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Recent Developments in International Taxation

Argentina

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Executive summary

The most significant international tax developments in Argentina between June 2021 and the date of this report are mainly related to:

- permanent establishment decision issued by the Federal Tax Court involving the treaty to avoid double taxation in force between Argentina and Belgium;
- long-awaited decision from the Argentine Supreme Court in a leading case dealing with alleged treaty abuse that involved the former treaty to avoid double taxation between Argentina and Chile patterned after the Andean Model Treaty;
- the Argentine tax authorities' disclosure of the non-exhaustive list of 'low- or nil-tax jurisdictions'; and
- the Multilateral Convention to Implement Tax Treaty Measures to Prevent Base Erosion and Profit Shifting (MLI) signed by Argentina on 7 June 2017 was submitted to Congress for approval in April 2022.

A. Federal Tax Court ruled out permanent establishment characterisation alleged by tax authorities

On 20 May 2022, the Federal Tax Court (Courtroom B) rejected the Argentine tax authorities’ position that alleged the existence of a permanent establishment in a case of royalties paid by an Argentine entity (‘Indupa’) to a foreign Belgian entity (‘Solvay’) under the treaty to avoid double taxation between Argentina and Belgium (the ‘AR-BE Treaty’).

Indupa hired from Solvay certain engineering services comprising technology – developed through experience and research – to expand its industrial plant in Bahía Blanca, Province of Buenos Aires. All the construction services were commissioned to an Argentine construction company (‘Techint’). The tax authorities claimed the existence of a permanent establishment based on the following arguments:

1. the construction works taking place in Argentina during a two-year period (considering the AR-BE Treaty provides a six-month threshold after which a permanent establishment is deemed to exist); and
2. the services conducted by Solvay during a seven-year period during which Solvay’s personnel was present in Argentine territory for an average of 58 days per year.

In challenging Indupa’s position, the tax authorities considered that Indupa was jointly and severally liable for Solvay's tax obligations and, at the same time, claimed that Indupa should have applied income tax withholding regimes applicable to payments between domestic parties rather than the income tax rate applicable to royalties under the AR-BE Treaty. Additionally, the tax authorities considered the application of the ten-year statute of limitations due to the lack of tax registration of the foreign entity.

With respect to the first argument concerning the length of the construction activities taking place in Argentina, the Federal Tax Court sustained that evidence clearly showed that the construction activities were conducted by an Argentine entity. Therefore, Solvay was not
involved in the conduct of construction works in the country, so the tax authorities’ argument based on this aspect was discarded.

Regarding the technology agreements executed between Indupa and Solvay for the provision of technical assistance related with the industrial plant, the Federal Tax Court analysed the provisions of the AR-BE Treaty dealing with permanent establishment characterisation when on-site services are provided. Said provision determines the existence of a permanent establishment when on-site services rendered by personnel of the foreign entity exceed ‘a period or periods aggregating more than six months within any 12-month period’. Based on said grounds, the Federal Tax Court highlighted that the tax inspectors expressly stated that Solvay’s personnel’s presence in Argentine territory had not exceeded a 58-day average period per year, concluding that the tax authorities were unsuccessful in proving that the minimum length of time required by the AR-BE Treaty to configure a permanent establishment was met.

### B. Argentine Supreme Court decides on controversial matter regarding application of treaty benefits

In a split three-to-one decision, the Argentine Supreme Court has finally reached a conclusion on a controversial and highly debated matter involving the grant of treaty benefits in an alleged ‘treaty abuse’ setting. The case involved an Argentine taxpayer (‘Molinos Argentina’) that incorporated a Chilean-based holding entity (‘Molinos Chile’) to which it contributed equity participations in three Uruguayan companies and in a Peruvian company. Dividends paid by Molinos Chile to Molinos Argentina – which mainly derived from dividend distributions made by the underlying Uruguayan and Peruvian entities – were treated as exempt by Molinos Argentina due to the provision stated under the by-then existing treaty to avoid taxation between Argentina and Chile structured under the Andean Model Treaty that granted exclusive taxing rights to the source country (‘AR-CH Treaty’). In turn, Molinos Chile, which was a holding Chilean entity incorporated under the Platform Company regime that provided no taxation for income derived from sources outside of Chile, was not subject to income tax in Chile on dividends distributed by the second-tier operating entities. The tax authorities challenged Molinos Argentina’s position claiming that the ‘double non-taxation’ scenario resulting from the interposition of Molinos Chile implied a ‘treaty abuse’ that discards the application of the exemption under the AR-CH Treaty, adding that the position adopted by the taxpayer was against a good faith construction of the terms of said treaty.

The tax authorities also invoked the ‘economic reality principle’ (Argentine domestic general anti-abuse rule (GAAR)) characterising Molinos Chile as a ‘conduit entity’, even when the AR-CH Treaty did not provide any specific rules on the application of domestic GAARs.

Prior to the Argentine Supreme Court’s decision, the Federal Tax Court and the Court of Appeals ruled against the taxpayer confirming the existence of a ‘treaty abuse’, further stating that the domestic GAAR (ie, the ‘economic reality principle’) did not conflict with the higher hierarchy of a treaty to avoid double taxation and could be freely invoked in a treaty context. The Prosecutor before the Supreme Court, instead, had ruled in favour of Molinos Argentina arguing that a legitimate tax saving action should not be questionable, and further stating that the AR-CH Treaty did not provide any anti-abuse measures requiring a minimum
level of substance or business purpose in the dividend distributing entity, thus discarding the application of domestic GAARs due to the AR-CH Treaty’s hierarchy vis-à-vis domestic laws.

In general terms, the Argentine Supreme Court’s decision held on 2 September 2021 reached the following conclusions:

1. Following the ‘good faith principle’ that guides the interpretation of international treaties and in accordance with public law recognised under the Argentine Constitution, treaties should not be construed in an abusive manner, regardless of the actual existence of an anti-abuse provision in the treaty under analysis.

2. The ‘good faith principle’ stated under the Vienna Convention on the Law of Treaties should not lead to a ‘double non-taxation’ scenario.

3. The ‘economic reality principle’ can be invoked in a treaty scenario. Therefore, the use of a legal structure that has no substance other than to avoid paying income tax in Argentina cannot be acceptable.

The dissenting vote of Justice Rosenkrantz was decided on the following grounds:

1. Pursuant to the ‘good faith principle’ ruling the interpretation of international treaties, Article 11 of the AR-CH Treaty providing for Chile’s exclusive taxing power over the distributed dividends offers no interpretative complexity to conclude that Chile was the only contracting State with the authority to tax dividends distributed by Molinos Chile.

2. Since the legislator could have included in the AR-CH Treaty, at the time of its approval, provisions to avoid ‘double non-taxation’ scenarios, it is not viable to introduce – by way of interpretation – requirements that the constitutional bodies in charge of the conclusion of treaties did not include in their text.

3. The source principle adopted by the AR-CH Treaty structured based on the Andean Model Treaty entails a certain possibility that none of the contracting States may tax a given concept of income.

4. Invoking the application of the ‘economic reality principle’ established under domestic law to disregard the provisions of Article 11 of the AR-CH Treaty implies a clear departure from the wording of said treaty that unilaterally alters the conditions agreed by two sovereign States, affecting the *pacta sunt servanda* principle and the interpretation rules set forth under the Vienna Convention on the Law of Treaties.

This precedent stands out for being a leading case in matters dealing with the use of treaties to avoid double taxation where the interaction of the applicable rules resulted in a double non-taxation scenario. Its significance also lies in the various principles of international taxation involved in the analysis made by each of the justices of the Argentine Supreme Court, including the ‘economic reality principle’ whose application in the context of treaties to avoid double taxation has finally been enshrined under the Argentine Supreme Court’s case law.
C. List of low- or nil- tax jurisdictions disclosed

The material tax reform enacted by Law 27,430 in December 2017 introduced many tax implications in transactions involving 'non-cooperative jurisdictions' and/or 'low- or nil- tax jurisdictions'. Consequences of dealing with any of these jurisdictions could include inter alia: being subject to presumptions on unjustified increase of net worth when funds flow through any of these jurisdictions; being required to comply with transfer pricing filings in transactions dealing with counterparties located in any of these jurisdictions; being required to deduct expenses on a cash basis when payments are made to entities located in these jurisdictions; and being subject to higher capital gains taxation rates when an investor in said jurisdictions sells Argentine financial assets (this is only applicable to parties incorporated in 'non-cooperative jurisdictions').

‘Non-cooperative jurisdictions’ are defined as: (i) those countries or jurisdictions that do not have an agreement for the exchange of information on tax matters in force with Argentina or a treaty to avoid double taxation with a broad clause for the exchange of information in force with Argentina; or (ii) those countries or jurisdictions that do have an agreement of the type described under (i), but do not actually comply with the exchange of information requirements. Argentine income tax implementing regulations currently contemplate a list of 95 jurisdictions included under this characterisation.5

In turn, ‘low- or nil- tax jurisdictions’ are defined as those countries, domains, jurisdictions, territories, associated states or special tax regimes in which the maximum corporate income tax rate is below 15 per cent. Argentine income tax rules did not contemplate the enactment of an exhaustive list providing certainty on which jurisdictions should be included under this category until June 2022 when the tax authorities published a guiding list on their website.6 The list contemplates 41 different jurisdictions under this category, excluding in certain cases business activities that could be taxed at rates that exceed the 15 per cent threshold.7

Interesting to note is the inclusion of some jurisdictions that have treaties to avoid double taxation in force with Argentina (ie, Qatar, Switzerland, United Arab Emirates), that had not been previously included in any blacklist for Argentine tax purposes.

The tax authorities state in their website that the list is not exhaustive and was prepared only for guidance purposes and without including any ‘special tax regime’ – statutorily defined as any regulation or specific scheme that departs from the general corporate tax regime applicable in a given country and results in an effective rate below that stated under the general regime – so the analysis of the characterisation under this category remains subject to the taxpayers’ due diligence.

The list is intended to apply for tax periods initiated on or after 1 January 2018.

D. Executive Power sends MLI for Congressional approval

On 7 June 2017, Argentina – together with many other jurisdictions – adhered to the MLI to amend its existing bilateral treaties in line with base erosion and profit shifting (BEPS) minimum standards and recommendations. Argentina’s ‘Covered Tax Agreements’ included all existing bilateral treaties to avoid double taxation in force by the date the MLI was signed – adding up to 17 treaties – excluding those in force with Bolivia, Brazil and Germany.8
Argentina committed to include the text of the preamble provided under the MLI, adopting also the minimum standard by means of the combination of a ‘principal purpose test’ (PPT) and a ‘simplified limitation on benefits’ provision (‘SLoB’).

Although Argentina evidenced a strong commitment to the initiatives developed by the OECD and the G-20, the MLI was sent to Congress to obtain its ratification on 1 April 2022, almost five years after Argentina’s adherence in June 2017. Despite this fact, MLI provisions and the revision to the 2017 OECD Model Tax Convention had material impact in subsequent negotiations and renegotiations of bilateral tax treaties. Treaties signed with Chile, Mexico and United Arab Emirates already included limitation on benefits clauses (although Argentina did not have a tradition in the use of these clauses). The Protocol amending the treaty with Brazil and the treaty in force with Qatar also included many MLI provisions and clauses provided under the 2017 OECD Model Tax Convention, as well as treaties signed with Austria, China, Japan, Luxembourg and Turkey, and an amendment Protocol to the treaty with France (which are still subject to Congressional approval for their entry into force).9

The long-expected ratification of MLI’s provisions, coupled with recent Argentine Supreme Court case law, will result in a renewed and updated focus regarding the application and interpretation of tax treaties in Argentina.

Notes:
2 See Article 5, paragraph 3, sub-paragraph (a) of the AR-BE Treaty.
3 Article 5, paragraph 3, sub-paragraph (b) of the AR-BE Treaty provides that the term ‘permanent establishment’ encompasses: ‘[…] the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only where activities of that nature continue (for the same or a connected project) within the country for a period or periods aggregating more than six months within any 12-month period […]’.
5 The current list of non-cooperative jurisdictions includes: Bosnia and Herzegovina; Brechou; Burkina Faso; State of Eritrea; State of the Vatican City; State of Libya; Independent State of Papua New Guinea; Plurinational State of Bolivia; Ascension Island; Sark Island; Santa Elena Island; Solomon Islands; The Federated States of Micronesia; Mongolia; Montenegro; Kingdom of Bhutan; Kingdom of Cambodia; Kingdom of Lesotho; Eswatini; Kingdom of Thailand; Kingdom of Tonga; Hashemite Kingdom of Jordan; Kyrgyz Republic; Arab Republic of Egypt; Syrian Arab Republic; Algerian Democratic and Popular Republic; Central African Republic; Cooperative Republic of Guyana; Republic of Angola; Republic of Belarus; Republic of Botswana; Republic of Burundi; Republic of Cape Verde; Republic of Ivory Coast; Republic of Cuba; Republic of the Philippines; Republic of Fiji; Republic of the Gambia; Republic of Guinea; Republic of Equatorial Guinea; Republic of Guinea-Bissau; Republic of Haiti; Republic of Honduras; Republic of Iraq; Republic of Kenya; Republic of Kiribati; Republic of the Union of Myanmar; Republic of Liberia; Republic of Madagascar; Republic of Malawi; Republic of Maldives; Republic of Mali; Republic of Mozambique; Republic of Namibia; Republic of Nicaragua; Republic of Palau; Republic of Rwanda; Republic of Sierra Leone; Republic of South Sudan; Republic of Suriname; Republic of Tajikistan; Republic of Trinidad and Tobago; Republic of Uzbekistan; Republic of Yemen; Republic of Djibouti; Republic of Zambia; Republic of Zimbabwe; Republic of Chad; Republic of the Niger; Republic of Paraguay; Republic of the Sudan; Democratic Republic of Sao Tome and Principe; Democratic Republic of East Timor; Republic of the Congo; Democratic Republic of the Congo; Federal Democratic Republic of Ethiopia; Lao People’s Democratic Republic; Socialist Democratic Republic of Sri Lanka; Federal Republic of Somalia; Federal Democratic Republic of Nepal; Gabonese Republic; Islamic Republic of Afghanistan; Islamic Republic of Iran; Islamic Republic of Mauritania; People’s Republic of Bangladesh; People’s Republic of Benin; Democratic People’s Republic of Korea; Socialist Republic of Vietnam; Togolese Republic; United Republic of Tanzania; Sultanate of Oman.
British Overseas Territory Pitcairn, Henderson, Ducie and Oeno Islands; Tristan da Cunha; Tuvalu; Union of the Comoros.

6 ‘Low- or nil- tax jurisdictions’: Andorra, Anguilla, the Ascension Islands, the Bahamas, Bahrain, Bermuda, Bosnia and Herzegovina, the British Virgin Islands, Bulgaria, the Caribbean Netherlands (the BES Islands), the Cayman Islands, Cyprus, Estonia, Gibraltar, Guernsey, Hungary, Ireland, the Isle of Man, Jersey, Kosovo, Kyrgyzstan, the Labuan Islands, Liechtenstein, Macao, the Marshall Islands, Moldavia, Montenegro, Niue, North Macedonia, Palau, Paraguay, the Pitcairn Islands, Qatar, Switzerland, Timor, Tristan de Acuña, Turks and Caicos, the United Arab Emirates, the US Virgin Islands, Uzbekistan and Vanuatu. See www.afip.gob.ar/fiscalidad-internacional/jurisdiccionens-no-cooperantes/jurisdicciones-baja-nula-tributacion/documentos/JBNT.pdf (in Spanish).

7 Andorra; Anguilla; Ascension Islands; Bahamas; State of Bahrain; Bermuda; Bosnia and Herzegovina; Bulgaria; Cayman Islands; Cyprus; United Arab Emirates (excluding Oil & Gas and banking activities); Estonia; Gibraltar; Guernsey (except for Oil & Gas and certain regulated activities taxed at 20 per cent); Hungary; Ireland; Isle Of Man; British Virgin Islands; Jersey (except for public services companies, hydrocarbon companies, rental and real estate developments and large commercialization companies taxed at 20%); Republic of Kosovo; Kyrgyzstan; Labuan Island; Liechtenstein; Macao; Northern Macedonia; Marshall Islands; Moldova; Montenegro; Nieu; Palaos; Paraguay; Pitcairn Islands; Qatar; Switzerland (only cantons, including: Appenzell Ausserrhoden, Appenzell Innerrhoden, Basel-Stadt, Fribourg, Geneva, Glarus, Lucerne, Neuchâtel, Nidwalden, Obwalden, Schaffhausen, Schwyz, St Gallen, Thurgau, Uri, Vaud, Zug); East Timor; Tristan de Acuña; Turks and Caicos Islands; Republic of Uzbekistan; Vanuatu.

8 Bilateral negotiations were allegedly taking place to amend the existing treaty with Germany and Brazil (although no new amendments were introduced to the treaty with Germany, the Protocol modifying the treaty with Brazil was finally signed on 21 July 2017 and is applicable as of 1 January 2019). The treaty to avoid double taxation in force with Bolivia was excluded as a ‘Covered Tax Agreement’ since it follows the Andean Model Treaty.

9 Treaties under current negotiations include Colombia, Germany, India, Israel, Kuwait and Saudi Arabia, although no texts have been disclosed.