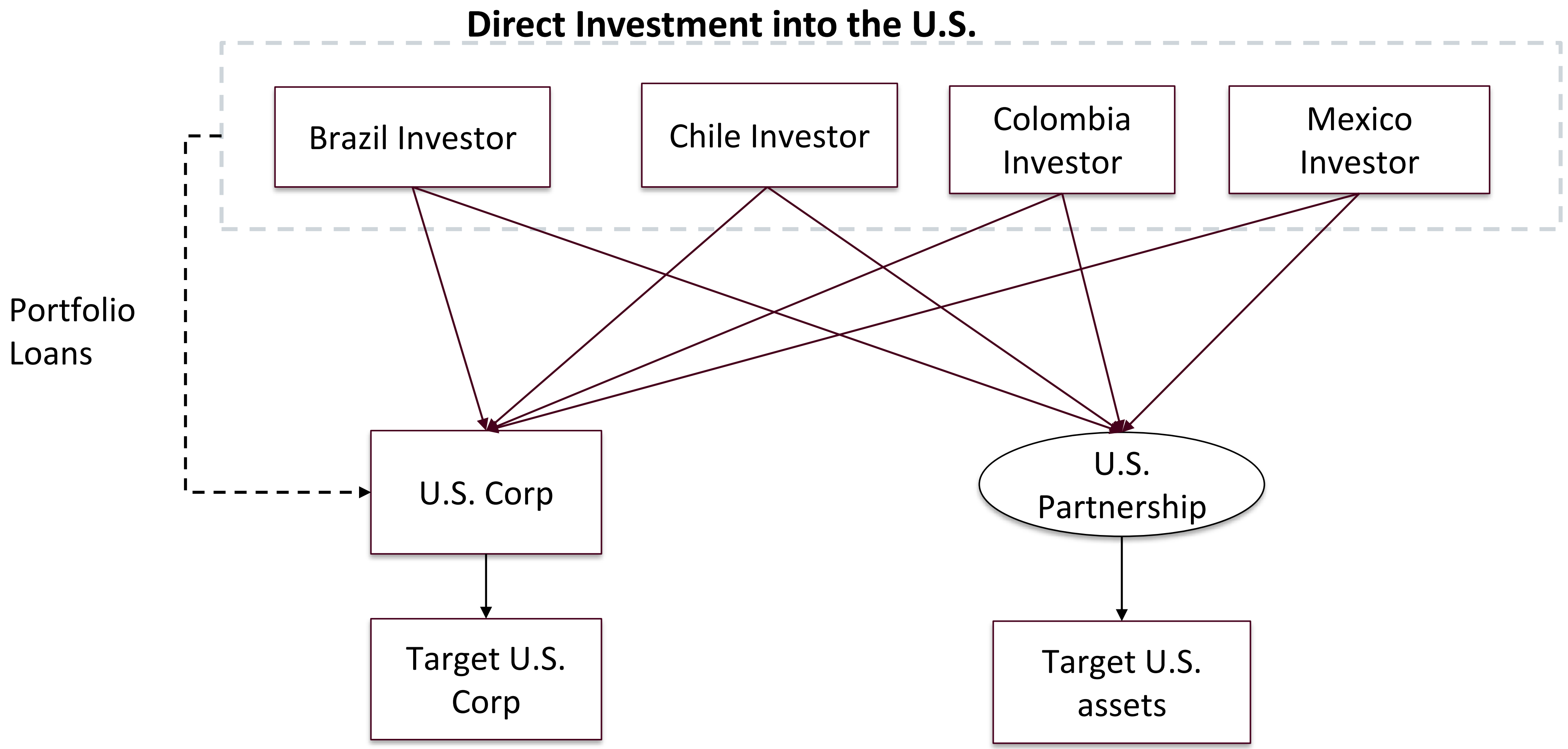
  - Capital investments made abroad must be registered with the Colombian Central Bank

2. Tax challenges Latam investors face in their residence countries on outbound investment

Mexico

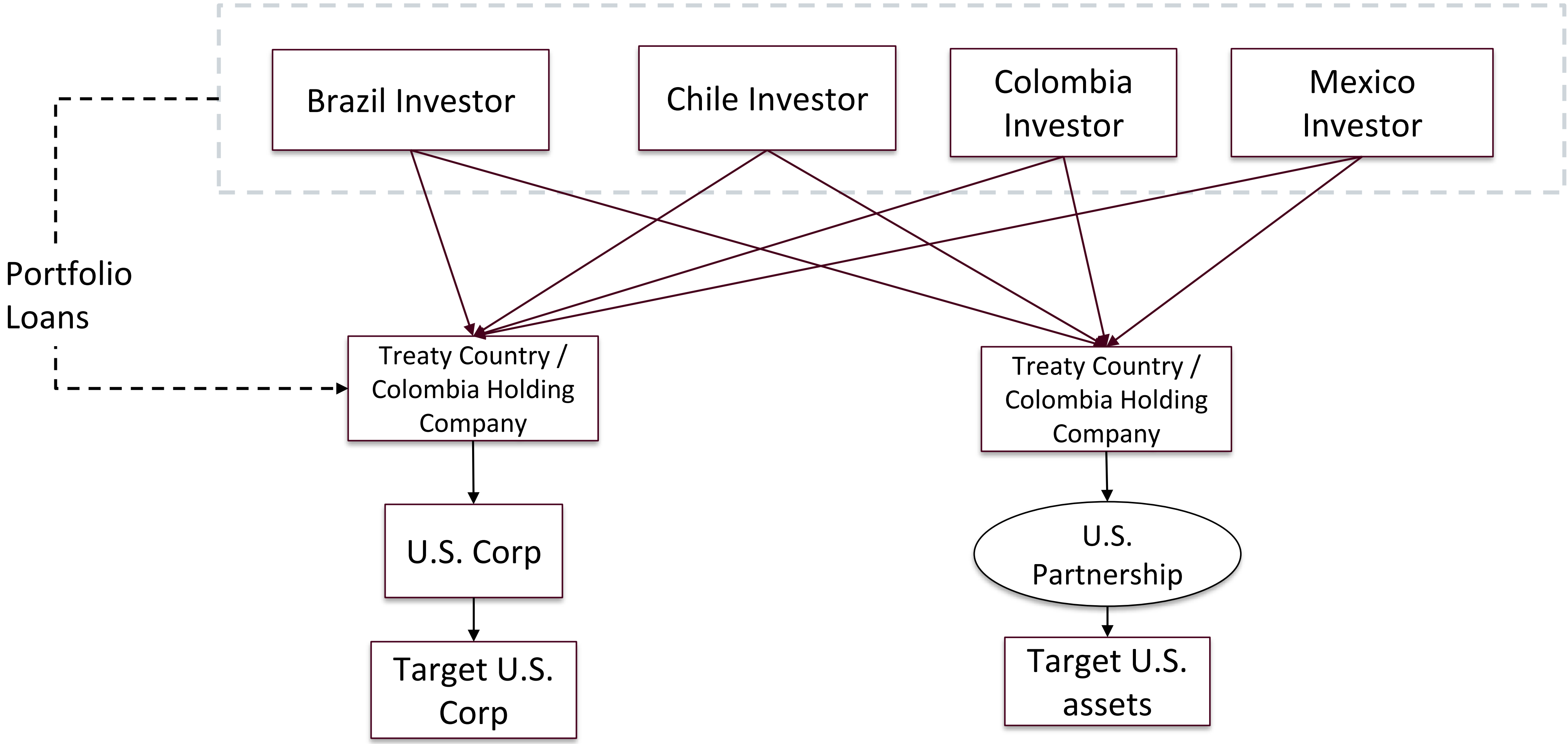
- Informative return for income of investments that qualify as investments in low tax jurisdictions (February of each year)
- New mandatory disclosure regime (Mexican equivalent to DAC 6)
    - Cross-border transactions among related parties that involve the transfer of intangibles which value is difficult to determine
    - Certain corporate restructures
    - Non remunerated transactions among related parties
    - The use of hybrid structures
    - Relevant consequences if reports are not filed
    - Applicable to taxpayers and tax professionals

3. Addressing U.S. inbound and Latam outbound issued



3. Addressing U.S. inbound and Latam outbound issued

U.S. Investment using offshore entity



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