Centro Interamericano de Administraciones Tributarias
Inter-American Center of Tax Administrations

Manual CIAT de Control del Planeamiento Tributario Internacional

Manual on International Tax Planning Control

Español

English

2007

CHAPTER I

INTERNATIONAL TAX PLANNING CONTROL

I. Introduction

I.1.The importance of controlling the international abusive tax planning in a globalized world.

Advances in the worldwide economic relationships and the rapid development reached by the process of globalization and computerization; as they bring important advances to the countries set in this context, they caused new challenges to the tax administrations regarding controls for the fulfilment of tax liabilities; including also the achievement of a more favourable environment for not only the performance of evasion acts, but also a wide variety of schemes and manoeuvres of international tax planning.

This process of worldwide economy development leads us to a state in which tax administrations cannot deal with the common concept of the taxpayer. This economic reality brought about the beginning of another type of taxable person, the worldwide taxpayer, without origin, to whom what really matters is the economic group's profit as a whole, instead of a single company or Headquarters' profit. Taxes are considered as a cost for them, and therefore must be reduced to a global level, maximizing the earnings of the company group.

What follows presents a brief evolution of the worldwide trade development and the multinational companies presence in the economies, which are decisive factors for the international tax planning improvement.

I.2 International trade and multinational companies flows.

International trade is still growing faster than world production, showing an increasing opening and interdependence of the national economies. In this process, it is worth mentioning the growing role of export trade flows of multinational companies, which explains why the fight against schemes and manoeuvres used for tax planning is increasingly attracting the attention of tax administrations and taxpayers.

Statistics of the World Trade Organization (WTO) for the year 2000 shows that foreign subsidiaries exports of multinational companies represents 45% of worldwide exports. A large extent of these exports are destined to other subsidiaries of the same group that, certainly, favours the adoption of international tax planning schemes among these economic groups. Besides, we must consider that global exports of multinational companies, including subsidiaries and headquarters, represents 60% of worldwide trade, which proves the strong control of these companies over the transactions of the goods and services worldwide trade.

It is worth noting that, 53% of the total transactions of this trade comes from the trade flows of the 8 (eight) following countries: USA (16%); Germany (8%); Japan (7%); United Kingdom (5%); France (5%); Canada (4%); Italy (3,5%) and China (4,5%).

It is also shown that international trade is made up of 80% of goods trade and 20% of services trade, even though services trade are growing much faster than goods trade. Undoubtedly, there was a diversification in export guidelines of developing countries which leads to an important advance in manufactured products as a result of the globalisation process.

A key point that must be taken into account and observed, though controlled as regards legal standards, is that trade among companies and carried out by multinational groups, plays an important role in the strategic planning of such organizations owing to the fact that its management at a worldwide level may help them to lower costs, to maximize the use of its productive units and to stimulate the integration of its productive processes worldwide.

It is important to highlight that trade among those related companies differs from trade among not associated companies because it can, within a short time, neutralize changes on relative prices, on exchange rates or on general economic conditions. Furthermore, prices charged by these companies in theirs transactions within the group may show specific determinants and characteristics, turning into transfer pricing which may affect tax bases in countries where these companies are located as well as distort financial flows worldwide.

Statistically, the data available shows that in 2001 there was approximately 65.000 multinational companies -at the same time distributed in another 850.000 subsidiaries abroad- responsible for 90 millions of direct jobs and, as it was aforementioned, controlling 60% of worldwide trade of goods and services.

Available information on the Atlas of the Multinational Corporation published by Dobla Inc. shows that in a list including the Gross Domestic Product (GDP) of all the countries of the world and the Gross Earnings of the Companies, from the first hundred (100), 53 of which are multinational companies (12 companies are in the first 50 from the list), which means that they are larger –regarding production- than over 130 countries in the world, since the main oil company in the world, positioned 21st in the list, has a level of earnings higher than the product of 180 countries.

What is certain is that as regards the current reality of the multinational groups, we can say that these companies – centralizing almost 30% of the worldwide production and covering 60% of the worldwide trade, with representations in almost all the countries – are empowered to dominate the worldwide trade.

Considering that the reduction of tax pressure worldwide may be one of key factors for these companies - together with the development of those countries which adopt preferential tax systems, and the advances in the financial system worldwide and the communication facilities - it may be worth noting that all the elements are together to foster international financial planning, that many times are abusive and malicious.

A key point to be considered in this global scenario, is related to flight of capitals from countries towards tax havens. Studies of “Tax Justice Network” pointed out that 11,5 trillions of American dollars of personal wealth are controlled offshore. Operations of capital transfers towards tax havens are real, which is more and more intensified. Such operations are specially appointed to those countries with favoured taxation.

Economic estimates show that if this tax were subject to taxes on its place of origin (considering an annual average growth of 7% for this fixed wealth), the volume of the collection, considering an average tax rate of 30%, would be approximately of 241 millions of American dollars annually. It should be bear in mind that this value does not include tax elusion, which is annually practiced in transactions that derives from abusive tax planning performed by multinational companies.

In this context, academic studies show that approximately 500 millions of American dollars flight annually from underdeveloped or developing countries as flight of capitals by means of corruption practices, commercial investigation of the weaknesses of tax systems of such countries and other means of flight of capitals in general.

It can be noticed that tax evasion, in all forms, means the loss of due tax incomes, attempts against equity in the distribution of the worldwide tax pressure, distorts the allocation of resources and involves a disloyal practice regarding legal conditions of competition in markets.

On the other hand, it becomes one of the most serious cases of unfair competition because, not only it is in non-compliance with legal standards, but also makes who practices it to take unfair, unjustified and illegal advantage comparing to other taxpayers who does not deal with this kind of operation.

In this context, strengthening international tax coordination among nations has become a basic element to reduce international tax evasion. Furthermore, efficient operation of tax cooperation contributes to guarantee that taxpayers who have access to international transactions may have not access to major possibilities of tax evasion and elision than of those taxpayers who only operate in their local markets.

I.3 General Objectives

International tax planning is a difficult issue for Tax Administrations, and must be approached by identifying the implications of the world economic situation today in each specific area of competence.

In effect, while international operations are not limited nor bound by borders, taxable events resulting from them must be controlled and verified by National Tax Administrations with national competence only.

Evidently this places before National Tax Authorities a great challenge as, in order to defend and protect the taxation interests of their jurisdictions, they must enforce, receive and audit tax payments that come under their area of responsibility in matters of international taxation.

As mentioned in the 2003 CIAT Technical Conference in Lisbon, “The speed and complexity with which world transactions are carried out have allowed taxpayers the use of a fiscal planning mechanism which, from the standpoint of this analysis, has favored the drainage of the tax base, either in favor of countries with low or no taxation or else, toward jurisdictions where tax advantages involve privileged tax regimes or, even, inaction on the part of the Tax Authority with regard to appropriate control of international operations.”

Awareness of this international problem led to great efforts on the part of certain International Organizations for providing mechanisms and recommendations to deter the creation and use of harmful tax planning practices.

This work does not seek to discredit those efforts, and addresses the issue from the perspective of the CIAT. Its aim is to directly favour and maximize the actions of tax administrations against the effects of harmful tax planning by strengthening mutual asisssistance in identifying and detecting the commercial and legal structures and mechanisms on which they are based, including cooperation in enforcing regulatory, administrative and auditing mechanisms in order to control and prevent them.

From this specific objective, the Working Group has set the general objective as:

“To exchange information on experiences and identify areas for cooperation and implementation of joint strategies by tax administrations, in order to effect international tax planning control and avoid harmful tax effects, particularly with respect to subsequent reductions in the tax base, rate arbitrage, tax payment deferment, credits and refunds, which would otherwise not arise”

Within this framework, participating countries have provided valuable information so as to:

1. Identify the problem that involves the international fiscal planning, recognizing the context in which is originated and the circumstances that facilitate its generation. Also it tries to visualize the role that assume its developers and the measures adopted on the subject.

2. Make known the actions of the Tax Administrations before international tax planning since both the adoption of an adequate structure to confront its control and discouragement and the interaction with other national and International Agencies –included the remaining Tax Administrations- as a

becoming and information producer and know-how mechanism that strengthen its role in the control of the international operations and the development of its specific missions of application and examination of the right decision of the base subject to imposition of each one of the taxes charged to it.

3. Detect structures and mechanisms used by taxpayers to set the fiscal planning, grouped depending on schemes in which said structures and mechanisms are developed with the identification of the administrative and legal measures which would had been adopted for counteract or to discourage the harmful effects that can produce.

4. Identify the procedures adopted by Tax Administrations in order to set international tax planning control. Those procedures include the processes of investigation, detection and inventory of indications to foster the audits with mention to concrete cases of audits.

I.4 Characteristics and scope of the work

The complex and constant evolution that frames the problem of the international tax and specifically of the extra-border fiscal planning, make necessary the continuity of the task developed by the Tax Administrations that are members of the working Party "International Tax Planning Control".

That is why, in order to this Manual have a constant utility, a mechanism of presentation and approach of the themes has been adopted , which facilitate their permanent updating to the pace the modifications that adopt the taxpayers in their actions, and that at the same time allow the remaining Tax Administrations that form of the CIAT to incorporate their own experiences in order to enrich the task faced within this Group so that constitute a tool of search and permanent training.

With that purpose, this work is designed in Chapters that contain a theoretical and technical description of the themes that are undertaken in each one of them, with the inclusion of links that permit the access to the cases, comments and pertinent experiences –identified by country- which have been contributed by each one of the Tax Administrations that form of the work team.

Thus, both the incorporation of new information and the updating of the information that composes this Manual, will be able to perform it through the only modification of the linked contents without altering in substantive form –except when necessary- the theoretical exposition of each one of the aspects that are undertaken in the present work.

CHAPTER II

II. INTERNATIONAL TAX PLANNING

II.1. Concept

Nowadays, the international context pose a series of mechanisms and strategies of commercial exchange that go beyond the geographical limits of the States, motivated –among others reasons- by the continuous technological changes mainly applied to the communication.

This upturn of the economic actors toward the gaining of new markets can be explained in the need to seek advanced technology -generated by the continuous advances in the matter-, that guarantees the reduction of necessary costs to maximize its benefits.

The objective of achieving and extending the consumption -internationalizing the commerce-, sounds attractive to obtain greater profits, but undoubtedly in every decision of investment to install in new markets, the tax cost plays an extremely important role.

So, one of the aspects that prevails in an economic group at the moment of making decisions of investment, is the tax structure that has the country receiver of this investment.

An economic group located in different fiscal jurisdictions will define its strategy of benefits in function of the profit that obtain each business in special, in order to consolidate its results. Thus, through a system of fiscal planning the contributors will be able to find the best alternative that allows them to minimize its tax burden.

In this regard, the international tax planning arises, concept that since the point of view of the collection of a country would be able to generate the decrease of its tax base, for that reason this is nowadays an outstanding theme of the agendas of the Fiscal Administrations of the entire world.

In that sense, not only the Fiscal Administrations should adapt themselves to this new economic reality, but in legislative matter the countries will need to reconcile their legitimate right to tax the utilities of their residents that be originated inside and outside of their territory with some caution in preventing to tax the same concept in more than one jurisdiction.

Thus, a vast quantity of nations in the world have adapted its legislations by means of the inclusion of the concept of world income, by which collecting the principle of territoriality of the source or origin –economic locating of the taxable fact-, and the principle of residence –in base to the continuance in fact of a subject in a determined fiscal jurisdiction by a determined prearranged period, intends Taxable matter pertaining to a Nation.

As it can be appreciated, the new setting challenges to the Tax Administrations to be more dynamic, to be able to be adapted to the new international economic conditions, to propose legislative changes in this matter and to expand its operating capacity to control and to audit the new business strategies that happened of a fiscal planning increasingly elaborated.

As it was mentioned, among the decisions of an economic group that acts commercially in different fiscal jurisdictions, to minimize the tax burden is an extremely important fact, and it can be achieved through the study of the facts and legal acts that develops an economic group and of the knowledge of the different existing tax systems in the countries in which has commercial presence, in other words through strategy or international tax planning

In this regard, the International Tax Planning arises like a strategic tool of business decision, which is characterized by a coordinated group of business behaviours, aimed at creating legal relations and situations directed to the optimization of the fiscal burden, inside the framework of legality, and with the clear objective of diminishing the tax cost.

This fiscal planning does not have in itself neither an aim of evading or eluding the tax burden, nor forging or feigning legal acts, facts that would cause an illicit one, on the contrary, inside the framework of legality it is claimed to seek the most efficient alternative to diminish the tax pressure that bear an economic group.

As it was mentioned by Javier Rodriguez Santos in the Manual of International Taxation of the Institute of Fiscal Studies of Spain: "In the international tax planning, it is not a matter of simulating acts or business but of really carry out the ones that are considered more convenient from the fiscal point of view among those that are legally alternative.", "… a fiscal plan, as well as being legal, it should be profitable, sure and consistent."

The international tax planning is based mainly on two axes, one is the knowledge of the international tax legislation and the other is the efficient development of the legal nature of the world operations; both of them permit to save resources in taxes.

Furthermore, the Tax Administrations in order to confront the problem of be diminished their tax bases, as a result of the execution of a tax planning by taxpayers, should adapt themselves and modernize in order to measure up their international transactions, whether through the updating of their legislations, the improvement the administrative structures and the management processes, audit or tax audits, and of advance in their relation with taxpayers and other tax administrations both domestics and international.

II.2. Description of the Problem

International Tax Planning is a complex issue for Tax Administrations, and must be approached by identifying the world economic implications.

The effect of the globalization has brought about that commercial operations be not limited by borders or fiscal jurisdictions, while the imposition that derive from the latter should be controlled for National Tax Administrations whose competence is limited to its country.

In this scenario a great challenge for the Tax Administrations, is posed in order to defend and to protect fiscal interests of their jurisdictions, for this purpose, they should be qualified to perform audits in order to control the correct statement of taxes and to apply their appropriate regulations to a context of international taxation.

The velocity and complexity with which international transactions take place have arisen in the taxpayers the use of tax planning mechanisms -harmful or not- through which they can achieve -among others-, the deferral of the obligation, to avoid the double taxation, to place incomes in countries with a smaller level of tax pressure, etc..

II.3. Harmful Tax Competition

In a context as the one described with international transactions of goods, services, capital, technology, among others, carried out in a framework of interaction between the legal- tax systems of two or more States, and through a strategy of coordinated action, whose purpose is to minimize tax effect, the interest of the States by attracting foreign investments appears, at the same time they retain the own investment, thus arising a constant Competition for offering the best opportunities of investment through tax incentives.

In that understanding, countries modify their tax and economic policies, for example diminishing the tax charge, affecting in this manner the decisions of other States that with the aim of locating activities and taxable bases, they are forced to amend their internal rules, generating a tax competition among territories, that can be healthy or not.

When Fiscal Competence among different States arises, it can concomitantly crop up the term of evasion of the States. Thus, since by means of the active cooperation by some countries in the hiding of incomes or wealth of non- resident individuals, they damage the fiscal interest of third parties States, what finally is translated in a harmful Tax Competence.

On the subject, the first factor that has cooperated in the appearance of the Harmful Tax Competence has been the virtual disappearance of borders considering the increase in the flow of goods and services, capital, transfer of technology, of information and the increase of funds flow seeking more profitable and new opportunities of placement.

All that, has been deepened by countries with responsible tax systems with the existence of tax heavens and the proliferation of tax regimes with very profitable conditions.

As it can be observed, in a context of globalization can appear not only the elusion and evasion caused by the taxpayers but also that of the States and with it a deep concern by the countries because the consequence of this harmful tax competition is made clear in the decrease of the world taxable base.

Thus, we can concluded that Harmful Tax competition, is a matter of a series of legal acts that, though they are aimed at optimizing the taxable bases, unfortunately these situations cross the limit of the lawful decrease of the tax burden.

Well then, it is worth mentioned to point out that the limits to the activities of International Tax Planning of companies, just as expounded Pietro Adonnino in "The International Tax Planning and tax Heavens" : "…they are constituted by rules against the elusion understood in the internal codes or in treaties signed by the States".

In that sense, adds the abovementioned author, that: "Keeping in mind the experiences reached in the different codes and the existing rules in them, whichever the legal plans adopted may be, …and the terminology used to identify the behaviour as elusive, the reconstruction of the notion of elusion is in fact, the same one and the legislative, technical or judicial means adopted for fighting the phenomenon of elusion in their different demonstrations are similar"

As a result, all assessment techniques to determine if an economic operation has been carried out with the intention to elude the tax payment tend to establish which was the economic result truly obtained by the parties, by means of the analysis of the real nature of the business beyond the legal form that the taxpayer has given to it and the appearance that they have.

In that sense, taking into account that there isn't a universal criteria about the subject we are dealing with, it will be mentioned some examples of Harmful Tax Competition or not:

-When a State hides incomes and wealth of a non resident person, exists likewise an illegal behaviour by the non resident persons because they primarily pretended to evade their taxes and subsequently they found the area that enabled that conduct. On this assumption, we can mentioned the countries of low or null taxation and to those jurisdictions that abet the impunity of the offender person.

-A State cooperates in tax elusion when it creates preferential regimes –an example of this is the constitution of holding companies - with the only fiscal purpose of offering tax advantages, injuring to third parties States. On the contrary, if tax systems were modified with the main of making them more neutral, efficient and simpler, of avoiding the discrimination, the double taxation and of enlarging the horizontal equity, we would be able to speak of a Healthy Tax Competition.

-Another example of Harmful Tax competition, is found in the refusal by the countries with privileged regimes to sign agreements with other countries by virtue of that said agreements assume the inclusion of clauses in favour of the exchange of information.

Is possible for the International Tax Planning the use, by businessmen, of the legal vacuum that have the legal codes of some territories. Nevertheless, in an opposite sense, we can find the use, by taxpayers, of legal instruments established by the States with a specific purpose, for different objectives from those for which they have been predicted, with the only motive that it permits to reduce the fiscal burden.

As instruments that the countries use in Harmful Tax competition can mention: that of including a legislation that permits the creation of the companies called off shore. If then, we add that said country have a network of agreements signed with other countries, these companies become Conduit Companies, otherwise the use of these companies will be that of the Base Company.

The analysis of the mechanisms and instruments whereby countries organize a tax structure, which harmfully competes against other fiscal systems allows for the identification of factors pointing to potential harmful practices. In other words, through the analysis of legal and tax structures in different countries, it is possible to identify and list those factors indicating probable harmfulness to the tax systems of other countries. Therefore, if these factors are analyzed together with the actual economic effects, they may indicate that a certain legal and tax system is a harmful preferential system.

The legal structures which determine the harmfulness of systems promoting harmful tax competition may be, among others, those which:

- Do not levy taxes on the most relevant economic transactions, or else grant low tax rates;

- Are not transparent with regard to domestic legislation, concealing the mechanisms leading to the creation and enforcement of legal and administrative provisions (non publicized actions);

- Inaccurately or artificially define the tax base, which precludes estimation of amounts involved in tax assessments;

- Adopt general exemption mechanisms for profits obtained from transactions involving non residents, in hand with a ban on business conducted with national residents;

- Allow for the creation of corporations of an exclusively legal nature, without requiring the development of actual economic activity; and

- Grant the tax authorities the right to negotiate the tax amount and payment methods with taxpayers.

As mentioned above, these characteristics could indicate that a certain tax system may be harmful. Nevertheless, the analysis should be made on a case by case basis, considering not only the potential harmfulness involved, but also the actual harmful effect on the other countries. Thus, some tax systems may not be considered harmful in spite of showing some of the above-mentioned characteristics since they may be justified within the context of the economic reality of the country.

It is necessary to distinguish between countries which show almost all of the determining factors mentioned above, among other harmful practices, added to uncooperative behavior when it comes to supplying information relative to business and transactions carried out in their territory. Recently, the OECD has adopted a new approach which indicates that the determining criterion for defining a country or jurisdiction as a harmful preferential tax system is the existence of an internal ban on the exchange of fiscal information. Thus, a country or jurisdiction would be defined as a tax haven and promoter of harmful tax competition when it deliberately refuses to supply tax-relevant data.

This new OECD approach has led to changes in the behavior of member countries. The inclusion of a country or jurisdiction in the category of tax haven is no longer determined by low or null taxation but on the actual possibility of exchange of information for the purpose of combating fraud and money laundering. As a result, the so-called black lists including countries and preferential tax systems whose features lend themselves to potential harmful tax competition started to include not only uncooperative countries but also those which do not commit to signing agreements for the exchange of fiscal information. In parallel, these jurisdictions have begun to be systematically approached, with a view to establishing specific agreements for the exchange of fiscal information.

On the other hand, with the aim of developing the present Chapter, the CIAT' s countries members have brought some legal and commercial structures and l mechanisms used by some taxpayers in international operations for tax fraud, evasion and/or elusion.

Additionally, the representatives of the participating Tax Administrations have contributed with information on the main developers of generating mechanisms of harmful fiscal planning. Besides, said representatives have collaborated with a description of those measures of administrative and regulatory restrain that permit to discourage said mechanisms, which are addressed in the present chapter.

II.3.1. Preferential regimes in countries where there is or is not information available

In order to attract foreign investment, many countries will use their tax systems to offer preferential regimes.

As such, tax competition is not necessarily harmful, nor is it used solely in places known as tax havens.

Here we will attempt to make assumptions regarding how the use of preferential regimes in one country may favor or give rise to fraud, tax avoidance and/or evasion in other countries.

Clearly, if the preferential regime in question exists in a jurisdiction where there is no access to information, the resulting lack of transparency may not only give rise to harmful planning practices but also create a high level of suspicion that through concealment of profitable activities, assets, financial holdings and financial movements there will continue to be an attempt to reduce the amount of taxable income, taxable events or assets which are subject to taxation.

On the contrary, when such preferential regimes are implemented in countries where there is access to international information, the problem is not directly linked to such concealment but rather to possible abuse of such preferential regimes or the provision of false results suggesting transactions or activities under preferential treatment, which in fact never took place.

ARGENTINA

Although regulations to discourage harmful tax practices have only recently been introduced in Argentine legislation, it has been possible, however, to identify operational modalities that generate these practices, and increase controls.

In this regard, the following examples are worth noting:

1.Modalities used by companies involved.

- Directing profits to jurisdictions with low or no taxation through transfer pricing manipulation.

- loss creation in companies established abroad, which are owned by local taxpayers, in such countries where there is no information exchange. In such cases, the results are included in the local taxpayer's worldwide income, and consequently taxable income in that country decreases.

  In some cases these circumstances have involved companies established in foreign jurisdictions with few or no accounting provisions, and resulted in a lack of credible balance sheets on which to base verification of results required for assessment of the Argentine income tax.

  These situations were tackled through the enforcement of transfer pricing regulations.

  - Borrowing concealed as export of assets, with advance payment and agreed long term delivery (7 to 10 years), implemented through trusts in tax havens and complex financial structures. In such cases losses in tax revenues occurred because taxes were not paid on loan yields that were in fact Argentine tax revenues.

- Agreement on technological service transactions with entities or individuals abroad suspected of never having taken place. These cases are being checked through auditing. On occasion when the foreign counterparts are situated in countries where double taxation agreements are in force, information exchange processes have been used to increase the means available for determining the tax interest.

- Borrowing from entities or individuals abroad with insufficient substantiating documentation. In certain cases, suspicion arises that the entity or individual abroad does not exist. Use is made of all available channels for obtaining information from abroad to determine if the transaction is non-existent and to dispute interest deduction in company tax accounts.

- Routing of export transactions through international intermediaries situated in jurisdictions where there is low or no taxation. In order to understand the magnitude of the problem, suffice it to mention that during certain periods 90 % of all Argentine traditional primary exports were recorded by entities or individuals in tax havens.

2.Modalities used by natural persons.

- Directing financial assets and property to trusts abroad to avoid paying taxes on personal wealth. This situation has been contested on occasions when it has been proved that although assets were transferred to an international trust, the local entity or individual still manages wealth in the trust and profits to own benefit. In fact, the wealth does not change hands.

CANADA

Different modalities include:

- Moving assets offshore to avoid paying Canadian tax. Barbados spousal trusts:

Canada taxes capital gains realized by its residents. In order to avoid paying Canadian tax, a Canadian taxpayer will settle a trust in Barbados. The taxpayer’s spouse is the sole beneficiary of the trust. The taxpayer then transfers shares of a Canadian corporation to the trust. This can be done at the cost value of the shares because the sole beneficiary of the trust is the spouse of the taxpayer. The shares are sold by the trust for fair market value which generates a substantial capital gain. The trust pays no Barbados tax or Canadian tax on the gain. The proceeds from the sale are returned to Canada free of tax.

A legislative amendment was made so that tax-free transfers are no longer available to spousal trusts that are not resident in Canada.

The Canada Revenue Agency is challenging a number of these types of arrangements on the basis that there was no transfer of property to the trust and that the trust was legally resident in Canada when the property was sold.

- Moving assets offshore to avoid paying Canadian tax. Canadian spousal trusts moved to Barbados

Following the amendment to the legislation noted above, tax planners continued with a variation of the arrangement. In this variation, trust is settled in Canada and the property is transferred to the trust while it is resident in Canada. Shortly thereafter, the Canadian trustee resigns and a new trustee, resident in Barbados, is appointed. Under common law, the residence of trust is determined by the location of the trustee. The trust then disposes of the property and pays no Barbados tax or Canadian tax on the capital gain. The proceeds of disposition are then returned to Canada free of tax.

Canadian law provides that when a resident of Canada, including a trust, moves from Canada, there is a disposition of capital property immediately prior to the move so that any accrued capital gains are realized and taxed in Canada up to the point in time immediately before the move.

It is the view of the Canada Revenue Agency that when the trust changes its residence to Barbados, there is a disposition of the property owned by the trust so that any capital gain is realized at that time and the gain is taxed in Canada.

Some tax planners are promoting this type of arrangement on the understanding that there is no disposition of the assets of the trust when it leaves Canada. Several of these types of files are currently being challenged and are before the Courts.

- Moving assets offshore to avoid paying Canadian tax. Health and welfare trusts

A Canadian corporation or an individual with a business settles a trust in a tax haven country for the benefit of a limited number of employees (often shareholders, spouses, and key employees). The corporation/individual claims substantial amounts and expenses the amounts transferred to the trust.

The amount paid to the trust represents a one-time payment to insure the principals of the corporation against long-term disability. Canada Revenue Agency is of the opinion that the payment is excessive and that there is no real insurance. The purpose of the arrangement is to move funds offshore to a tax haven for the ultimate benefit of the principal shareholder of the corporation. The Canadian taxpayer effectively remains in control of the funds.

These types of arrangements are being challenged on the basis that there is no real insurance being provided and the amounts are simply payments made for the benefit of the Canadian taxpayer.

CHILE

Different modalities include:

- Movement of profits, increasing the holding's income in countries where there are special tax regimes, in order to reduce the tax burden or generate losses where taxes are higher or there is greater control on taxpayer compliance.

- Making investments in tax havens, without subsequent inclusion of income derived from activities abroad in the parent company's consolidated balance sheet, in order to lower total taxable income earned within the country.

- Increasing costs and expenditure with respect to transactions in tax havens to reduce the tax burden within the country, thereby making it difficult to check the truthfulness of taxpayer documentation used to prove expenses incurred abroad.

MEXICO

Income tax regulations focus on three problems that involve the use of preferential regimes in countries where there is no information exchange:

a) Identification based on a list of countries where there are preferential regimes and no exchange of information. The list of countries included was taken from an OECD study. Additionally, legislation allows exclusion of countries from this list if they have effective agreements with Mexico on information exchange.

b) Payments made to residents of countries with preferential regimes, leading to two problems:

    - the Mexican authority – Mexico being the source country – is unable to verify if the income characterization is correct, as made by the parties; and

    - as these countries have lower or no effective tax rates compared to Mexico, companies in these countries have a competitive advantage, resulting in harmful business competition.

    Mexico has special legislation to counter this.

c) Investments of residents in Mexico in countries where there are preferential regimes

Whether there is information exchange or not, preferential regimes may cause investors who reside in a given country, such as Mexico, to move their capital to subsidiary companies in these other countries, resulting in a difference in accumulated revenues in Mexico, and consequently, to prevent this from happening, provisions are now in place with respect to countries where there are preferential regimes and no information exchange.

Despite such legislation, Mexico sees the need for similar provisions to be made regarding countries where there is information exchange but the effective tax rate is very low. This would include countries such as Switzerland, Luxembourg, the Netherlands, etc.

II.3.2. Treaty Shopping

Concern over the consequences of international double taxation is highlighted in nearly every paper about the topic, which has been an area under study for many decades now.

International legal double taxation can be defined as the result of the application of similar taxes, in two or more States, to the same taxpayer regarding the same taxable matter and in the same period of time. Causes derive not only from conflicting personalist jurisdictional principles, or jurisdictional principles with respect to territoriality, applied by States, but also from circumstances in which, despite the application of the same criterion, there is a different definition of who is a resident or where the source and/or the assets are located.

To avoid legal double taxation, States generally apply unilateral solutions, including: a) exemption for income earned by non-residents in the country of origin, or more often income earned abroad by residents; or b) crediting the corresponding tax, paid by those residents on foreign-source profits, in different ways.

Nevertheless, these measures are usually supplemented by each State signing many broad agreements for avoidance of double taxation (DTAs), usually of a bilateral nature, although there are also multilateral agreements in force such as the Nordic Agreement on Income and Wealth signed by Denmark, Finland, Norway and Sweden.

Similarly, regarding regional integration, harmonization of tax systems may be another way to avoid instances of double taxation, and this seems to be the trend for future developments within the European Union.

On signing these agreements for avoidance of international double taxation, contracting States give up a part of their fiscal sovereignty to this end.

For example, the OECD Model is based on giving exclusive competence for taxing certain types of income and/or wealth preferentially to the beneficiary's resident country, depending on the nature of the gains, although in the case of some gains taxation will be shared with the source country, but generally in a more limited manner in the latter country.

In such cases, double taxation adjustments are made in the resident country through the exemption method or by crediting the tax paid abroad.

This aspect is of particular relevance with respect to interest, dividends and fees or royalties, as the circumstance mentioned in the previous paragraph causes these incomes to be taxed in the source country at a lower rate, or may mean that they are simply not taxable.

Obviously, clauses in double taxation agreements are applicable to residents of these States in such cases.

Therefore, third party conduits (individuals or legal entities) are part of an international tax planning method used in jurisdictions with which a country has signed these agreements so as to benefit by their clauses.

The English term *treaty shopping* is used to designate the act planned by a resident person in none of the signatory countries with the aim of choosing the tax treaty more favourable to benefit a certain operation of transference of yields.

Treaty shopping shows the use of an Agreement of Double Imposition by a legal or natural person or person who holds a right, that with correctness, it lacks legitimacy to do it. The improper use of a Treaty consists of the situation that takes place when a resident of a third State that is not a contracting state establishes a legal person or organization within one of the contracting States of the treaty, with the aim of obtaining advantages of its forecasts.

This mechanism of tax planning causes a serious distortion in the implementation of the dispositions of the agreement to avoid double taxation. This happens because a person that is not resident of any of the Contracting States - condition that does not assure to him the benefits of the agreement - becomes to enjoy its tax advantages, which only correspond to the residents of the signatory countries. It is a question of the search of the most favourable convention for the effective beneficiary who is not resident and who; therefore, it would not have right to enjoy the agreement in normal conditions.

The aim of planning, in this case, is an operation that must be carried out by some resident of another country, with which its country of residence has not signed any agreement, or it has, but in less favourable conditions. By means of the interposition of a third person in one of the signatory countries of the profitable agreement, the not resident person become to fulfil the requisite of subjective connection of the agreement, that is to say, the residence. The consequence is the removal, as a result of the convention, of the regime applicable to the yield for the country of the source, advantage that the effective beneficiary would not have if it make not use of this mechanism.

In this sense, it is possible to emphasize that the abuse of Treaties gives way to the imbalance of the fiscal sacrifices agreed in them by the signatory countries, by virtue of which the resident subjects of a third State, unconnected with the contracting States, make the most of the advantages granted in the International treaties in question.

Treaty shopping is undertaken using the mentioned conduits in a signatory State, which usually offers special advantages, with the sole aim of benefiting from double taxation agreement provisions, thus reaping tax savings.

To prevent this situation from occurring, the model agreement has added anti-abuse clauses, the most relevant of which concerns the effective beneficiary. By virtue of this clause, recipients will benefit from this treaty only if they have a role different from mere intermediaries in channeling income. In fact, the recipients must have a real material presence and activities in the signatory jurisdiction.

ARGENTINA

Although there has been little practical experience on this, it is worth mentioning that in the case of most double taxation agreements, Argentina has included the “effective beneficiary” concept in order to benefit from them.

Consequently, in less clear-cut cases the information exchange mechanism is used to determine whether the individual or entity concerned, which receives the income abroad on which lower rates are applied, is the real beneficiary.

Furthermore, in order to apply the preferential treatment envisaged in the agreements, the Argentine tax Administration requires that a certificate be recognized by the tax Authority of the other contracting State specifying who is “the effective income beneficiary".

CANADA

Canada recently challenged a treaty shopping case at the Tax Court of Canada.

This case dealt with a corporation resident in the Cayman Islands. That company owned shares of a Canadian company. The value of the Canadian company was derived from natural resources and, accordingly, Canada maintains the right to tax non-residents on the disposition of shares of such companies. Approximately fifteen days before selling the shares of the Canadian company, the Cayman Island company moved to Luxembourg and claimed a exemption from Canadian tax pursuant to the Canada-Luxembourg tax convention. The tax at issue was approximately $500 million.

In Court, the Canada Revenue Agency argued that the general anti-avoidance rule applied to these transactions. The Court found, however, that the rule only applied to the Income Tax Act and not to the tax convention. The Agency also argued that the exemption under the tax treaty was only available to bona fide residents of Canada and Luxembourg and that this company was, in fact, a resident of the Cayman Islands and should not be granted treaty benefits under that convention. The Court ruled that there was nothing in the treaty itself to deny benefits.

Canada Revenue Agency has appealed this decision to a higher level of Court.

The full details of this case can be viewed at MIL (Investments) S A v. The Queen

CHILE

Different forms of tax evasion include:

- Use of a shell conduit company situated in a State that allows it to invoke the use of a favorable double taxation agreement, giving the impression that the transactions are being carried out through this conduit company.

- Making a false statement about actual residence in the country, in order to benefit from lower rates or exemptions envisaged in the double taxation agreement.

Nowadays our country has used the exchange of information with other Tax Administrations with the aim of verifying if the receiver of the revenues is the real effective beneficiary.

In order to apply the benefits understood in double taxation agreements, that is to say, to apply the reduced rate regarding a type of revenue, our regulation has stipulated that the beneficiary of the revenue must give to the withholding agent a certificate of residence that justifies his quality of such in a country with which current agreement exists.

At present, the Service of Internal Taxes issues a certificate of residence upon request of the interested person, if the later fulfils the corresponding requisites. This certificate makes possible to prove that the individualized taxpayer has domicile or residence in Chile for tax purposes or with the aim of applying an Agreement to avoid double taxation

MEXICO

There are certain concepts within its agreements that are anti-abuse rules, such as the “effective beneficiary” concept. With respect to some countries, Mexico has specific rules concerning profit restrictions such as with the United States of America. (Section 17).

II.3.3. Legal structures specially used for international tax planning including, among others, hybrid and /or nonconventional companies

The so-called companies off-shore are, in principle, companies illegally constituted according to the organization of it jurisdiction. Therefore, in no way the constitution of this kind of societies represent *a priori* an unlawful fact.

Nevertheless, the above- mentioned companies are usually used as instruments of an international tax planning which aim is to reduce or to eliminate the fiscal burden in the country of residence of the related company.

Where the companies off-shore are used within a tax planning, their aim is to make the most of fiscal advantages offered by certain countries or territories. Companies off-shore, whose capital always belongs to non resident persons, develop activities exclusively in countries that are different from its location. The off-shore regime consists of offering fiscal advantages to a company on the basis of two principal rules:

1) national persons of this country cannot enjoy these benefits, since they are granted exclusively to non resident companies and

2) it is “forbidden” for these companies to do business with the national persons of this country, and must direct their transactions abroad.

This type of companies is established in countries or areas which body of laws adopts the tax system named *participation exemption*. This system consists of the authorization of exemption, either total or partial, to capital dividends and profits gained out of the territory.

These companies can be used in different ways within an international tax planning.

Holding companies constituted pursuant to the off-shore system are intended to the participation, exclusively or not, in the principal of other companies abroad, which are normally located in countries with high tax rates. Holding companies are used as vehicle of investments to receive dividends, capital profit, interests in loans and remunerations on rights of license.

These companies offer as advantage the possibility of centralized control of the investments with decentralised management and the centralized financial management of the transnational group. From the fiscal point of view, the *holding companies* established in tax heavens aim to accumulate yields obtained by the whole group for the later distribution among partners. This mechanism avoids the financial double taxation and the taxation in the country of residence of the subsidiary companies. This is possible since some laws consider *holding companies* to be clear companies, excluding the profit obtained in the allocation of dividends among the companies in which they have participation.

Another way of using these companies off-shore is given under the form of the so-called *rent a star company*. In this case, it is about of companies constituted by natural persons (artists, athletes, models), so as to centralize the perception of high sums that said persons receive as remuneration for image rights and *cachets*.

With a different legal capacity from that of their partners, these companies allow the allocation of the revenue derived from the activity or right of the natural person towards countries with low or null taxation, reducing the tax base in their country of residence.

Companies off-shore can also be used under the form of “coordination centres ”. This form of association of companies is quite similar to that of the *holding*, although they neither acquire interest in companies nor carry out loans over certain limits. They develop activities of financial and administrative coordination of a multinational group, centralizing the flow of operations and of services.

Their fiscal advantages are compared with those of the *holding*. Their aim is to accumulate the yields obtained by the whole group for a later distribution, avoiding the economic double imposition, making use of the mechanism of *participation exemption*.

Companies off-shore assume the denomination of *conduit companies* when they are constituted with the purpose of mediating the acquisition of yields and profit between persons placed in two or more different jurisdictions.

They are shell companies that take part in the canalization of the revenues that would be produced in a country of high tax burden to another country of minor tax burden, which can be a tax heaven or a country with an extensive network of agreements with considerable fiscal advantages.

This form of tax planning is used, in most cases, to centralize the payment of dividends, interests and royalties.

Base companies are companies off-shore constituted to promote the re invoicing of goods, services or transactions with license of use of rights or to promote the generation of financial expenses which are fiscally deductible for the head office and branches.

These companies are not considered *holdings*, since they are not aimed at securing participation in the assets of other related companies, although they have the same purpose of accumulating yields and capital profit in areas of low or null taxation.

Base companies are used in a tax planning when:

- Purchase at normal prices in the exporting country and re-invoice said purchase at overvalued prices in the importer country (high tax burden);

- Purchase at undervalued prices in the exporting country (high tax burden) and re-invoice said purchase at normal market prices in the importer country.

Goods are directly sent from the country of origin to the recipient country, whereas the commercial transaction transits the area off-shore.

Another use of these bases companies, constituted in centers off-shore, it happens when they interhappen in the rendering of international services, generating expenses or deducible costs of the taxable base of the diverse group companies in different countries.

Also, we can mention the method of income attribution from hybrid companies consists of placing the responsibility of payment of taxes on profits earned by certain entities lacking legal corporate existence or tax subjectivity on their partners or members.

Use of partnerships in jurisdictions with favorable tax legislation can result in rate arbitrage and tax payment deferment.

However, the widespread use of Joint Ventures makes them an interesting topic of analysis; this refers to the association of business interests between two or more entities or individuals, usually without legal corporate existence, and often a subsequent designation or attribution of income earned by the joint enterprise or temporary association to those entities or individuals involved, simply for tax purposes.

Specifically, it is a question of identifying situations that allow taxpayers to carry out arbitrations from the different treatments that can grant the legislations of the countries (for example: a contribution that is considered as *capital* in a State and *debt* in other State) with regard to a same entity - hybrid entity - or instrument - hybrid instrument-.

ARGENTINA

About Companies off-shore, Argentina has a great expirience of fiscalitation, which is analized in subject related of transfer prices and in triangulations of operations.

There are no experiences of major significance related to hybrid companies. Nonetheless, the international fiscal transparency rules introduced into Argentine legislation are a valuable tool for countering effects.

CANADA

Tower structures often take advantage of hybrid entities that are classified differently under foreign and Canadian tax regimes, with differing tax consequences. For example, the foreign regime may have consolidated filing for tax purposes, and/or so called ‘check the box’ legislation that allows a hybrid entity to chose its structure for taxation purposes (partnership, corporation, etc.).

The CRA may apply paragraph 20(1)(c), the specific anti-avoidance provision in subsection 95(6), and the GAAR to combat abusive schemes involving hybrid entities.

MEXICO

The country does not recognize the notion of fiscal transparency that tax legislation in other countries applies to certain legal concepts –Partnerships and Trusts-.

II.3.4. Manipulation of legal forms in the organizational and restructuring processes of companies.

In an attempt to companies act in accord with the law, they must organize themselves under some of the forms established in the legal system. Therefore, they can be organized as sole proprietorship, sole proprietorship with limited responsibility, general partnership, limited liability company, stock company, limited partnership, joint ownerships, society of professionals, associations or participation accounts, etc.

The form of organization that takes a company, will depend among other factors on, the activity that it will undertake, the form in which the principal will be composed, the facility that is wanted in order to transfer the participation be this one in shares or societal rights, the form of administering the society and the limit of responsibility that the proprietors are ready to take.

Diverse are the reasons for which the proprietors of an already organized company and in full running, decide to modify its organizational structure. These reasons depend on the strategic aims that they pursue.

We can mention:

1. Commercial reasons: to make the most of technical and industrial knowledge that certain companies have in the manufacturing or making of certain products or services, to attract customers or potential clients through databases, market positioning, to improve the corporate identity through a well-known mark, etc.

2. Economic reasons: working with less personnel, diminishing fixed costs, economies of scale, etc.

3. Financial reasons: the companies that reorganize themselves have access to lines of credits and greater bank loans, preferential fees, complementary services of lower cost, better negotiation in relation to its creditors, etc.

4. Tax reasons: to diminish tax burden, to obtain tax refunds or to defer taxation.

Corporate reorganizations can also be promoted by tax reasons. These transactions that imply the transference of stock shares, which can give birth to new companies, are used as mechanisms in a tax planning, aiming at the economy of taxes.

In the case of the incorporation or the merger, a controlled company abroad, which obtains profit that must be burdened in the country of residence of the controlling company, joins or merges with another company of abroad, which has accumulated losses of previous tax periods. In the hypothesis in which tax legislation of the country of residence of the incorporating company does not prohibit such a practice, the results and the yields will be consolidated, which had been burdened if the incorporation would not have existed. They will stop composing the tax base, being neutralized by the absorption of losses of the incorporated company.

The corporate reorganization established through the figure of the split is used to avoid the incidence of the tax on the transfer of real estate *inter vivos*, especially when it implies properties of high value. In this case, a company is constituted between the seller and the buyer, forming the capital partly in money offered by the buying partner and partly with the property offered by the selling partner. Then, after a certain period, the company splits off. When the capital is withheld, the buying partner will leave the company with the real estate and the seller with the sum of money. Thus the incidence of the tax on the transmission on real estate buy-sell transactions is avoided

This type of planning is possible by virtue of the tax legislation of most of the countries, and it pursues the best allocation of resources between the companies, with a fiscally neutral effect regarding the movements of concentration and dispersal of companies.

ARGENTINA

Income tax legislation excludes taxation of profits that may derive from a company's reorganization processes, provided there is evidence of compliance with certain legal conditions.

There are many examples of manipulation of situations with the aim of benefiting from preferential treatments, but they all involve local reorganization, and do not include companies abroad.

Although there have been some cases involving foreign companies, they were few in number and not significant or consequential enough to be considered as international tax planning mechanisms.

CHILE

Different forms of tax avoidance include:

- The creation of shell intermediary companies in order to reduce the tax burden, such as an investment company that receives all dividends, share of company profits and any other income, postponing taxation to the taxpayer's benefit.

- Merging with the intention of using losses generated by another company, and resulting in company reorganization not for a legitimate business reason but simply to misuse tax benefits.-

- Building large and complex organizational structures so that relations or connections are confusing or difficult to detect.

- Transferring company shares or shareholder rights at lower-than-market prices, allegedly for the sole reason of restructuring companies in the holding and not with intent to profit from it.

- Creating companies that generate very low or no profits, simply for the purpose of bringing together all capital withdrawals so that they will no longer be taxed. This refers specifically to partners or individual entrepreneurs, since such taxpayers have caps on taxable income or profits generated by this company.

- Deduction of losses generated before a change in ownership of shareholder rights, shares or share in the profits, derived from income received or income due after the change.

- Losses generated abroad that affect the results of companies placed in Chile (Good will). These losses are generated since, as a result of the merger of the companies, assets and liabilities of the company or acquired companies, they are of a value lower than the cost corrected by the variation of the IPC rates of the shares purchased and entered into books, so that the produced difference - as it has been instructed by the Service of Internal Taxes through the pronouncement of diverse written communications- becomes part of non-monetary assets of the received company or companies, generating repeated losses as costs and depreciation of fixed assets.

MEXICO

Effective January 1st 2004, stricter rules were introduced concerning mergers and spin-offs. If requirements are not fulfilled as set out – minimum permanence time before and after the spin-off for all partners; that the company's activity before a merger be maintained afterwards; and the need to ask for authorization on undertaking a merger after a spin-off or another merger – this will be considered as a sale. (Section 14-B)

II.3.5. Moving effective company headquarters and residence for tax convenience

Although the location of company activities is influenced by economic reasons that are different from tax reasons (legal certainty and predictability, labor system, local currency stability, foreign investment rules, repatriation of profits, etc.), the tax aspect is an additional decision-making factor.

The most important tax aspect relates to taxation of the deemed investment profits.

Quite commonly tax planning envisages the possibility of investing in a jurisdiction through a company or a subsidiary, or through a branch that may later constitute a permanent establishment.

Effective company headquarters may be moved for the purpose of taking full benefit of preferential treatments, including those for holding companies, generally involving exemption for foreign source dividends and capital gains in the companies' resident State, and the existence of a network of agreements for avoidance of double taxation, applicable to such holding companies, giving the advantage of a lower tax rate in the dividend source country.

On the other hand, services and financial activities of the multinational group can be readily delocalized, and with respect to the latter it is important to have rules in place that will help counter possible tax abuse in the form of thin capitalization.

ARGENTINA

Experience has shown the Argentine Tax Authority that many affiliate companies, including stable establishments, are only formally established and are in charge of sales merely on paper.

Thus, companies have manipulated transfer pricing, and generated a high number of income transfers to other countries, including tax havens and countries with which there is no information exchange.

This situation was countered not only through auditing procedures but also through a change to income taxation in October 2003, when mechanisms were established for assessing export prices against widely known international prices in a transparent market, in cases when doubts exist with regard to the intermediary company’s economic standing.

In terms of an individual’s change of residence, most problems arise with regard to readily accessible neighboring countries and Mercosur partners.

Argentine citizens request to no longer be considered resident citizens, when they become residents of other countries mentioned above, and there is evidence of frequent entries and exits.

This is not always simple to verify as these countries and Argentina are Mercosur member states, with freedom of transit, and border entry and exit records are not always complete, rendering it difficult to check the number of days (183) envisaged under the tax law for setting up residence.

CANADA

Refer to II.3.2

CHILE

- Acquiring or obtaining residence in countries with a lower tax burden, without transferring the core business, family or investments, staying in the original resident country for a period of less than 183 days.

- Exiting the country where they carry out activities, before 183 days have elapsed, in order to not be resident in that country nor pay applicable taxes. There may be frequent exits, consequently making it even more difficult to add up the number of days spent there.

- Creating a company abroad to feign effective management or control from abroad, although activities in fact take place in that country.

- Setting up companies with the purpose of proving that the main business base is in that country, although in fact income is still being received from the country of origin.

This topic is still closely related to the transfer of intangibles, and marks one reason why the country has established an "exit tax" in section 12 of the Income Tax Act.

II.3.6. Permanent Establishments

Personal tax liability criteria, by which a State's power of taxation is based on the residence or nationality of the beneficiary of the income, and the territoriality criterion, which renders liable to taxation all income earned within a jurisdiction, are generally used by countries jointly. In this case, taxation of profits obtained by residents or nationals is based on criteria for worldwide income, while non-residents are taxed solely on profits earned domestically.

In addition, resident or non-resident status in a country is of relevance, resulting in the application or non-application of DTA, and determines the competent jurisdiction for taxation of different types of income.

A permanent establishment is constituted when a taxpayer, who is a resident of another State, carries out activities in a jurisdiction from fixed premises, or through dependent agents, or renders services for a set period of time. If the permanent establishment tax concept is met, it determines liability to taxation, and fulfillment of requirements for residence of that State, and it is considered, for tax purposes, that income earned by said Establishments (and their wealth) has been generated by a resident of that jurisdiction.

Description of this concept is essential for determining tax consequences, and can be found, to a greater or lesser degree, in a country's domestic legislation. However, when a DTA is applicable, the definition of the concept of permanent establishment contained therein will, by virtue of the superseding effect of such treaties, prevail over domestic legislation.

Unlike commercial companies or branches, Permanent Establishments do not have a different legal existence from that of their parent company.

Therefore, with respect to independent professionals, the OECD model convention referred to a fixed base that is simply a type of permanent establishment used by such professionals. For this reason, on including results earned by these professionals under company profits, the present version of the OECD CDI Model eliminates the distinction, and in fact includes the definition of fixed base in the notion of Permanent Establishment.

ARGENTINA

Please see II.3.1. and II.3.5.

With respect to agreements for avoidance of international double taxation, there is no information about cases where the existence or non-existence of permanent establishments was discussed.

CANADA

On December 21, 2006 the OECD Committee on Fiscal Affairs published new versions of Parts I, II and III of its Report on the Attribution of Profits to Permanent Establishments, along with a cover note containing an update on the status of that project. The project, which had been underway for several years, is aimed at achieving a greater consensus on the manner of attributing profits to permanent establishments under Article 7 (Business Profits) of the OECD Model Tax Convention, with a primary goal of avoiding double taxation.

The new versions of Parts I (General Considerations), II (Banks) and III (Global Trading) reflect the broad consensus of OECD member countries around an approach to attributing profits to permanent establishments which is based upon the arm's length principle as described in the 1995 OECD Transfer Pricing Guidelines. Previously published discussion drafts of Parts I-III are superseded by the new versions. The Committee announced that work on Part IV (Insurance), which was published in discussion draft form in 2005, is ongoing and that the intention is to publish a new version of Part IV as soon as possible.

CHILE

- Pretence of rendering simultaneous services for a period of less than 183 days in another country, and not providing services during an additional period of time, thus avoiding permanent establishment and subsequent payment of taxes on profits earned from the activity carried out there.

- Pretence of rendering services or transferring intangibles between the permanent establishment, generally a branch, and the parent company, in order to claim to have expenditure on a nonexistent or overpriced service, without prejudice to the provisions of the double taxation agreements with respect to permanent establishment expenditure.

- Appointing representatives without powers, or pretending that they have little decision-making power, in order to avoid setting up permanent establishment in the country and pay local taxes.

- Not applying monetary adjustment regulations with respect to, nor acknowledging as foreign currency assets, investments made abroad by local companies through permanent establishments.

- Pretence of having a representative, an office, branch or agency abroad so as to establish losses with respect to this establishment abroad, which losses are not proved or determined following generally accepted regulations in the country.

MEXICO

a) Setting up a permanent establishment.

The setting up of a permanent establishment and exceptions there to are regulated by sections 2 and 3 of the Income Tax Act.

b) Income attribution to the permanent establishment.

This is provided for in Section 4 of the Income Tax Act.

c) Prorata attribution of expenditure between permanent establishment and parent company.

This is provided for in Section 30 of the Income Tax Act.

II.3.7. Use of tax-exempt trusts, foundations, entities and individuals

Extraterritorial trusts, foundations and entities which are not tax liable in any way are frequently used legal structures in international tax planning.

Residents may use this type of concept purely for tax reasons, particularly when it occurs in jurisdictions where income and wealth are either not liable to any kind of tax or taxation is low. Nevertheless, these reasons are usually linked to other non-tax reasons, such as wealth protection, inheritance legislation, etc.

Lack of transparency of these concepts poses the greatest risk for control activities as they may be used for concealment of the real owner of the investments.

The *Fideicomiso*, or trust in the English language - original concept of the Anglo-Saxon right (common law) - is a legal instrument related to property rights. This legal mechanism makes possible the transfer of property rights to other persons without transferring totally property rights. It concerns a typical case of legal entitlement, resulting from the division of property rights.

Trusts, are legal contracts in which the owner (settlor) transfers goods or patrimony (trust fund) to another subject or trustee, who will have the formal entitlement (trust ownership) with the obligation to administer them so as to allocate profits and yields to the beneficiaries.

As regards trusts, tax planning may include –even if the trust is discovered, known or disclosed- from tax deferment to non-taxability of income and/or wealth, should domestic legislation not contemplate that particular concept, which implies loss of control and transfer of trust assets by the trustor in favor of an administrator (trustee), usually a resident of a different jurisdiction.

Trusts established within the country do not entail deep concerns for Tax Administrations, and they are not used as mechanisms of tax planning because of their fiscal transparency. Nevertheless, we cannot say the same about the trust constituted in other countries, especially in low or zero tax jurisdictions. On the contrary, in these cases, their use for fiscal purposes is very clear which are used to capitalize great fortunes and to administer wealth.

As instrument of an international tax planning, trusts are used in personal or universal probate proceedings to transfer goods to minors, to protect creditors, philanthropic actions, pension funds and, generally, to protect patrimony from possible aggressions.

Specifically, trusts can be used for avoiding the incidence of the *mortis causa* tax, which is a common tax in several tax systems. In this case, with the previous constitution of a trust that possess all homesteads, relative to the death of the decedent, there will not be goods to list in the will, thus avoiding the incidence of the tax.

Another use of this legal procedure with tax purposes occurs when the taxpayer establishes a trust in an area of low or null taxation and that it exercises a great secrecy of tax information. In this case, the aim of the trust is to conceal the ownership of goods and rights acquired with resources stem from an unlawful activity or that were not offered to taxation (evasion) in the country of origin.

In essence, trusts offer a legal mechanism whereby it is possible to “adjust” gains for the future use of specific beneficiaries. The trust administration may use discretionality to regularly distribute resources to the beneficiaries. From the fiscal point of view, the structure is advantageous when it is established in an area of low or null taxation vis-à-vis the trustee’s jurisdiction. Thus, the investment of the fund created under this legal institute may accrue upon a preferential tax rate, far from the tax authorities of the beneficiary’s jurisdiction.

ARGENTINA

Section 1 of law 24.441 defines the ordinary trust as a contract, by virtue of which a person (a trustor) transfers trust ownership of certain assets to another (trustee), who accepts the responsibility for exercising it to the benefit of whomsoever is appointed in the contract (beneficiary), and for transferring it to the trustor, beneficiary or trustee, at the end of a set term or upon compliance of certain conditions.

Section 19 of Law 24.441 defines the financial trust as a trust contract subject to ordinary trust regulations, under which the trustee is a financial entity or a company that has been specially authorized by the National Securities and Exchange Commission to act as a financial trustee, and beneficiaries are holders of share certificates under trustee control or debt securities, which are backed with assets thus transferred. On the other hand, this section establishes that the

National Securities and Exchange Commission shall be the implementing authority with regard to financial trusts, and shall be empowered to establish regulatory norms.

Law 24.441 created certificates representing a portion of trust assets and securities guaranteed with trust assets as a way to establish the rights of financial trust beneficiaries, determining that the latter “will be considered securities and may be part of a public offer".

In Argentine legislation trusts have received special treatment, and, under certain conditions, may be liable to income tax, as they are considered as wealth that is no longer owned by their trustors and beneficiaries.

Therefore, there are fewer possibilities of using manipulative mechanisms locally.

At international level we refer to what is above said in II.3.1 in relation to assets movements, performed by individual domestic taxpayers, towards foreign trust, with the purpose of understate the tax base in property tax of Argentina. This way of operating has been desputed by Tax Administration as a consecuence of having verified that the property is not really transferred.

Next it will be included in detail the trust tax treatment:

- Income Tax

Trusts are subject to Income Tax for their profits, except in the case when the settlor and the beneficiary are the same person and/or entity, or in the case we are dealing with a financial trust or when the beneficiary is a resident of a foreign country.

If the settlor is also the beneficiary, the profits obtained by the trust are attributed to the settlor-beneficiary.

- Value Added Tax

The trust is subject to this tax as long as it performs taxable events.

- Presuntive Minimum Income Tax

The trust is subject to this tax, except the case of financial trust

- Real Estate Transfer Tax

The transference of real estate performed by the settlor to the trust is not taxable as it is considered there is not a full property transference

- Personal Assets Tax

Property transferred to the trust is not taxable for it.

CANADA

While Canada has not encountered major difficulties with tax-exempt entities, Canada does experience substantial problems with trusts, both domestic and international. This is because trusts are very easy to establish, require minimal documentation and the settlor (the person who establishes the trust) need not reside in the jurisdiction in which the trust is resident. Many financial institutions will act as a trustee for minimal consideration. In this way, it is very easy to establish an entity in a foreign jurisdiction to hold legal title to assets while control of those assets ultimately remains under the control of the resident of Canada.

CHILE

- Non-payment of tax by charitable organizations, set up as non-profit companies. This term means that profits are not distributed but reinvested, and not, as erroneously believed, that they are not liable to taxation.

- Providing members with products, magazines and articles, on behalf of charitable organizations, as well as other items which have not been taxed with sales and services taxes (VAT) because these institutions set down that they are not liable to VAT.

- Non-compliance of tax obligations, including fiscal stamps, filing of tax returns and payment of taxes by foundations, renders it difficult to identify and thus verify tax compliance.

- Charitable institutions that provide technical advisory services to their members and do not make earnings received liable to sales and services tax (VAT), considering them simply as non-income producing.

- Overvalued or bogus donations made by first category taxpayers to institutions or foundations with the intent of benefiting from large tax relief provisions.

- Foundations do not issue invoices or receipts for rental of farms to members, considering them as non-income producing.

- Profit remittances abroad that are not considered as liable to Additional Tax because they are determined as being exempt from all taxation.

MEXICO

See II.3.3.

II.3.8. Manipulation of transfer prices for goods and services.

Increasing trade flows, the growing role of multinational companies and the relocation of production and competence/services centers are some of the aspects that influence decisions concerning transfer pricing manipulation.

This includes prices at which a company transfers material goods and intangible assets or renders services to affiliate companies (OECD).

In sum, the central idea is that the multinational may be tempted to carry out its intragroup transactions at prices that are different from those applicable in a free competition scenario, in order to reduce taxability in less favorable jurisdictions and relocate them to a more convenient jurisdiction. From a fiscal perspective, such decisions may be related not only to actual tax rates in one country, but also, for example, in the case where greater profits are attributed to a branch or subsidiary, which then uses them to absorb accumulated losses.

The tax planning that involved transfer prices is aimed at diverting the tax base to the areas of less fiscal pressure, resulting in economy of taxes, if we considered the global result of the transnational group.

According to the OECD clisification, criteria, transfer pricing is based on the arm's length principle, by which intragroup services must be similar to those services that would have taken place in free market conditions. If this is not so, profits will be considered liable to taxation as if they had been obtained by the companies under these conditions, and the difference will be liable to taxation in the other corresponding State.

Application of the free competition principle entails making a comparability analysis, in such a way that comparison of economic characteristics and effects of the goods, services or functions rendered be the same or, should there be differences, that these differences do not affect price determination and/or profit margin.

Following the OECD criteria, the methods used for application of the free competition principle are divided into two major groups: those known as "traditional transaction-based methods" – the comparable uncontrolled pricing method; the resale price method and the cost plus method – and "transactional profit methods" – the profit split method and the transactional net margin method.

Even when the OECD methods, mentioned before, let us know whether the conditions met by the comercial or financial relationships between related enterprises result compatibles with the arm's length principle, there may exist other methods aplicable and not described by the OECD.

It must be noted that in terms of avoidance of double taxation, DTA models envisage the possibility that the other State involved may make a corresponding adjustment; in other words, it will also adjust taxable profits to make them more in keeping with those that would have been obtained in a free competition scenario. However, except in cases of arbitrage, or amicable procedure established in the treaties, this adjustment is not mandatory in the case of the other State.

From the point of view of the Tax Administrations, the fiscal control of transfer prices is well grounded on the hypothesis that prices applied in the transactions between related parties are artificially stipulated, with the purpose of obtaining the less tax incidence for the economic group across the inadequate derivation of revenues to jurisdictions in which assets have not been destined, not assumed risks, not developed economic functions, that deserve the remuneration that tries to assign the tax planning of the economic groups as consequence of the minimization of the benefits in the countries in which there is generated the source of respective imposition.

ARGENTINA

The situations found through transfer pricing controls include the following:

1. A company with large export volumes adding up to millions of dollars and little or no tax yield: Manufacturing industries. Companies that had been amongst the country's major exporters for many years, and were producing negative results, while the multinational group obtained positive results.

2. Large volumes of commodity exports valued at transparent market prices, then invoiced by companies in tax havens and international traders without solid economic standing (invoice routing): Invoicing is done by the international intermediaries, while the physical movement of goods follows a completely different route, not specified in the customs documentation. Transfer pricing reasons invoked by the taxpayers in these cases were inadequate in terms of the assets, risks and functions that could be traced to the international intermediary.

3. International transactions structured with related companies, under commercial contracts that do not reflect the real scope of the transaction: Foreign financing obtained under pretence that exports were being paid for in advance, with a long-term (7 to 10 years ahead) delivery agreed. A complex business network design. In this case, income tax was not deducted at source on the financial profits of the foreign beneficiary.

4. Payment of royalties on the transfer of technology acquired abroad: there was found to be non-compliance of Argentine regulations on technology transfer in terms of registration of such transfers. In Argentina, non-registration makes it impossible to deduct the expenditure from income tax liability and produces an increase in withholding tax for the foreign beneficiary. With respect to agreements for avoidance of double taxation, it results in the impossibility of reducing tax deducted at source –this has been agreed in these treaties. In many cases, there has arisen high suspicion that the technology was never supplied. At present work is being done to check whether the technology has, in fact, been supplied.

Some of the most frequent problems in transfer pricing regime application that have resulted in adjustments in favor of the Tax Authority include:

a. Little acknowledgement of the existence of economic ties.

b. Inappropriate choice of the best method.

c. Inconsistency in comparability analysis.

d. Lack of appropriate documentation for comparability purposes.

e. Adjustments that are not appropriate for comparability purposes.

f. Choice of non-transactional methods without having exhausted the possibility of using transactional methods.

g. Inappropriate use of the transactional net margin method.

h .Inappropriate use of profit level indicators (PLI).

i. Use of comparable foreign data from other countries instead of comparable domestic data.

j. General tendency to use data bases with information based on profits (not prices).

k. Standard reasons for implementing the arm's length principle.

l. Tendency to look into the company abroad, without adequate efforts to find out more about the local company (In Argentina the testy party must be effected on the basis of the Argentine company).

On the other hand it is necessary to indicate with general character that in the cases controlled as for transfer pricing important differences were detected in favour of the exchequer, which in the main they find in administrative discussion, without any of the cases has come still to the ordinary justice.

CANADA

Canada has always required related parties to transact business at fair market value.

CHILE

- Obtaining credits abroad under conditions that are not in line with the market, in terms of interest rates, commissions, insurance and other related expenses.

- Acquiring goods and/or services at high prices and later effecting their sale at lower prices, in order to generate tax losses or lower revenues in the companies.

- No record of services rendered or received or non-existence of commercial exchanges between the related or associated parties.

- Sale of goods and/or services at lower-than-market prices or market prices for similar transactions with the sole purpose of transferring income from one country to another.

II.3.8.1. Administrative Curbing Measures. Use of established prices as reference in customs valuation procedures as a means of controlling transfer pricing

The application of the transfer pricing regime has given rise to the question of whether similar valuation mechanisms should be used in tax and customs procedures.

This section will describe how the situation is envisaged in the legislation of each participating administration.

Countries like Argentina, Brazil, Canada and Chile do not use the customs valuation procedures as a means of control of tansfer pricing, due to their legislation do not allow that methodology of customs valuation.

This is due to the fact that customs valuation and tax valuation of transfer prices are based on different legal provisions.

Additionally, in general terms, customs valuation does not take into account agreed transaction conditions, which nevertheless must be considered when estimating transfer prices for the purpose of comparison with independent third party prices.

However, as concerns import and export goods transactions, it is to be noted that in some cases, customs information on transactions, which did in fact take place, showed a marked difference with standard values, and sparked off initial inquiries regarding transfer pricing.

On the other hand Mexico says that up to now they haven’t used customs valuation, but they consider it as a possible element, even when this is not the main factor to consider to determing the transfer pricing that must be used by related parties.

II.3.9. Invoice Routing

The cases to be considered are those where a transaction is invoiced to a person different from the final recipient of the goods, the foreign counterpart to the transaction becoming a mere reinvoicing agent who receives profits without having economic substance.

These are the so-called reinvoicing transactions.

ARGENTINA

As mentioned elsewhere in this document, these transactions have been widely inspected by the Argentine administration, and the differences detected in favor of the tax authority are currently in the discussion stage.

Furthermore, said inspections derived in a legislative amendment, whose compliance is currently being assessed to measure its effect on the behavior of the taxpayer segments within its scope.

CANADA

Same as ll.3.8

As with other transactions involving related parties, Canada requires that they be undertaken at fair market value. If a related party in a tax haven were to be a party to such a transaction, Canada would require that this party contribute some measurable value to the final sales price to justify any compensation paid to that party. If the party cannot demonstrate this value added, the Canadian purchaser will not be allowed to deduct the additional amount billed by the party in the tax-haven as a tax expense.

CHILE

- Debt incurrence with foreign creditor through foreign entities which generates high costs resulting from interest recognized in the tax result of the parent company, further avoiding the Additional Tax and stamp tax associated with such debt.

- Sale of private shares by simulating they are public shares of the type exempted from capital gains taxes.

- Acquisition of a foreign company through an entity in countries considered tax havens with the purpose of disguising the transaction and setting off-market prices for the sale of shares between related companies.

MEXICO

This country adopted the concept of effective beneficiary, whereby an intermediary company can be denied the gains provided that it is not the effective beneficiary of income.

A specific regulation is lacking in Mexico to disown the corporate facade of these intermediary entities, which would have greater legal strength than the concept of effective beneficiary, which is too comprehensive and ambiguous.

II.3.10. Transfer of Intangible Assets

Intangible assets may represent much of the company's current worth. These include not only good will, but also a series of economically valuable rights which may or may not be subject to legal protection as such, but were nevertheless either generated by the business activity or purchased from third parties.

Although one could assume that the business priority will be to legally protect its intangibles, as well as the confidentiality of the information associated with them, there are aspects to be considered with regard to tax planning.

A major difficulty lies in the valuation of both business and industrial intangible assets. This becomes a sensitive issue, especially when the asset was created by the business itself. When these assets are transferred, not only the proceeds from the sale should be valued, but also the transfer pricing policy followed by the business, with the purpose of allocating profits to the most suitable jurisdictions.

ARGENTINA

There is no significant experience in controlling transfer pricing for intangible assets.

However, it can be pointed out that Argentine legislation does not allow cost sharing agreement mechanisms for the operating costs incurred by foreign businesses.

CANADA

Same as II.3.8

CHILE

- Transferring intangibles at lower-than-market prices or waiving the right to international distribution of goods or services and transferring it to a related company at a cost lower than the potential profits it would derive from doing business on its own.

- Capital contributions across intangible technology realized by foreign investors taken refuge in the Decree Law 600 whose real price of the contributed technology is low at the cost of market. Decrew Law 600 grants the possibility to the foreign investor of formalizing a contract with the State of Chile, which relies on special characteristics that they promote it, in all that it assures a rate of invariable tax, access to the exchange formal market with the type of change more favorably and other guarantees that not might to obtain to deposit the capitals to the country for other mechanisms.

MEXICO

Mexico has introduced the so-called exit tax, which consists of taxing as if the company changing residence had been liquidated, thereby stopping to pay taxes on its asset sales, which denies the country the possibility of taxing them in the future under the residence criterion.

Said provision is under Section 12 of the Income Tax Act.

II.3.11. Technical Assistance Payments

Technical assistance consists of the fulfilment of services of different nature in relation with application of technology or the start-up and maintenance of productive facilities. They differ from royalties because they involve a positive action, the obligation to do something. According to the applicable rules (local or agreed) the definition of royalty may include the transmission of acknowledgement (know how); in such case there may be difficulties to distinguish these provisions from the payment of the services provisions.

The distinction between technical assistance and royalties is relevant, especially if a double taxation treaty is applicable because, unless the specific agreement treats profits deriving from technical assistance services as fees, technical assistance is usually not subject to taxes in the source country, provided there is no permanent establishment. On the other hand, countries usually agree on reduced taxation at the source for any fee payments.

In this regard, the OECD recommends separating the services provided by company in order to apply appropriate tax treatment. Further difficulties encountered have to do with valuating these payments, especially with regard to the transfer pricing policy of the business group and, in some cases, verifying effective service provision.

ARGENTINA

In terms of transfer pricing, technical assistance issues are in the research stage.

Notwithstanding, it is worth noting that in Argentine legislation, when technical assistance is received from abroad, it is encompassed in the specific legislation on “technology transfer”.

The scope of this subject in tax legislation has been mentioned in II 3.8.

Controls performed have detected the following:

- Inadequate withholdings at the source.
- Inappropriate deductions and withholdings resulting from flawed registries.
- Non payment of value added tax on service imports.

- Agreed fees which, in principle, are excessive as per the arms' length principle, which were analysed under the transfer pricing verification process.

- Cases where there is a strong suspicion that the service has not been provided, which were subjected to auditing processes.

In addition to the above, a further equally important issue is auditing actual service provision.

In many cases, this type of audit requires thorough technical knowledge of technology matters, which tax officials lack.

Although the Argentine tax authority has experts on the matter, current audits have used indirect mechanisms of economic, financial and business nature.

Enclosed is a list of standards and aspects established for the assessment of effective service provision

Next are listed the parameters and aspects established to assessing the effective provision, on which the taxpayer is usually asked for information,

1) Note describing the nature and defining the acquired intangible

2) An explanation in detail of the facts and circumstances which determined the decision of acquiring the respective technology.

3) Treatment in board of directors where reasons for acquisition of technology were dealt with.

4) The taxpayer will have to indicate the benefits or improvements derived from the technology incorporated, measured by indicators that relate:

- Increasing in incomes and/or benefits
- Increasing in the level of production and/or competitivity
- Decreasing of costs and/or expenses.
- Changes in logistic
- Changes in production processes.

5) Analysis and/or studies of projection of the expected values and time needed to recover the acquired intangible.

6) Indicate whether the return of the intangible investment took place, technical characteristics of the technology transferred, the goods, material that were incorporated, details of the know-how, e.g. folders, manuals, formulas, design, advisory, etc.,

7) Specification of whether or not control parameters were established, in the affirmative case, indicating which controls were performed and the results obtained.

8) Indication about the possibility of equal provision in the domestic market.

9) Specification whether this is patented knowledge

10) Clear indications whether the transmission of acquired technology was implemented by tangible or intangible means detailing them (Plan, software, among others)

11) Indication of the length in time of the provision.

12) Number of technicians and/or persons who participated in the technology provision.

13) Evidences of expenses on transfer and accommodation incurred by the personnel entering the country to perform the provision of the technological service.

14) A detail of indirect costs incurred by the Argentine company in relation to the provision.

15) Explanations about the utilization of domestic suppliers or third enterprises to perform tasks complementary to the technology provision obtained abroad.

16) An explanation about the performance of training courses indicating, in case of provision of any material in such courses, what they consist of.

17) Indication whether the transfer conditions include limitations in the geographical area covered and the exclusive, or not, nature of the rights granted.

18) Indication whether the acquired provision can be transferred or sold to third parties.

Finally it is highlighted that there isn't any audit case finished at the moment on the subject.

CANADA

Same as II.3.8

CHILE

- Payments for technical consultancy work that was not effectively performed or materialized, whose purpose is to hide profit remittances abroad.

- Payments remitted abroad for technical consultancy with no substantiating documentation to prove such transactions materialized. Inexistence of contracts, technical reports or documents showing the services existed.

- Services retained from abroad which are not technical in nature but are nonetheless classified as technical consultancy with the purpose of using a reduced tax rate.

- Overstated payments for irrelevant technical assistance with the purpose of concealing profit remittances abroad.

- Pretence of technical assistance provision with the purpose of using tax benefits associated with said assistance. A specific case is that of exporters that may claim a rebate of the tax paid on assistance inasmuch as said assistance is part of the cost of an exported good or service.

In order to apply the taxation of payments for technical consultancies, the Service of Internal Taxes has interpreted that we must understand by this concept, those professional or technical services rendered through a piece of advice, report or plan by an individual or organization which is expert on a certain science or technique.

The payments made as services provides abroad are subject to tax to non-resident nor domiciled persons in Chile with an overall rate of 35 %.

Besides, a special treatment exists for the payments made abroad as long as they meet the condition to be qualified as technical consultancies and that are affected with a 20 % rate for the tax to non- residents nor domiciled in Chile.

MEXICO

On this issue, Mexico has established clear guidelines as to what should be understood as technical assistance and royalties. (Section 15-B of the Código Fiscal de la Federación – Federal Tax Code)

It further established comparable guidelines to determine the source of wealth for both institutes. (Section 200 of the Income Tax Act)

II.3.12. Royalty Payments

Royalties are incomes that comes from the session or concession of the use of tangible goods such as: intellectual property, industrial property and, according to the applicable legislation (local or agreed), the know how, it can also be included in this concept, payments for the rent of industrial, commercial or scientific equipment, specially if there exists an agreement to avoid double international taxation.

In addition to the considerations above regarding the need to differentiate these passive payments from those obtained for technical assistance and the valuation difficulties posed by the transfer pricing policy followed by the business group, with this type of payments it is necessary to determine that they are actually made in exchange for the transfer or concession of a right of use rather than the final transfer of same.

ARGENTINA

Most concepts generating fees or royalties – with the exception of transfer of software rights – are encompassed in the specific legislation on technology transfer.

No specific experiences exist on transfer pricing relative to this issue.

CANADA

Same as II.3.8

CHILE

- Overstating payments for rights on trademarks, patents, formulas, royalties, distribution, exclusivity or other intangible assets.

- Royalty expenses being acknowledged for the use of trademarks, patents, formulas, consultancy and/or other similar services paid to individuals directly or indirectly involved in the equity, control or management but with neither domicile nor residence in the country.

- Pretence of services associated to intangibles, such as trademarks, formulas, patents, royalties, given the inexistence of substantiating contracts or associated reports issued by the service providers to prove these were effectively provided.

For the purposes of controlling the total of payments related to royalties such as marks, formulas and other similar services subject to tax to non-residents, made by local taxpayers to a related company abroad, in article 31 N°12 of the Income Tax Act was added a limit of 4% of the total incomes regarding this type of payments abroad. Therefore, the amount exceeded from the above mentioned limit is considered to be a rejected expense subject to tax.

Examinations of mass and selective character have been carried out, which try to control the proper application of the above mentioned tax rule.

At the moment, our country is working on a legal alteration regarding the tax treatment applicable to the international software in article 59 N° 1 of the Income Tax Act, from 2007. This alteration will establish that the amounts corresponding to the use, enjoyment or exploitation of computer programs will be burdened wit a rate of 15 %, being understood for these ones, all the instructions to be directly or indirectly used in a computer or processor, in order to carry out or to obtain a certain process or result. These instructions are in cassettes, diskettes, discs, magnetic tape or another material or means support, in accordance with the definition or specifications provided for the Intellectual Property Act

MEXICO

Mexico considers that not only the residence country but also the source country can tax income from royalties, as per the qualification to Article 12.1, Mexico, contained in item 36 of the commentary to the OECD's Model Convention.

II.3.13. Thin Capitalization

The concept of thin capitalization originated in commercial law and refers to a censurable and contrasting disproportion in the ratio between legal or statutory capital and the company's business risk assumed. This decision may be prompted by different reasons, such as higher capital availability relative to corporate or exchange regulations, etc.

The phenomenon of the thin capitalization occurs when the company that belongs to a highly capitalized transnational economic group decides to finance its activity through loans. This phenomenon is known by the high level of indebtedness together with its partners or other companies of the same group, in scales higher than the habitual conditions of the business or activity. The debits for the partners overcome the capital stock – *hidden equity capitalization*.

We can analyse thin capitalization according to three different approaches:

- From the economic point of view, considering the bureaucratic rules as for the investments in the different countries, in many cases it is decided in favour of the loans transactions, since these are more agile and simplified and allow a better mobility of the resources intra-group.

- From the commercial point of view, the thin capitalization can be used in a harmful way regarding the creditors of a company who can be affected by its high level of indebtedness.

- From the tax point of view, the thin capitalization can be promoted by the exclusive purpose of reducing the fiscal pressure in the country of the company that applies for the loans.

Used as mechanism of tax planning, the thin capitalization offers the possibility of economy of taxes. The investor will be able to assign resources to the company according to two ways. First, through the increase of its capital stock. In this case, the total amount to be paid to the partner for the use of this capital will be characterize as dividend, which is distributed with base in the profit after taxes. Thus, the incidence of the tax in the determination of the profit arises and as a result its distribution to the partner.

The second way, which is more profitable than the previous one from the fiscal point of view, consists of the financing of the capital stock. In this hypothesis, the total amount to be paid for the use of the "capital - loan" will be characterize as interests. Thus, although the interests suffer the incidence of the tax when they are sent to the lender, they promote the reduction of the tax base in the country of residence, which significantly reduces the fiscal burden.

With regard to tax implications, given that, unlike profit distribution, interest is usually deductible, many companies are tempted to reduce a true capitalization of subsidiaries by funding them through loans. In addition, at the top of the recipient the dividends can pay to a type reduced in relation with the interests.

For it the expression the expression exiguous or concealed capitalization, it(he,she) is in use for describing the situation in which a company, financed seemingly by means of credit, actually(indeed) is being endorsed economically across the share capital.

CHILE

- Investors failing to contribute capital in the companies they create or are involved with in the country while taking loans from related companies with the purpose of generating deductible interest expenses, remitting said interest at a reduced additional tax rate, further creating fees which are exempted from said tax. Thus, profits are transferred abroad at a lower tax rate than that of a profit remittance.

- Incorrect assessment of the variables which rule overleveraging so that the net worth, own equity, contributions, withdrawals, interests in other companies, indebtedness, monthly debt balances, total loans committed are not assessed accurately, i.e. indebtedness percentages assessed are lower than actual.

- Disowning or concealing creditor information to render the relationship between creditors and debtors unidentifiable. This becomes a key variable when assessing the credits subject to overleveraging regulations.

- Establishing long-term schedules for interest payments so that, despite being reached by overleveraging regulations, tax payments are deferred given that there is no tax base to apply the tax on.

- So-called back-to-back loan transactions whereby a foreign company makes deposits or placements in a foreign bank or financial institution in an amount equivalent to that which the latter (the creditor) grants by way of loans to a related company with the purpose of concealing the relationship between the parties and thus avoiding overleveraging regulations.

MEXICO

Mexico has recognized the effects of inflation on tax matters since the 80’s. As a result, the high inflation rates of the 80’s and 90’s discouraged thin capitalization tax planning practices, since a highly leveraged Mexican company might accumulate income rather than gain access to tax deductions.

II.3.14. Interest Payments

Without prejudice to the considerations made on the topics of interest and thin capitalization, when a double taxation agreement is applicable, said payments are usually subject to taxation at the source at a reduced rate. Therefore, it is worth determining whether the recipient is the effective beneficiary since, if this is not the case, anti-abuse clauses established in the agreements shall be enforced.

When interest is paid abroad, another aspect to consider is the truthfulness of the loan transaction and/or the existence of the creditor with the purpose of ruling out the possibility of a self-made loan, a back-to-back transaction, or any other scheme aimed at concealing an inappropriate net worth increase of the local person and/or the business group.

Relative to the transfer pricing that may be established with these financial services, in addition to analyzing the fairness and comparability of the interest rate paid, anti-abuse rules may be applied when the creditor is located in a low or no taxation country, or is subject to a system allowing for lack of transparency in the financial transaction.

Also, in case when the liability is contracted with associated companies, it must be taken into account the hypothesis of undercapitalization according to what was exposed in the above point.

ARGENTINA

Some of the aspects inherent to this topic have already been included under thin capitalization and low or no taxation jurisdictions.

In terms of agreements to avoid double taxation, the institute of “effective beneficiary” has been created to reduce the rate.

It is worth noting that there are open cases where the inexistence of the foreign grantor is suspected.

With these cases the process of international exchange of information is underway.

CHILE

- Interest payments at a reduced (4%) tax rate on loan transactions that have not been effected with the purpose of concealing profit remittances abroad.

- Interest payments for loan transactions which lack substantiating documentation (e.g. contracts or accounting entries) to prove their existence.

- Loan transactions with foreign banks or financial institutions at off market interest rates.

- Taxpayers obtaining loans abroad through a creditor that does not meet the conditions of banking or financial institutions, and subsequently remitting interest at 4%.

MEXICO

Mexico has established two types of rules:

a) Regarding the interest-paying Mexican company, rules have been established to enable a recharacterization of said payments as dividends (Section 92 of the Income Tax Act).

b) With regard to the income received by the resident in a foreign country, rules are established to determine when a source of wealth exists in Mexico – it is enough for a resident to pay interest to consider them a source of income in Mexico. Furthermore, several financial concepts are adopted which were characterized as interest although, from the technical perspective, they are not loan profits.

Likewise, as part of the negotiation policy to avoid double taxation, Mexico has established in its agreements that the concepts mentioned should be allowed as equivalent to interest as per the definition of interest provided by these agreements.

On the other hand, banks are required to register in a special registry which allows for a tighter control on the income received as interest from Mexican wealth sources (Sections 195 of the Income Tax Act and 11 of the Agreement with the United States of America).

II.3.15. Leasing Transactions.

It is a contract of financial nature by which the lessor transfers the lessee, in a certain term, a good in lease, by means of the payment of certain price, remaining the lessor in control of the good and granting the lessee the right of returning it, renewing the lease contract or acquired the good, once the contract has finished.

The operation of leasing carried out between entities under the same legal lease is not, as a rule, used as instrument of abusive tax planning. Nevertheless, the question is different when the operation implies companies located in countries of low or null taxation. In this hypothesis, in order to avoid double taxation that can arise from the payment of consideration, contracts are signed with the exclusive aim of reducing the fiscal burden.

Leasing transactions involving companies located in different jurisdictions have been used as a means to implement international tax planning. In spite of the OECD´s recommendations to exempt transactions in the country of the paying source, some jurisdictions still levy taxes on this income and, as a result, double taxation occurs. With the purpose of avoiding excessive burdens, large economic groups establish leasing companies in countries of low or null taxation seeking to carry out transactions with countries which still levy transaction remittances.

Resident companies opt for this institute when they need to acquire or use highly valuable assets in their activities, such as complex industrial facilities, vessels or aircraft. The fiscal advantage lies in the possibility of deducting the transactions from the Income Tax base of the leasing firm's country of residence.

Nevertheless, tax planning is considered abusive when, for instance, the transactions are carried out at prices well above standard market prices, unduly reducing the tax base in the country of residence.

Abusive use of these transactions may also occur in the use of captive leasing companies, usually located in countries of low or null taxation. In this case, the purchase of the assets to be leased is made with the leasing party's own resources, with no official deeds signed, and then transferred to the jurisdiction imposing strict banking secrecy rules, which warrants the opacity of transactions.

ARGENTINA

In Argentine law, leasing is considered a typical contract with features of its own. Law 25.248 defines said contracts as those whereby the lessor agrees to transfer the holding of a certain good to be used by the lessee in exchange for a fee payment, further granting a purchase option for a given price, which may be set in the leasing contract or established based on agreed procedures or guidelines. The unique features and conditions established for leasing arrangements led to the passing of regulations to define accurate and adequate tax treatment of said arrangements.

A brief outline of the tax treatment provided by the regulations in Decree No 1038/00) follows:

a) in terms of income tax, these transactions are treated as financial transactions of leasing, purchase/sale, depending on the lessor and other specific requirements;

b) in terms of VAT, the transaction is treated as a leasing contract. At the time the lessee exercises the purchase option, it should be treated as a purchase/sale. To determine whether or not the leased good should be taxed, the type of good should be taken into consideration.

The decree does not regulate the leasing treatment in cases where the lessor is located in a foreign country ("cross border leasing"). However, said transactions are contemplated in the framework of law 25248.

Given that the tax framework differs depending on the type of leasing – financial, operating, or leaseback – appropriate treatment should be determined by qualifying the economic reality of the transaction performed by the parties, thereby considering the transaction as either an ordinary rent, a rent with a purchase option, or a financed sale.

With regard to the consequences of transactions with non-residents, the Argentine Administration has detected cases where, although local source income has been detected with foreign persons, the payer failed to make the applicable withholding – as a once-off tax payment – of the foreign beneficiary.

CHILE

- Leasing contracts with agreed installments that result in amounts or prices different from international market prices for the leasing of similar goods.

- Treating as an expense the amortization amount of capital goods subject to leasing with or without a purchase option.

- Preparing documents and accounting records in connection with leasing transactions that fail to materialize, i.e. where the good or product involved is not purchased.

Among the operations of leasing, we can mention the Operative Leasing and the Financial Leasing. The first one corresponds to a leasing of rental, which does not generate tributary differences.

The tributary treatment applicable to the quotas of rental is that it is accepted as necessary expense to produce the revenue both in the financial and operative leasing. With regard to the interests in leasing and monetary correction of obligations in leasing, these are not accepted as necessary expense to produce the revenue and therefore they are subject to tax.

The concept of leasing or contract of lease with or without option of an imported capital good, is discussed in the Article 59 N°6 of the Income Tax Act. In this article it is stated that a tax of 35 % will be paid to not residents or not domiciled persons in Chile, on that part that corresponds to the utility or interest included in the operation, which in this case corresponds to 5 %. In other words, the taxpayer should pay as a result of the withdrawal 1,75 % of the total amount sent

MEXICO

Financial leasing provides financing rather than the right of use for a certain good. Therefore, the Mexican legislation treats it as interest (Section 15 of the Federal Tax Code, Section 198 of the Income Tax Act and qualifications to the commentary contained in Article 11 of the model tax convention of the OECD).

II.3.16. International Financial Transactions

Financial transactions are increasingly prevalent internationally, not only in terms of the growing figures involved but also the greater degree of sophistication used to effect them.

This situation is even more complex when contracting parties are economically related, since their relationship may favor financial engineering efforts designed exclusively to avoid taxation, either by effecting transactions in such a way as to conceal the actual transaction or by transferring profits to jurisdictions with preferential tax treatment.

A multinational group may use an extraterritorial financial corporation to channel loans towards a foreign subsidiary. Channeling the interest towards an extraterritorial financial corporation, the proceeds may be effectively diverted from the resident subsidiary to the offshore company, which shall pay low or null taxes on the interest received.

On having directed the interests to the financial extraborder society, the earnings can turn aside really of the resident subsidiary to the extraborder companie, who will pay a low or null tax on the received interests.

The tax advantages stem from the capability of providing debt-based funding to the companies in a group, instead of capital contributions. Thus:

- Interest expenses become an expense which is deductible from Income Tax as an offset to the earnings subject to high taxes in the host country; and

- Interest-derived earnings are received as a relatively low or null tax withholding and are accrued in a tax-free or low tax jurisdiction.

These transactions may be considered abusive when they are carried out in terms which differ from customary market terms and which only seek to reduce the tax base in countries with high tax rates. In this case, tax planning promotes the improper diversion of income towards low tax jurisdictions.

Abusive tax planning may also include typical financial market transactions. Currently, it is common to see *hedge* or *swap* transactions structured between legal entities located in different countries and which are highly complex. The same goal is sought in financial derivative transactions and sale of goods with future delivery dates and advance payments.

In many cases, these transactions are not made with the exclusive purpose of diverting income to low or null tax jurisdictions, but on the contrary, to generate significant losses tending to offset earnings materialized in higher tax rate jurisdictions, thus voiding the effect of the tax provision in the country of residence.

ARGENTINA

It is worth noting on interest-generating transactions subject to local taxation and maneuvers disguised as advance payment sales, like examples Chapter III.

In addition, note that financial derivatives have specific treatments as per the Income Tax Act.

The tax treatment provided by the Income Tax Act consists mostly of treating as of Argentine source any profits arising from the rights and obligations of derivative instruments and/or contracts, provided the risk taken is located in Argentine territory, which location is applicable when the party obtaining such profits is a resident of Argentina or a permanent establishment of a foreign person.

Notwithstanding, should the different components of any such instrument or set of related instruments indicate that these do not reflect the parties' true economic purpose, the location of the source shall be determined as per the principles applicable to the generating source based on the principle of economic reality.

CANADA

Canada has recently begun examining these transactions in detail, especially in the context of the financial institution sector. These transactions are often complex, are undertaken with both related and unrelated parties and, it is suspected, often for purely tax motivated reasons. As this is a new initiative, it is too early to comment meaningfully on any results.

CHILE

- Loan transactions with financial or banking institutions established in tax havens with the purpose of simulating a financial institution to justify the use of reduced tax rates.

- Indebtedness maintained by entities abroad to fund parent company transactions with the purpose of evading the Additional Tax and Stamp Tax associated with remittances or payments to foreign countries and loan transactions, respectively, while incurring financial expenses which translate into tax losses recognized in the parent company's profit and loss statements.

- Loan transactions between related parties with excessively high charges owing to multiple concepts. In some cases, although these may be associated to the type of transaction, we may question their nature, amount or timing. A few examples of this type of charges include: interest rates, associated operating expenses, guarantee fees, commitment fees, closing fees, prepayment, intermediation, syndication, restructuring, management, obligation to purchase insurance from specific companies.

MEXICO

The legislation makes a basic distinction between those deriving from debt and those deriving from equity, providing for unique rules on wealth sources when the entry is booked by a foreign resident.

Likewise, for the purpose of the agreements, the treatment is mostly determined by the nature of the transaction as per national legislation, which establishes interest, capital gains, business benefit or other income (Section 16 A of the Federal Tax Code).

II.4. Encouragement of International Tax Planning and penalties

International tax planning materialized by using off-shore entities may help advance certain economic activities, although they do not seek to encourage avoidance as their main objective, they benefit from the maneuvers of their potential customers. Thus, the financial sector, off-shore banks, etc. are economic entities which, however indirectly, serve as encouragement to international tax planning.

Furthermore, in some cases these entities may become experts in perfecting avoidance practices.

It is in the interests of Tax Administrations to identify them with the purpose of both curbing such avoidance and/or evasion attempts and tightening controls over them, in addition to deriving useful data for the investigation and control functions.

II.4.1. Promoters

Professionals promote international tax planning as an additional means to market their services.

These entities may also become a potential source of relevant information although, on occasions, access to such information may be hampered by the fact that professionals have the right to keep secrecy.

Promoters of many abusive offshore schemes rely on the difficulty of access to records of tax haven banks, attorneys, and trustees.

Furthermore, in the absence of government scrutiny, some offshore banks, attorneys, trustees, and other service providers have been known to falsify or fabricate records.

In addition to considering that certain jurisdictions which maintain a generally acceptable tax conduct have special tax regimes which might be considered harmful to the interests of other nations by virtue of their tightness or lack of transparency.

II.4.2 Penalties for planning consultants and promoters.

Included is a list of provisions relative to penalties for advisors and promoters of mechanisms that may favor harmful tax planning practices.

In this case, degree of effectiveness will be indicated concerning modification of conduct.

ARGENTINA

Argentine legislation does not contain provisions that specifically penalize the promotion of tax planning practices.

However, it must be noted that through law 25.874, which was recently passed (in Jaunuary 2004) the concept of conspiracy is now contained in the penal tax regime.

It is typified inside the area of the penal tax law - the crime of unlawful assembly for the cases in which more persons will meet two or for the commission of some of the tax crimes or for whom more persons will form a part of an organization or association composed by three or to commit crimes of the above mentioned nature.

If tax planning were to involve the committing of an offence, the new legal provision could be applicable, basically in line with the following:

Whosoever:

a) Issues an opinion, informs, confirms, authorizes or certifies legal acts, balance sheets, financial statements, or documentation, in order to facilitate the perpetrating of offences envisaged in this law, will be liable to the special ineligibility penalties for double the time of the sentence, as well as the corresponding penalties for his or her criminal role in carrying out the offence.

b) Takes part, together with two or more persons, in committing one of the offences typified in this law, will be sentenced to a minimum of FOUR (4) years in prison.

c) Be part of an organization or association containing three or more persons, which habitually is meant for committing the offences typified under the present law, will be sentenced to a prison term ranging from THREE (3) years and SIX (6) months to TEN (10) years. If this person is the head or organizer, the minimum sentence will be raised to FIVE (5) years in prison.

For major illustration exposed precedentemente exposes later jurisprudence related to the application of the legal norm:

- “Real de Azúa, Enrique y otros”

- “Chen Qibin”

- “Michanie, Valentina R. y otros”

- “V.R.G. y otros”

- “Viazzo, Roberto G. y otros”

- “Di Biase Luis Antonio, Belloni Adolfo, Bruno alejandro, López Adrián, Perkins Andrés. Hoyos Horacio, Freiberg Efraín y Calot Silvina”

BRAZIL

Legislation on transfer pricing and foreign source income does not envisage penalties for those who benefit from international tax planning practices.

The only aspect that focuses on this is contained in the fourth paragraph of section 1 of law 9532, dated 1997.

CANADA

Canada has enacted legislation which provides for penalties for third parties such as tax planners and valuators who assist a taxpayer in filing false returns.

Further, Canadian law also provides substantial penalties for promoters of tax shelter arrangements who fail to register those arrangements with the Canada Revenue Agency prior to selling them.

CHILE

The Chilean legislation, by means of the article 97, number four, final subarticle, of the Tributary Code, punishes with the penalty of short-term imprisonment in its medium to maximum grades and with a fine of up to 40 tax annual units, the selling, making, provision, circulation and transfer for any reason of invoices, in order to maliciously and fraudulently reduce the burden for concept of Value-added tax (VAT) or to obtain improper returns of taxes, when falsely increasing the fiscal credits that correspond to them,.

Besides, the accountant who, on having made or having signed any tax return or balance or who as person in charge of the accounting of a taxpayer will commit misrepresentation or fraudulent acts, will be punished with a one to ten tax annual units fine and will be able to be punished with a short-term imprisonment in its grades from medium to maximum, according to the seriousness of the infringement, unless a serious punishment will correspond to him as copartner of the taxpayer’s crime, in whose case the latter will be applied apply the last one to him. furthermore, it will be informed to the Accountants Association for the effects of the sanctions that be appropriate.

MEXICO

In conformity with section 89 of the Federal Tax Code it is considered a misdemeanor to advise taxpayers to omit to pay taxes.

The fine for the latter misdemeanor is envisaged in section 90 of the Federal Tax Code and is paid in money (from 19 to 38 thousand pesos).

Additionally, section 95 of the Federal Tax Code states that persons responsible for committing the offence are, amongst others, those who induce another intentionally to commit it or intentionally aid another to commit the offence.

II.5. CURBING MEASURES OF INTERNATIONAL TAX PLANNING:

Abusive tax planning is a permanent item on the agenda of tax administrations in several countries. In order to neutralize the advantageous effects of preferential tax systems, countermeasures are implemented pursuant to the need and nature of the legal system in each country. Among these countermeasures, we may mention the enforcement of rules or principles against the abuse of tax regulations, provisions on international fiscal transparency or legislation on Foreign Controlled Companies, rules on residence and migration of individuals and legal entities, restriction of rights set forth in tax treaties, the application of rules on transfer pricing or the adoption of criteria for deducting certain expenses or costs, when these are incurred in jurisdictions of low or null taxation.

II.5.1. Rules to combat tax avoidance

Almost all countries have legal provisions or unwritten principles whereby the tax authorities may challenge seemingly normal transactions, but whose form masks other purposes, generating strictly or mainly fiscal concerns. Without prejudice of these general provisions, other countries also include specific rules in their tax legislation in order to combat concrete tax avoidance schemes.

In general, such provisions allow Tax Administrations to find out whether a taxpayer’s transactions have enough economic substance. And besides, the actions carried out by the taxpayer must be justified in the business environment for their legal effects to be considered. That is, there must be both the “objective economic substance of transactions” and the “subjective motivation of the underlying business”. Therefore, the analysis of this issue implies two factors which shall define whether a certain transaction may be considered a simulation, disregarded for tax purposes:

- The economic substance of the transaction, which implies the objective analysis of the realistic and practical economic effect, apart from the fiscal benefits; and

- The subjective motivation of the business, checking whether the taxpayer has been motivated by business purposes other than the attainment of tax benefits when carrying out the transaction, which implies subjective analysis of the taxpayer's motivation.

Countries whose legislation is based on the *common law* system generally follow two approaches:

- The approach based on the rule of business purpose; and

- The approach of substance over form.

According to the doctrine of "business purpose", a transaction must have a main or predominant business purpose, that is, a business case beyond the tax benefit obtained through said transaction. The mere tax advantage cannot be regarded an acceptable business purpose; proof needs to be provided about a business purpose, beyond tax purposes, valid and distinct from relief in tax obligations.

If the main purpose is other than the reduction of the tax burden, the transaction is considered acceptable tax planning. On the other hand, if the main purpose is obtaining tax benefits and the transaction would not take place if it were not for the tax advantage, the transaction should be considered tax avoidance and, therefore, unacceptable. There is obviously no legal definition for business purpose. The courts, however, take their stance on the basis of practices considered customary in the universe of usual transactions, upon the analysis of each concrete case.

According to the principle of substance over form, facts should be evaluated on the basis of economic and business substance based on good faith and not on the formal content. The principle of substance over form is broader than the test of business purpose, since it allows tax authorities to examine the legal nature of the transaction in order to assess its underlying economic reality. This doctrine also deals with artificial transactions having an apparent business purpose but really exclusively motivated by the reduction of the tax burden. There are several alternatives in this doctrine:

- Absence of economic substance: this occurs when, due to the legal institute used for the transaction, a taxpayer has actual economic power over the taxable income and, in spite of this, does not infringe the tax provision;

- Simulated transactions: this refers to transactions where the parties state one thing while their purpose is another. In a simulated transaction, they pretend to carry out a transaction which does not actually occur, or which they do not intend to carry out. In a simulated transaction, all the parties are aware of it at the time of carrying out the transaction;

- Doctrine of classification: the parties use an incorrect "classification" or description on indicating the nature of the actual rights and obligations under a certain transaction. The difference with simulation lies in the fact that these transactions generate rights and obligations which actually exist or which do not differ from those which actually exist.

In turn, the countries whose legal system comes from Roman-Germanic law observe the effective provisions and, strictly speaking, do not follow the principle of precedents prevailing in the countries under the common law system. Nevertheless, the rulings of the higher courts ultimately interfere with the enforcement of the legal provisions. Over time, part of the case law has been incorporated into the system, under the form of specific devices. In this sense, the experience of different countries has generated norms reflecting the following theoretical approaches:

- Abuse of right: the abuse of right consists on manipulating the intent or the spirit of the law. The courts do not take the legal form into account when the transactions are exclusively or predominantly used to avoid tax incidence, that is, without a *bona fide* business purpose. According to this principle, the taxpayer cannot exercise his right with the exclusive purpose of avoiding or reducing the tax obligation. The taxpayer has the right to perform a fully lawful transaction, but the legal form should be the normal and usual method used in seeking the usual economic result for that type of business;

- Abuse of law (fraud against the law): some jurisdictions apply the common law doctrine of “fraud against the law”. This concept is similar to the rule of business purpose. The principle of “fraud against the law” allows the court to rule out a transaction made to avoid tax payment and substitute it with an ordinary transaction. The tax is applied as if the taxpayer had not made the ruled out transaction, but a similar tax-liable transaction;

- Simulation: some countries whose legislation is based on the *civil law* system apply the simulation doctrine to guarantee substance over form. The apparent transaction differs from the actual transaction, and is not based on reality nor on actual or effective intention. In such cases, tax authorities may rule out the simulated transaction and substitute it with an actual one. This principle is similar to the classification doctrine, where transactions are hidden or fictitious and the actual intent of the transaction differs from the legal form.

The experience in countries applying general anti-avoidance rules in the fight against international tax planning has not always been positive. General anti-avoidance rules are limited in their practical application. This occurs because it is very difficult for tax authorities to prove fraud against the law or simulation regarding international transactions.

In this sense we may state that the tax authorities are better prepared to fight international tax planning through the use of specific measures which apply to certain situations. The Courts have shown, however indirectly, preference for specific anti-avoidance norms in detriment of the general provisions which entail in practice higher complexity at the time of proving the irregularity.

II.5.1.1. Criteria that permit use of the economic reality principle if there are clear indicators

Here under commentaries concern whether the legislation contemplates the possibility of applying the economic reality principle, and if so, there will be included a list of cases where this is possible.

ARGENTINA

The economic reality principle is contained in the law on tax procedures.

It states that, in order to determine the real nature of the taxable event, account will be taken of the economic acts, situations and relations effectively carried out, pursued or established by taxpayers. If a taxpayer submits these acts, situations or relations in legal forms, or structures, that are not effectively like those presented or authorized in civil law procedures for appropriately setting out the exact economic intention of the taxpayers, consideration of the real tax event will disregard inadequate legal forms and structures, and the real economic situation will be adapted to the forms or structures that would be applicable under civil law without taking into account those chosen by the taxpayer, or the taxpayer might be permitted to apply forms or structures that would be most appropriate to his or real intention.

These criteria are used to govern cases of simulation (deceit and misrepresentation), fraud and other similar abuses. However, their effectiveness depends on the results obtained -in each individual case – by auditors.

Their application generally gives rise to legal controversy, with uncertain results on the whole.

Therefore, our country has included in legal tax texts different types of rules, such as transfer pricing rules, anti-tax haven rules and the fiscal transparency system.

None of these mechanisms are aimed at increasing tax collection as such. They are aimed at making ensuring the proper collection of taxation.

BRAZIL

The economic reality principle cannot be applied in Brazil as the Brazilian legal system is based on the strict legality principle.

Current Brazilian tax legislation does not make a distinction between establishments with or without legal personality nor between those establishments located in tax havens or in countries with preferential taxation treatment.

If a Brazilian company has branches, subsidiaries or agencies in countries with preferential taxation treatment, profits earned by these entities cannot be reached by the Brazilian Tax Authority or at least they cannot effectively be verified. In the case of partnerships, if dividends are not distributed, they will not be taxed in Brazil.

At present amendments to current legislation are under study, for countering evasion of income remitted to tax havens, and are aimed at placing the burden of the proof on the taxpayer. It would therefore be the responsibility of the taxpayers to prove that it is in fact their branch, subsidiary, or agency, which is controlled and located in a country with those characteristics, that carries out productive activities, for that country's domestic market. If this cannot be proved, IPRJ and CSLL deductions will be made from the results of those entities abroad. Amendments will also cover individuals who are partners and are not affected by current legislation.

CHILE

The "received income" accounting principle establishes that economic results should only be taken into account when they are received, in other words, when the transaction from which they are derived is completed from a legal standpoint, or based on applicable commercial practices, and all transaction risks have been seriously considered. Generally speaking, it should be noted that the concept of "received income" is part of the "accrued income" concept.

MEXICO

At present, there are no rules that take into account economic reality and not the form of the juridical acts involved.

Within our administration in charge of income policies, there is the intention of submitting to Congress a rule known as a general anti-abuse rule, similar to that envisaged in Spanish legislation.

II.5.1.2. Powers for reallocation of profits and expenditure between companies

This item will include powers granted by laws, or other regulatory provisions, that allow tax authorities to carry out the reallocation of profits.

ARGENTINA

In Argentine legislation there are no specific regulations concerning the reallocation of profits and expenditure between companies.

However, transfer pricing regulations fill that need in cases when transactions, which are carried out by entities and individuals affected by this regime, have not been agreed in conformity with the independent operator principle (arm's length).

In addition to the provisions of section 14 of the income tax law, branches and other stable establishments of a foreign company, individuals or entities, must effect their accounting records separately from their parent companies and other branches of the company, in order to determine the Argentine source income.

When accounting records are lacking or these records do not reflect, in exact terms, the net Argentine source profits, the Argentine Tax Authority may consider that these mentioned establishments in the country and abroad make up a single economic unit and determine the respective net profits that are liable to taxation.

Consequently, if such a situation were to occur, the possible decision of the Tax Authority could entail a reallocation of profits and expenditure internationally.

BRAZIL

No legislation on transfer pricing or on foreign source income exists that permits reallocation of profits or expenditure between foreign companies.

In this respect, there is one single restriction, contained in section 25, no. 5, of Law 9249/95.

CANADA

See II.3.8

CHILE

No specific powers exist that permit the taxpayer to reallocate profits and expenditure between companies, but companies may attempt to abuse regulations established in the law, with regard to the following:

a) Section 31 of the income tax law: it refers to expenditure that may be deducted from gross income.

b) Section 41 b of the income tax law: provides that taxpayers may transfer profits, in other words, they may increase the holding's profits in such countries with special tax regimes, in order to lower the tax burden or generate losses in countries where taxes are higher or there is stricter control on tax compliance by taxpayers.

   This section thus establishes that taxpayers, domiciled or with residence in Chile, who make investments abroad through permanent establishments or agencies, must add directly the tax results (positive or negative), obtained by the permanent establishment or agency abroad in the fiscal year, to the net taxable income in the first category of Chilean-source income tax.

MEXICO

Verification powers envisaged in the Federal Tax Code, which may also be implemented after a revision by higher authorities, or based on cabinet recommendations, or after an on-site inspection, enable verification of due compliance with tax provisions and generally result in a reallocation of non-accrued income by the taxpayer, or after rejection of deductions on the latter's tax declaration, but usually does not result in reallocation of the income to the partner of the audited taxpayer.

Exceptionally, the power to reallocate profits and expenditure between companies, as such, is only permitted with regard to transfer pricing by means of use of the adjustment concept, envisaged in sections 215 to 217 of the Income Tax Law.

II.5.2. International fiscal transparency rules

In order to defer taxes on investments that are easily re-deployable (bank deposits, loans, bonds, shares, etc.) many entities or individuals establish affiliated, base or controlled foreign companies in territories that have low taxation or establish special regimes for the purpose of attracting certain types of assets, and that income generated by these assets accrue in these countries, not being deducted from taxes in the investor's country of residence until the repatriation of profits.

This strategy allows for the channeling of income towards jurisdictions of lower fiscal pressure, thus reducing the tax base in the residence country and deferring tax payment until the time said income is repatriated. In an attempt to curb this type of tax planning, the States have implemented the norms of international fiscal transparency.

To counter this situation many countries have established the use of international fiscal transparency rules, which consist in attributing the affiliate companies' income to the parent company when it becomes due, in other words, it will be added to the taxable base without waiting for the effective distribution of profits.

International fiscal transparency is directly related to the use of so-called *base companies*. These are companies located in territories of low or null taxation, destined to obtain gains whose taxation shall be deferred to a later moment or otherwise never occur in the State of residence of its effective beneficiary. International fiscal transparency falls under the figure of *controlled foreign companies* (CFC), as named in the doctrine and comparative law.

The rationale behind international fiscal transparency lies in the principle of taxation on worldwide income by the taxpayer's State of residence. Said State taxes all its residents' income, regardless of the location of the source of said income.

When non-resident entities of the group develop activities and derive offshore gains, most of the States establish, one way or another, that these profits shall be taxed in the country of residence when they refer to payment of services rendered in that State or when there is distribution of dividends originated at those non-resident entities. Consequently, international fiscal transparency is subject to a basic limitation, since this anti-avoidance norm is only applied on certain income, which could be classified within the category of liable income.

International fiscal transparency is also related to the idea of neutrality in capital imports and exports. The principle of taxation on the worldwide income in part contributes to neutrality in capital exports, since income is taxed regardless of the location of its source. Meanwhile, that neutrality is not fully achieved until the global consolidation of the tax base is completed.

Nevertheless, neutrality in capital imports acquires certain significance when viewed from the point of view of the consequences brought about by the repatriation of income of foreign source. This income shall be taxed by the State of residence only at the time of effective repatriation or when it is attracted to the jurisdiction of that State on account of its international fiscal transparency rules. On a different note, international fiscal transparency is also affected by neutrality in capital imports when it is exempt in the State of residence of the foreign-source income.

In summary, international fiscal transparency rules may be the result of several tax goals. Thus, they should be applied:

- To support anti-avoidance legislation;
- To stop the transfer of income towards non-resident related companies; and
- To support a policy of neutrality in capital exports.

ARGENTINA

Specific rules on international fiscal transparency were introduced into income tax rules, in Law 25063 (published in the Official Gazette on December 30th 1998) on the establishment of regulations with regard to World Income. Later these rules were extended to encompass certain types of joint stock company income resident in countries with low or no taxation in Law 25.239 (published in the Official Gazette on December 31st 1999) and were passed in Decree 1037/00, published in the Official Gazette on November 14th 2000.

These rules were aimed at preventing tax losses caused by certain companies or individuals benefiting from profits through Tax Havens, which our legislation prefers to refer to as “Countries with Low or No Taxation”.

The central aspect regarding the rules on international fiscal transparency is indicated in section 133 of the income tax law that establishes the principle by which , in terms of profits and expenditure abroad, assessment will be guided by the rules of Section 18 of the applicable law, taking into account some amendments of the first of these rules.

It may be said that section 133 complements section 18 of the tax law with respect to world income, in other words, with regard to foreign source income treatment obtained by residents in the country.

For the purpose of our analysis, it is extremely important to mark the principle which establishes, according to the income tax law, that dividends distributed by joint stock companies constituted abroad are liable to taxation, as well as profits that are attributable to shareholders or partners of such companies. In such cases, the exceptions envisaged in sections 46 and 64 of the tax law are not applicable. These exceptions benefit profits and dividends derived from certain local companies.

The fiscal transparency rules contain specific provisions regarding the following:

a) Income attribution to local resident holders of companies –with the exception of joint stock companies – and stable establishments located abroad.

b) Income attribution to local resident shareholders of joint stock companies constituted or located abroad.

c) Income attribution to local resident shareholders of joint stock companies constituted or located in countries with low or no taxation.

d) List of territories with low or no taxation, including jurisdictions, territories, associate States and tax regimes.

e) Definition of and special treatment for passive income.

f) Treatment for foreign source losses.

g) Calculation of credits for similar taxes paid abroad.

BRAZIL

Brazil introduced international fiscal transparency rules back in 1995, with the enactment of Act N° 9.249/95, which on paragraph 25 sets forth the principle of universality as a basis for taxation of legal entities with offshore investments. Later on, this issue was ruled by paragraph 1 of Act N° 9.532/97, which is supplemented today by the rule established in paragraph 74 of Provisional Measure N° 2.158-35/01.

CANADA

Canada has a system whereby all individuals and corporations must annually pay tax on investment income earned by foreign corporations or other entities which they, or together with related parties, control. Canadian tax must be paid whether the income is paid to Canada or allowed to remain with the foreign entity. Under this type of system, investment income is not allowed to accumulate in a low tax foreign jurisdiction until it is repatriated to Canada.

These rules are very complex and comprise a substantial portion of domestic Canadian tax law.

CHILE

Essentially, international fiscal transparency is a tax regime that aims at taxing individuals or entities who are residents of a certain country or territory, in addition to income obtained by entities residing in a different country or territory, provided that three requirements are fulfilled:

- The entity residing abroad is controlled by resident persons or entities.

- The entity residing abroad benefits from a privileged tax regime.

- Income obtained by the entity residing abroad meet certain characteristics, which are related to the nature of the income or having economic ties with the individuals or entities that control it.

In this country there are no international fiscal transparency rules.

MEXICO

The fact that some countries grant fiscal personality to some entities, while other countries do not**,** may have an impact on the deferral of income accumulation, re-characterization of income and crediting of taxes paid abroad, for the convenience of taxpayers, or for avoiding taxation or the impact of double taxation.

Two instruments are most frequently used in these circumstances: one involves partnerships, and the other involves trusts. In the latter, it is quite common to find that one State considers them as taxable entities or individuals and the other as not liable to taxation and treats them like transparent entities or individuals. In both cases, duality can give rise to a situation in which taxpayers try to carry out tax planning, although they might later unexpectedly find that they suffer double taxation.

Mexico does not recognize fiscal transparency as attributed by foreign law to certain legal institutions, to which legal personality is also granted. Thus, if a legal entity registered in another country receives a Mexican-source income, the income will be taxed, without taking into consideration if it is considered as transparent or not, for tax purposes in that country.

Furthermore, it must be mentioned that the interpretation given above is maintained by the Tax Administration, and has been published on the web page of the Administration with what was known as inappropriate interpretation criteria for the authorities, and will later be described in the section that deals with other regulatory measures.

II.5.3. Thin Capitalization Rules

The rules to prevent thin capitalization do not restrict the excessive payment of interest on loan funds, pursuant to arm's length principles (transfer pricing) but, in some cases, they reclassify the interest as dividends and the loan as capital contributions (increase). International thin capitalization rules vary from country to country. In general, one of the following four approaches is used, or some combination thereof:

- The arm's length approach: this approach is based on the general transfer pricing principles. The determining factor is whether a non- related party would provide funds under the same terms as those in the deal carried out with the related party in a loan contract;

- The approach of hidden distribution of profits: under this approach, the specific provisions in tax legislation allow for the interest on the loan to be reclassified as dividends. In general, these rules are applied when the lender and the borrower are related parties or engage in a defined relationship, such as Board members or shareholders;

- The fixed-ratio approach: several tax jurisdictions specify a maximum parity ratio for the net worth in order to restrict the loans granted by non resident controlling shareholders. Under this method, the residing borrower cannot deduct the interest over the loans granted by non resident shareholders if they exceed the parity ratio specified for that net worth;

- "No-rule approach": several tax jurisdictions lack specific rules for combating thin capitalization. Some countries whose legislation comes from the Roman-Germanic tradition rely on their general anti-avoidance provisions, such as "fraud against the law" or "abuse of right".

When there should be applied the economic reality, fraud of law, abuse of forms, etc., the main target of the analysis will be to determine if the company disposed, at that moment of the concession of the loan (or the consecutive renewals), the possibility of gaining (in the same conditions or by a third party) the same resources contributed by the moneylender it is related to. In case this situation does not occur, and according to the scope allowed by the general legislation against abuse, the supposed liability may be reclassified as a shareholder's equity with the tax consequences it implies (non-deduction of taxes, etc.).

Determining the above mentioned is a question of fact and proof whose evaluation has to be made in each case in particular. Specifically, it has to be affirmed if the company in case of independency would have entered into that loan agreement for both the conditions of the agreement and the power to obtain from a third party, the amount of the liability under the correspondent analysis.

Owing to the fact that circumstances of each case have to be analysed individually, it is not possible to establish *a priori* a group of elements or evidences that allow to fix a unique but not arbitrate standard to determine if liability is actually a capital equity. Without prejudice of the above mentioned, it should be pay special attention to the existence of particular circumstances (as, among others, the following: non-setting of terms and ways of capital and interest payments amortization, non-effective annulment of such, and/or alterations in the conditions without considerable reasons regarding the character of the supposed liability) that suggests that, actually, the loan had been always thought as a capital.

It would be advisable to evaluate the risk assumed by the supposed creditor (that is to say if his wage is or is not subordinated to the business risks of the debtor company), state which apparently concerns with the situation of shareholder.

<u>ARGENTINA</u>

Argentina added thin capitalization regulations to its national legislation in late 1998. In 2003, the relevant regulations were amended to make adjustments based on the experience gathered over almost five years.

The regime described below was established in Law No 20628/1997 – Income Tax – and its regulatory decree No 1344/1998, as per the language in force until the amendments introduced with Decree No 916/2004 - BO 21/07/04 -.

As a general rule, Section 81 of the Income Tax Act enables deductions from the tax year profits of debt interest, interest updates and expenses originating in the set-up, rollover and repayment of such debt.

Notwithstanding, for companies incorporated or permanent establishments located in the country – excluding banking and financial entities, financial trusts and companies set up with the primary purpose of entering into leasing agreements, their secondary purpose being financial transactions only – interest on debt with non-residents who control them shall not be deductible from the tax balance sheet - where they should be charged in the corresponding ratio to the originating liabilities amount as at the fiscal year-end - when it exceeds twice the amount of net worth as at the same date.

The limitation excludes interest paid to non-banking or financial entities located in jurisdictions not deemed low or no taxation by the regulations and with which existing agreements enable effective information exchange, given that interest payments to persons not meeting those conditions are subject to withholding in the country – as a once-off payment for the national income obtained by the foreign beneficiary – resulting from applying the (35%) tax rate on the total income tax paid, no actual nor deemed deductions being allowed.

The law establishes that non-deductible interest shall receive the treatment foreseen for dividends.

The total amount of liabilities to be considered is that originating in the financial debt at the end of the business or calendar year. Therefore, it does not include any debt resulting from acquiring assets, locations or service provision associated with the cash flow.

Likewise, it establishes that, when the liabilities at year-end show changes that seem to respond to avoidance of anti-abuse regulations, the cap shall be calculated by determining the average monthly balance, excluding that of the last month of the year.

Furthermore, should the economics indicate that a financial debt has been concealed, said debt shall also be included in the total liabilities amount to be considered.

For the purposes of the calculation, the net worth to be considered is either that arising from the business balance sheet or, if no books are kept, that obtained from the difference between the total asset value and debt – including deferred profits, if applicable. The contributions or advances received on future equity payments are considered part of the net worth inasmuch as duly documented or irrevocable commitments exist to purchase shares with neither interest accruals nor any accessory in favor of the payer.

Finally, it is established that the regulations may determine that the limitation is inapplicable should the type of activity performed by the taxpayer so warrant.

BRAZIL

In Brazil's legal structure, there is no provision exclusively seeking to avoid tax planning based on this behavior, present in transnational companies.

The choice made by Brazilian lawmakers was promoting some sort of fiscal neutrality among the options available to the foreign investor. Thus, from the fiscal point of view, it makes no difference whether the investor chooses to increase his own capital or to finance it. The applicable tax burden is very similar in either case.

There are two specific measures underlying this treatment. The first being that Brazil does not levy taxes on income distribution, regardless of Double Taxation Agreements. This measure suppresses the possibility of economic double taxation, which is one of the goals behind this type of planning. The second being that it is the implementation of a mechanism which allows for offsetting own capital in a way similar to payment of offsetting interest on loan capital.

The company may deduct from income tax assessments the sum paid, remitted or delivered to the offshore partner, in the form of interest for own capital compensation, up to a certain tax rate cap, determined by the relevant government agency and based on the financial market. Such interest is affected by a 15% tax rate at the source, which equals the tax rate applicable on loan interest.

Thin capitalization, which lies in the reduction of the tax base in the country of residence, is indirectly curbed through the adoption of measures providing for equal treatment of own and third-party capital. Brazil has chosen to allow for the deduction from the Legal Entities Income Tax base the amount of effectively paid interest as own capital gains. Thus, it is possible for firms, as an equivalent to paying interest on a loan (third-party capital), to deduct the offsetting interest of own capital in Income Tax assessments.

In the case of Brazil, this measure encourages firms to opt for capital increases, instead of engaging in a loan transaction between related companies. The goal in this specific situation is reestablishing fiscal neutrality. This occurs because the result would be indifferent, be it that the firm seeks to capture resources by way of loans or by capital contributions made by the controlling or related company. This neutrality is achieved also because of the fact that Brazil imposes no taxes on dividend distribution.

CANADA

Canadian legislation provides that interest on debt payments by Canadian corporations to related non-residents is not deductible for income tax purposes if the debt is three times the equity (share capital and retained earnings) of the corporation. If this ratio is exceeded, the interest on the excess amount is not allowed for income tax purposes.

Because this is a well known aspect of Canadian tax law, new corporations established by non-residents will usually arrange their capital structure to comply with this rule.

CHILE

From the Act N°19.738 of the year 2001, alterations were introduced to the article 59 N°1 of the Income Tax Act about the rule of Excess of Indebtedness between related entities, when the creditor is domiciled out of Chile.

The above mentioned rule establishes that the proportion of interests of debts with related foreign creditors that exceeds the limit of 3 times the wealth, will be taxed with a rate of 35 %, assuming this way the excess of resultant indebtedness as a withdrawal of utilities. Similarly, the type of operations of indebtedness with related parties covered by the rule is specified, which can be only Credits with Foreign or International Financial Institutions, Balances of Prices for admission of goods with deferred coverage or system of collection, and Bonds placed abroad, including those denominated in national currency.

Article 59 N°1 of the Income Tax Act defines the Excess of Indebtedness, the Total Annual Indebtedness and the Wealth for effects of Excess of Indebtedness. The article clearly specifies that the excess of indebtedness is relating to the credits with related entities domiciled abroad. It also establishes the direct or indirect patrimonial relations (greater or equal to 10 % of patrimonial property) that point out a credit as member of the calculation of excess.

Through the Circular letter N ° 24, 2002, the rule of excess of indebtedness is pointed out and its form of calculation is defined:

- Wealth for Effects of Excess of Indebtedness: It is establishes from the Proper Tax Capital on January 1 of the year in which debts were contracted (or as of the date of beginning of activities) with related entities domiciled abroad. To this, we must add the contributions (sum) and retirements (subtraction) as its permanence during the year, and we come to a Patrimonial result on December 31 of the year to be informed.

- Total Annual indebtedness: It is the total sum of all the debt settlement with related domiciled persons abroad which are unpaid as of the last day of every month, during the year in which the credits were contracted. These settlements include unpaid balances of previous periods. The result of the sum is divided into 12, which gives an average annual settlement of Debts with Related persons.

- Factor of Excess of Indebtedness: It is the result of comparing the Total Annual Indebtedness with 3 times the wealth. It is a factor expressed in percentage terms. It represents the percentage of the debt belonging to excess of indebtedness, for which it is applied to the remittances of interests in order to determine the proportion of these ones that must pay 35 % of Additional Tax.

MEXICO

In view of the improved macroeconomic situation (low inflation rates), proposals are being analyzed for the legislative branch to include thin capitalization rules for the next tax year.

II.5.4. Transfer Pricing Rules

Legislation on transfer pricing is another commonly used measure in countries seeking to fight against international tax planning. Among transnational companies, the transfer of goods, services and duties is made through so-called “transfer pricing”. The issue here is determining, from the fiscal point of view, what would be the correct and fair price for a transaction between related parties.

In the field of International Tax Law, theoretical studies on transfer pricing conclude that the fiscally correct price would be “the price which would have been agreed on by unrelated parties engaging in the same or similar transactions in terms equal or similar to those used in the open market”. This is the substance of the *Arm’s Length* principle, also called “free competition” principle, to be observed by the companies in their transactions with foreign related companies.

When the prices set intentionally promote the shift of the tax base with the only purpose of reducing taxes, they constitute a violation of the *Arm’s Length* principle, which should be avoided by the transfer pricing rules. This type of harmful behavior is the rationale behind fiscal controls on the part of authorities in countries where prices have been artificially set with the purpose of reducing the fiscal burden.

In general, the application of transfer pricing rules on transactions between companies located in jurisdictions considered to be tax havens does not vary from the general application of these rules to transactions between related companies. Argentina and Brazil have also adopted legislation establishing that transactions made by resident companies, or even permanent establishments of foreign companies, with individuals or companies located in countries characterized by low taxation systems are, on a legal presumptive basis, contrary to the rules about arm's length practices. This presumption leads to shifting the burden of proof, since the company must prove that its transactions did not generate abnormal offshore profit transfers.

In the meantime, some countries have introduced specific rules for setting the price at arm's length in the case of transactions with companies located in tax havens.

ARGENTINA

From 1998 onwards, with the passing of Law 25.063 – that governs transactions carried out as from December 31st 1998-, the Income Tax Act was amended, amongst others, and new aspects of transfer pricing were introduced, with the inclusion in the tax law of an updated set of regulations in line with the position that other countries had adopted on the matter. It should be noted that, generally, Argentine legislation has followed OECD criteria and principles.

Later, on the passing of Law 25.239, published in the Official Gazette on December 31st 1999, the Income Tax Act was amended once more, with changes to the setting of transfer pricing. Decree 1.037/2000 regulated this law.

With the passing of Law 25.784, published in the Official Gazette on October 22nd 2004, the transfer pricing regime was once again amended with changes regarding arm's length treatment in import and export transactions. Prior to the changes, these operators were to apply the transfer pricing methodology in certain cases.

The most important change introduced in the mentioned law was the inclusion of a new transfer pricing method. This method acts like an anti-planning and tax avoidance regulation, as it is aimed at stamping out ploys that were detected in auditing processes, and generated great losses to the tax coffers.

In order to assess the losses, it should be noted that, over a 5-year period, 7 companies sold 22 billion dollars, and paid 2 million dollars to the Tax Authority as income tax, in other words, approximately 0.09 %, while the Argentine economy paid 1.6% during that same period.

This method is applicable to goods with known international prices in transparent markets exported by an international intermediary of low economic standing – a shell -, whose participation in the transaction is solely aimed at directing profits to tax havens in general.

The change introduced in the mentioned law included a method assumes that the international intermediary is an entity or an individual of low economic standing (shell), unless proof to the contrary is provided based on legal criteria.

In order to determine the taxable base for income tax purposes, if it cannot be proved that the international intermediary is not a shell, then the export price must be considered as the price of the goods in the transparent market on the last day that cargo was loaded, and not the agreed price.

<u>CANADA</u>

Additionally, since 1997, Canada relies on legislation requiring related parties to document how prices were established. This legislation also provides that these parties may be subject to penalties for not maintaining this documentation. The legislation also provides for substantial penalties in the event that the transfer prices are adjusted by Canada Revenue Agency.

If a Canadian corporation is charged in excess of fair market value for goods or services by a related party, that excess amount cannot be deducted by the corporation for tax purposes. Additionally, if a Canadian company undercharges a related party for goods or services rendered, the deficiency will be added to the company's income for tax purposes.

<u>CHILE</u>

Wit the aim of controlling those situations that involve operations of transfer prices, our country has applied the regulation associated with the topic, understood in the article 38 of the Income Tax Act, which is in keeping with the guidelines of the OCDE.

<u>MEXICO</u>

In order to avoid manipulation as mentioned, and following OECD criteria, this country has implemented transfer pricing legislation, contained in section 86 XV, XVI and XVII, 215, 216, 217 of the Income Tax Act.

Its legal framework sets forth that multinational groups must agree on prices for transactions undertaken by companies of the same group, in line with market prices. Problems have arisen in its implementation because of high training costs in this field and the country's budgetary restrictions. This has resulted in the restructuring of the area in charge of reviewing compliance with such provisions.

<u>II.5.4.1. Penalties for transfer pricing manipulation and non-compliance of documentation rules.</u>

The economic dimensions of international transactions cannot go unnoticed, as well as the difficulty of controlling and monitoring them when information and documentation are inadequate. Thus, the penalties system, applicable to formal and material non-compliance in this regard, must be in direct relation not only to these dimensions but it must also consider –based on practical experience – the underlying tax loss.

This is not a case of establishing excessive penalties that might result in unfair competition between Tax Administrations, but of assessing types of non-compliance and related tax losses, so that non-compliance is not less dear than compliance with current rules.

It is worth mentioning that if no information is submitted regarding taxpayers' international transactions, this is not treated as a comparable omission in a domestic transaction.

In both cases, the Tax Administration is adversely affected, even with regard to efforts undertaken to obtain information to enable control, but in fact, locally, as the Tax Authority can audit all parties in a given transaction, this makes it easier to solve the situation.

This differs from when formal non-compliance involves international transactions, not only with regard to the administrative task of obtaining necessary information from abroad to enable control, but also because of a possible need to meet, in full or partly, the inability to control in cases involving transactions agreed with entities or individuals residing in a territory that does not assist in the exchange of information.

The penalty system used in international taxation could take account of how much effort was made by the taxpayer to comply with the rules, essentially with regard to the transfer pricing system.

ARGENTINA

Recently, on the passing of Law 25.795, which amended the tax procedures law, specific regulations were included in Argentine legislation with regard to penalties applicable to non-compliance of rules concerning international transactions.

The penalty system includes the following:

1. An immediate fine –without prior summons– for not submitting tax declarations on last date for meeting requirements:

   - Additional tax return with information about import and export transactions between independent entities or individuals: $1,500 (approximately US$ 300) for individuals and $ 9,000 (approximately US$ 3,000) for companies.

- Additional tax return with information about transactions with entities or individuals abroad –except those mentioned above-: $ 10,000 (approximately US$ 3,330) for individuals and $45,000 (approximately U$15,000) for companies.

2. Fines for non-compliance with the regulations that establish or require compliance with formal tasks for determining tax obligations, for verifying and inspecting for compliance of those tax obligations by the responsible taxpayers.

   - A fine ranging from $ 150 (approximately US$ 50) to $ 2,500 (approximately US$ 830).

   - In the following circumstances the fine will range from $ 150 (approximately US$ 50) to $ 45,000 (approximately US$ 15,000):

     - Resistance to a tax audit (repeated non-compliance of Tax Authority requirements).
     - Not keeping price documentation in international transactions.
     - Not providing information for international transactions control.

3. Non-compliance with the requirements of the Argentine tax and customs administration (AFIP) with respect to submitting tax declarations with information about international transactions and own or third party informative statements

   - Fines: ranging from $ 500 (approximately US$ 160) to $ 45,000 (approximately US$ 15,000). These fines can be added to the previous ones, and are fixed according to the taxpayer's situation and the seriousness of the misdemeanor.

4. Higher income taxpayers.

In the case of taxpayers with annual incomes equal to or higher than $10,000,000 (approximately US$ 3,333,000), if there is non-compliance after three summons, the applicable fine is 2 to 10 times higher than the maximum foreseen amount ($45,000) and will be added to the other fines.

5. Omitting non-payment of tax

   - General: from 50 to 100% of the tax that was not paid, withheld or received.

   - International transactions: 1 to 4 times the tax that was not paid or withheld.

BRAZIL

No penalties are contemplated for such situations in current legislation on Transfer Prices or Foreign Source Income. However, there is a penalty (fine) for the non-collection of Income Tax or Corporate Tax on Net Profits.

If a taxpayer does not keep financial documentation of foreign entities or proof of taxes paid abroad and set against a Brazilian tax, nothing can be done.

CANADA

Please refer to Section 247 of the Income Tax Act, and IC87-2R

CHILE

In sections 38 and 21 of the income tax law, which establish penalties for transfer pricing manipulation.

MEXICO

With respect to transfer pricing manipulation, as was established in the first part of this paper, the penalty consists of adjusting and subsequently reducing the deductions made or increasing the income.

As concerns non-compliance of documentation rules, there are several penalties. Non-presentation of informative documentation mentioned in section 86 of the Income Tax Law, which has been included in section 3.1.1., results in the non-deductibility of payments made abroad, in conformity with section 31 V of that same Law.

In some cases, presentation of information is required in order to obtain a benefit, and the non-presentation thereof generally results in not being granted the benefit, which was conditional on presentation of the information. In other cases it results in a fine for non-presentation of documentation.

The non-presentation of the statement on investments in territories with preferential tax regimes results in a fine, as well as not being permitted to pay taxes on income obtained through said investment on a net basis.

II.5.4.2. Use of Advance Pricing Agreements (APAs)

Prior or advance agreements on transfer pricing are agreements that carried out between the Administration and the taxpayer that determine, prior to transactions between related companies, appropriate criteria for setting those prices during a specific period of time.

The aim of these agreements is to establish transfer pricing with some certainty, which is never easy to do. In addition, this means that the Tax Administration must obtain information regarding the transactions involved, which would otherwise be hard to do.

Although countries with legislation that contemplates the signing of APAs, generally do so unilaterally, in other words, the agreement is made between the Administration and the taxpayer, without the involvement of the tax authorities in the countries of residence of the other related companies. Bilateral agreements are also possible (and are incorporated into OECD criteria), as well as multilateral agreements, despite the need for them to recognized and accepted by the company or companies involved.

ARGENTINA

This does not apply because it is not envisaged in the legislation.

BRAZIL

The system for pre-established margins in transactions methods included in transfer pricing legislation renders it unnecessary to adopt solutions agreed on between the government and taxpayers such as the Advance Pricing Agreements.

CANADA

Canada has made use of advance pricing arrangements for approximately ten years. This procedure has worked effectively for both parties to these agreements.

CHILE

This is not applicable to our tax system.

MEXICO

Our legislation envisages that the taxpayer will obtain a decision from the authorities regarding transfer pricing in advance. Technically this is not a formal agreement as such, but a resolution, requested by the taxpayer, who needs to know with certainty which prices are to be applied in transactions with business counterparts.

Section 34-A of the Federal Tax Code, which contains provisions with regard to advance resolutions on transfer pricing

II.5.5. Measures Related to Tax Havens

In addition to the already mentioned, anti-abuse rules can encompass those established under domestic law for the purpose of countering undisclosed or misleading transactions declarations, income or assets located in tax havens.

In this regard, tax legislation generally establishes different penalties or tax offences, and limits expenditure deductibility or payment options.

Furthermore, some countries also establish restrictions with regard to changes of residence, which in general imply postponing it or establishing an exit tax when the individual or entity has potential income, in that jurisdiction, on which taxation has been delayed or when the pattern of some tax profits is no longer consistent

Additionally, it is also possible to establish presumptions of continued residence, even without suffering them to be rebutted by counter-evidence, at least during a limited amount of years, and when the change of residence is believed to be bogus.

Some countries have included in their tax legislation different measures related to payments made by their residents to other entities located in countries with low or null taxation systems.

A common measure is restricting the deductibility of costs and expenses incurred by a resident company coming from a transaction with an individual located in a tax haven or a jurisdiction with low preferential tax regimes. In this hypothesis, objective criteria and terms are defined, allowing for deduction from the tax base of the costs and expenses paid to a resident in a country with more favorable tax conditions. This norm transfers to the taxpayer the burden of proving, among other aspects, that:

- The beneficiary develops a substantial economic activity in his country of residence and meets the necessary technical and operating conditions to supply the products delivered or made available or to render the agreed services;

- The transaction actually occurred, submitting delivery notes or certificates of availability of the acquired goods or of the actual rendering of the contracted services, as well as payment and receipt documents;

- The payment beneficiary has fiscal residence in the country indicated, submitting charters of incorporation duly processed by the registration office as well as the correct identification of his partners, representatives and statutory auditors;

In other cases, it is possible to establish a specific correlation between payments to countries characterized by low taxation systems and the application of differential rates to tax withholdings at the source. The countries adopting these measures apply in the withholding hypothesis a tax rate which is higher than the usual one. This higher burden is applied to any payment resulting from a transaction where the beneficiary's domicile or establishment is within a "low tax jurisdiction". The rationale behind these provisions lies in the presumption by tax authorities that the payments made to beneficiaries located in jurisdictions of low or null taxation do not consider the rule about arm's length practices.

Along this same line, we also find rules on transfer pricing among the measures designed to combat international tax planning implying countries or jurisdictions with low or null taxation, which include transactions with companies located in these jurisdictions, regardless of the fact that they are considered related parties.

Furthermore, some countries do not grant exemptions on withholdings, normally applicable to interest paid offshore, when the beneficiary's country of residence is included in the black list of countries with low taxation systems.

ARGENTINA

In Argentine legislation, tax havens are known as "countries with little or no taxation".

In conformity with the income tax law, this concept includes not only countries, but also dominions, jurisdictions, territories, associate States or special tax regimes.

Initially, legislation referred to countries with little or no taxation, identifying them by a conceptual definition established under General Resolution Number 702.

That caused taxpayers to be uncertain as, pursuant to the rules regarding such countries with little or no taxation, they had to determine which were, or were not, the territories having or not the characteristics included in the definition mentioned.

Therefore, subsequent legislation adopted the criterion followed in other countries, and thereupon proceeded to list the countries considered as being countries with little or no taxation.

Thus the decree regulating income tax in a seventh, unnumbered section, added immediately after Section 21, includes a list of 87 jurisdictions considered as effecting little or no taxation, including special regimes such as for Financial Corporations envisaged under Law 11.073 of the Oriental Republic of Uruguay.

In the decree that regulates the income tax law, it is further established that the list may exclude those dominions, jurisdictions, territories or associate States that have a valid information exchange agreement with the Argentine Republic, or which, should the case arise, establish income tax amendments in their domestic legislation to meet international criteria in this matter, resulting in the fact that they cease to be countries with little or no taxation.

The following rules regarding countries with little or no taxation are contained in Argentine legislation:

1. Income tax:

    a. Transfer Pricing.

Pursuant to Section 15 of the income tax law, it is deemed that transactions effected by Argentine taxpayers with parties incorporated, residing, domiciled or located in countries with little or no taxation are not in conformity with the arm's length principle, between independent operators.

That implies that, whatever the transaction entered into may be, and whether or not there be an economic link between the local operator an the party from the countries where little or no taxation is levied, the Argentine taxpayer must apply the transfer prices scheme in order to justify that such transactions have been contracted at market value between independent operators.

b. Single tax payment through withholding tax paid by beneficiaries abroad.

Pursuant to the income tax law, non-residents in Argentina pay taxes on Argentine-source income in the form of a single payment withheld at source.

For this purpose, the tax law considers — without accepting proof to the contrary — that a certain percentage of net income (of the amount transferred abroad) is payable for each of the income items concerned.

As concerns interest or consideration paid on credits, loans or investments obtained abroad, of any origin or nature, the percentage of Argentine-source net income envisaged in the law is set at 43%.

The tax rate (35%) is to be applied on this percentage of net income, in order to determine the tax payment, effective tax rate of 15.05% of the gross amount of the remittance abroad.

However, if the creditor abroad is an entity residing in countries with little or no taxation, the presumed Argentine-source net income is set at 100% of the amounts remitted abroad, resulting in an effective tax payment of 35% of the amounts remitted as interest or consideration paid on credits, loans or investments of any origin or nature.

This provision is not applicable if the borrower is an Argentine financial institution.

c. Expense accounting

In order to establish their net income that is liable to income tax, corporate taxpayers have to account for both income and expenses using the accruals method.

However, if — among other aspects —payments generate Argentine-source income for the foreign entity that was incorporated, resides, is domiciled or located in countries with little or no taxation, accounting must be done using the cash method.

This means that expenses can only be deducted after the income has been paid out to the foreign beneficiary and, consequently, after the single tax payment on such income has been withheld.

Thus, the rule prevents amounts outstanding from being accounted as expenses, for it allows them to be deducted only after taxation of the Argentine-source income of a beneficiary from a country with little or no taxation.

d. Fiscal transparency rules. Income assessment of joint stock companies located in countries with little or no taxation.

Since it was first included, subsection b) in Section 133 of Law 25063 rules that income attributable to stable establishments mentioned in Section 128 is be assessed in accordance with the provisions in Section 18 of the tax law. This implies that:

- In the case of stable establishments, the income for a given fiscal year is the income accrued during that year, and the establishment may, when applicable, exercise the option of reporting the income in the accounting year when it is payable.

- The rules on income accounting methods shall be applied likewise to expense accounting methods, in the absence of a provision to the contrary, whereas expenses that cannot be traced to a specific income source shall be deducted in accounting year reports for the year in which they were paid.

Law 25239 (OG: 12/31/1999) was enacted and from the date of publication of the fact in the official gazette, the scope of the mentioned provisions was extended to include the joint stock companies located or incorporated in countries with little or no taxation, being applied to all fiscal years as from the date of enactment, with regard to income derived from interest, dividends, royalties, rent or other passive income similar to that mentioned in the regulations.

2. Statutory Presumptions

In the unnumbered section added after Section 18 of the tax procedure law, it is established that income entering the country from States with little or no taxation, whatever its nature, denomination or type of transaction involved, it will be deemed that such income adds to the wealth of the local borrower or recipient unjustifiably.

The unjustified increase to wealth mentioned in the previous paragraph, added to an extra 10% for income disposed of or consumed by non-deductible expenses, constitute net profits for the fiscal year in which they were produced, and provide the basis for determining the applicable income tax and, if it be the case, for estimating unreported taxable transactions on which value added tax and excise taxes should have been levied, having occurred during the fiscal year period in question.

The provisions in the foregoing paragraphs notwithstanding, the Argentine tax and customs administration (AFIP) will deem justified income entered, which the holder thereof proves beyond all doubt to derive from activities in fact effected by the taxpayer himself or by third parties in such countries or derived from returns on investments, duly and timely reported.

This rule is of great importance, for if the taxpayer does not show compliance with the requirement set out therein, income from jurisdictions with little or no taxation will not only be taxed as income, but also be liable to excise tax, the implication being that they are derived from sales unreported for tax purposes.

CANADA

Canada does not distinguish tax havens from other international countries in its legislation. Canada does, however, distinguish between countries with which it has negotiated a double taxation agreement and those with whom it has not in its provisions dealing with controlled foreign corporations.

CHILE

The relation between the parties is presumed for transfer prices and cases of over-indebtedness.

Please find attached a copy of the following provisions:

- Section 38 of the Income Tax Law (LIR): establishes rules concerning transfer prices.

- Circular 72, dated December 27th, 2002: amends the aforementioned Section 38 of the Income Tax Law. Law 19.840 enacted in the year 2002.

- Circular 3, dated January 1st., 1998. Section 38 of the Income Tax Law 19.506, dated July 30th., 1997.

- Income Tax Law (LIR), Section 59, subsection c): provides for a presumed connection between the parties, in matters of indebtedness, when the recipient or the creditor to whom interest be due is incorporated or domiciled in a country with little or no taxation.

- Circular 24 dated March 14th: includes instructions on amendments introduced to the income tax law, Section 59, Number 1 under Law 19.738 enacted in 2001, concerning companies who are over-indebted on account of credit granted to them by foreign entities or individuals with whom they are connected under the terms established under such Section, as amended.

- Circular 48 dated September 26th, 2003: amending Section 59, subsection 4, Number 1 and Section 74, subsection 4 of the income tax law pursuant to Law 19.879, enacted in the year 2003.

- Exemption Resolution 5412, passed on December 11th, 2000: establishes a simplified procedure for granting “RUT” Numbers to foreigners, who are not resident in Chile, for stock exchange transactions, for compliance with certain requirements and tax payments to which they may be liable.

- Exemption Resolution 20, passed on June 1st, 2001: complements Exemption Resolution 5412.

- Exemption Resolution 47, passed on May 5th, 2004: complements Exemption Resolution 5412.

For effects of the rules of Excess of Indebtedness, it will be understood that the receiver or creditor of the interest is related to the payer or debtor of the interest when the former is constituted, domiciled or resident in countries or in territories that they are considered for the OCDE to be tax heavens or subject to fiscal preferential harmful systems.

For effects of the rules of Transfer Prices, it will be supposed that relation exists with regard to taxpayers who realize operations with companies that are constituted in tax heavens.

In the simplified system of Rut for foreign investors the access is not allowed when the investor is constituted, domicile or resident in a tax heaven.

The Supreme Decree N°628 of 03.12.2003 establishes the payroll of countries considered tax heavens, which are enumerated next:

1. Principality of Andorra
2. Anguilla
3. Antigua and Barbuda
4. Aruba
5. The Bahamas
6. Kingdom of Bahrain
7. Barbados
8. Belize
9. Bermuda
10. British English Islands
11. Cayman Islands
12. Cook Islands
13. Republic of Cyprus
14. Dominica
15. Gibraltar
16. Grenada
17. Guernsey
18. Isle of Man
19. Jersey
20. Republic of Liberia
21. Malta
22. Republic f Mauritius
23. Montserrat
24. Netherlands Antilles
25. Niue
26. Republic of Panama
27. Samoa
28. Republic of San Marino
29. Saint Kitts and Nevis
30. Saint Lucia
31. Republic of Seychelles
32. Saint Vincent and the Grenadines
33. Principality of Liechtenstein
34. Principality of Monaco
35. Republic of Marshall Islands
36. Republic of Nauru
37. Republic of Vanuatu
38. Turks and Caicos Islands
39. Virgin Islands (United States).

MEXICO

Since the nineties, Mexico has implemented provisions in its Income Tax Law in order to prevent tax planning practices, which make use of preferential regimes in countries where there is no information exchange.

The rules address three sets of problems involving the use of preferential regimes in countries without information exchange. Firstly, the provisions indicate that there are countries which have preferential tax regimes and no information exchange; secondly, they address the problems related to payments made by Mexican residents to residents in countries where there is no information exchange (henceforth known as payments to residents under preferential regimes), and finally they approach the problem of investments by Mexican residents in countries with the aforementioned characteristics, where there are preferential regimes and no information exchange (investments under preferential regimes)

a. List of territories with preferential tax regimes.

Mexico adopted the more objective criterion and the one that best fulfills the legality principle, to establish which countries have preferential tax regimes, by listing the names of all these countries or geographical regions. Known in Mexican fiscal circles as the “black list”, it is in fact envisaged under the Law, in the Second transitory Section, subsection VI, dated 2003-

Mexico transcribes the aforementioned subsection and the country list.

The countries were not placed on the list randomly. The list was obtained from an OECD study, wherein it was stated that, in these countries or regions, either little or no taxation was levied or no financial and fiscal information was provided, or both, in other words, there was little or no taxation and no information was provided.

The amendments were implemented in 2003 and permit countries or regions to be excluded from the list, if they agree to exchange information with Mexico, and the exchange is effective.

In the revenue policy area, Mexico is to determine whether to submit to Congress a reform in which the country list be no longer used and be replaced by a formula which would account for the difference between real taxation actually generated in the country where the investment is located, or whereby payment would be received of the equivalent amount that would be generated in Mexico by the same items. This comparison would established that if the tax generated in the other country were lower than the 75% of the tax that would have to be paid in Mexico, the provisions concerning the territories with preferential tax regimes would be applied to the income derived from such investment.

b. Payments to residents under preferential regimes.

Payments to residents under preferential regimes, where no information is provided, essentially give rise to two problems, addressed by Mexican tax legislation in the Income Tax Law.

Firstly, payments to residents under preferential regimes, with no available information, prevents the Mexican authorities, should Mexico be the source country, from verifying if the type of income reported was in fact correct, as it cannot obtain information from the resident country of the income recipient. In other words, there is no way to verify whether, for instance, the income paid to him actually matched the services rendered, and not to royalties or interest, which have source rules and rates that are different from those applicable to services rendered.

Additionally, due to the fact that these companies enjoy lower effective tax rates than in Mexico, and in some cases, none at all, companies from those countries have a competitive advantage over their Mexican counterparts, which generates a harmful commercial competition as a direct result of the tax provisions in those countries.

For these reasons, Mexico has the following legislation on this subject (Income Tax Law).

Please find attached a copy of Sections 190, 204 and 205.

c. Investments under preferential regimes.

Preferential regimes, with or without information exchange, may lead investors from a certain country, such as Mexico, to relocate their capital to subsidiaries in countries with preferential regimes. They thereby delay income accumulation in Mexico, which has led Mexico to establish provisions for preventing such delays in countries with preferential regimes, which do not provide information.

II.5.6. Impact of agreements for the avoidance of international double taxation on international anti-avoidance rules

Usually, and in conformity with the constitutional State regulations, international treaties have supremacy over domestic legislation.

This circumstance is relevant in the case of DTAs, as part of the international anti-avoidance regulations established in domestic legislation might not be applicable with regard to transactions with residents of another signatory State, if they violated such an international treaty.

Of special interest is the non-discrimination clause in the Agreements, which aims at avoiding differences in fiscal treatments with regard to nationality. This provision also encompasses permanent establishments and companies that include shareholders residing in the other State.

Different anti-abuse clauses have been added to the model convention, including the effective beneficiary clause, in order to avoid the application of domestic anti-avoidance regulations.

However, with respect to certain measures such as international fiscal transparency, the OECD has suggested in the convention commentaries that these regulations are not incompatible with the treaty, although the non-discrimination clause does prevent it from being solely applicable to non-resident individuals and entities.

ARGENTINA

Argentina has signed 17 Conventions for avoidance of international double taxation, 2 of which were based on the Andean Pact Model and the others on the OECD/UN Model.

One aspect, which could be controversial – although there are no signs of this yet – is the difference between the definition of the economic connection concept in domestic legislation, with regard to application of transfer pricing methods, and the definition in the signed Agreements for avoidance of double taxation.

It is like that because on there not having been defined in these agreements such concepts as percentages of association direct or indirect participation in order that the related companies is formed or which is the scope to assigning to the concept of control that also is a parameter to define the existence of related companies, there must be applied the internal Argentine legislation that foresees a more wide concept to know the related companies.

This one is a relevant aspect and can think difficult if it is considered that probably complex situations of fact should be evaluated.

CANADA

Whether or not the general anti-avoidance rule applies to a particular situation is a question of fact. However, where a non-resident of Canada enters into a series of transactions designed primarily to secure an exemption or reduction from Canadian tax under an income tax convention that Canada has with another country, the department may seek to apply the general anti-avoidance rule to deny any tax benefit that such transactions would otherwise produce."

CHILE

The impact that the agreements of double taxation produce in the tributary Chilean administration is the modification of the rates of the additional tax applicable to the taxpayers without domicile or residence in Chile for the revenues that they perceive or accrue of Chilean source.

The impact of the agreements:

a) The treaties have supremacy over domestic legislation, and implementation of these agreements must involve application of different tax rates, depending on the type of income and country concerned.

In order to carry out the agreement provisions, the withholding agent must demand that the non-resident in Chile present a certificate of residence attesting to residence in the signatory country to the valid agreement.

b) Non-collection of the additional income tax with regard to corporate profits, as this income is only taxed in the taxpayer's resident country, except in the case of the treaty with Argentina (Article 7 of the treaties).

c) Income is only taxable in the resident state, being that a signatory country, and is considered tax-exempt in the other country (Treaty with Argentina).

d) Acknowledging as credits those taxes paid abroad by Chilean residents.

e) Difficulty in determining if taxpayers who exercise activities in Chile are or not country residents, in other words, if they spend more than 183 days in the country, which determines permanent establishment in that country (Article 5 of the treaties).

f) Permits taxpayers that are not domiciled or non-residents in Chile to name representatives without powers, or to pretend to have little decision making power, in order to avoid setting up a permanent establishment in Chile and not be liable to local taxation.

So far, Chile has signed 16 Agreements to avoid the International Double Taxation, based on the OCDE Model. These countries are Argentina, Brazil, Canada, South Korea, Croatia, Denmark, Ecuador, Spain, Mexico, Norway, New Zealand, Peru, Poland, United Kingdom, Sweden and France.

These are the applicable rules in this matter:

- Circular 5 dated 01/19/1999: instructions regarding changes introduced to Chapter II, para. 6.6. of the income tax law, concerning international double taxation regulations in Law 19.506, dated 1997.

- Circular 10 dated 02/09/2000: concerns the publication and entry into force of international agreements on double taxation.

- Circular 32 dated 05/25/2001: agreement between the Republic of Chile and Canada for the avoidance of double taxation and prevention against income tax evasion and wealth tax evasion.

- Circular 17, dated 03/30/2004: establishes model certificates of residence and tax situation in Chile for presentation in countries with which there are valid agreements for avoidance of double taxation and to other tax administrations, and it establishes procedures for requesting and issuing these certificates.

- Circular letter N°08 of January 26, 2005: on the coming into effect of new agreements for the avoidance of international double taxation and the application of the most- favored – nation clause.

- Circular letter N°33 of June 30, 2005: on the application of the most- favored – nation clause included in the Agreement signed between Chile and Canada, to services given by natural persons.

- Circular letter N°62 of November 24, 2005: on application of the most- favored – nation clause included in the agreements signed with Canada, Denmark and Mexico.

- Circular letter N°50 of September 05, 2006: on the deduction as credit of taxes paid for revenues that are not mentioned in articles 41 A and 41 C of the Income Tax Act

MEXICO

Agreements for avoidance of international double taxation are instruments, with regard to the Income Tax Law, that can only benefit entities or individuals who can prove that they are residents of the signatory country to the agreement. The international anti-avoidance regulations contained therein only apply to provisions in these agreements. However, the agreements do not contain tax avoidance regulations regarding cases that are foreseen in domestic Law. Information exchange is an exception to this as the agreements contain clauses with respect to it, and it is also included in domestic law. Nevertheless, information exchange is restricted in the case of certain countries.

As drafted, the clauses on benefit limitations are highly useful, such as the clause with the United States, and mentioned in the first part of the paper. The concept of effective beneficiary and other specific clauses have also been included to cover this type of income.

II.5.7. Other measures

II.5.7.1. Taxpayer Documentation and Evidence Required

This section shall include a description of the documents required of taxpayers by Tax Administrations, as well as a detail of the information these should contain, according to the purpose.

ARGENTINA

1.Arms' length import and export transactions of goods with known quotations in transparent markets.

A biannual return (F 741) is required in electronic format including the detail of all transactions made with indication of the customs item, the foreign counterpart and the price agreed. They should further indicate the international market price of the good being imported or exported. This obligation derives from Argentine legislation which determines that, for the purposes of settling income tax for this type of good, the transparent market price should be used, unless proven otherwise. The necessary information is sought in order to control compliance with the legal provision.

2.Import and export transactions of goods without known quotations in transparent markets. As per the recent legal amendment of the income tax applicable, in these cases the Tax Administration shall require supplementary returns to income tax settlement returns when a figure in excess of $1,000,000 (approximately U$333,000) is reached in a given year.

3.Transfer Pricing:

General Resolution No. 1122 sets forth two types of obligations:

a. Obligation to document: a list of documents the taxpayer should have available for submission to the Tax Authority, if so required. The grounds for this regulation is to provide greater legal certainty and predictability for taxpayers in order that they are aware in advance of the type of documents the Tax Authority may request when conducting transfer pricing audits. The resolution lists a number of documents. This listing is not comprehensive, but merely descriptive. The data to be documented include: Argentine taxpayer's data and information relative to his/her functions and activities; complete information of the foreign related person and any documentation, should it exist, which proves the nature of the alleged relation; documentation of transactions effected; consolidated financial statements, when relevant based on the pricing methodology used; information on the taxpayer's financial standing, the company's environment and the market where it does business, business strategies, cost structure, etc.

b. Transfer pricing returns in electronic format to supplement the income tax return (F 743). This return is required by the Income Tax Act to verify compliance with transfer pricing regulations. The taxpayer shall report all transactions performed with the related foreign persons, with a discrimination by type of transaction, e.g.: imports, exports, financial loans, loans granted, reinsurance, technology transfer, etc., identifying the foreign person, the price agreed and the transfer pricing justification method used. Should a difference be generated in favor of the Tax Authority, said difference shall be stated on this return. All of this information has allowed us not only to perform more efficient controls, but also to derive statistics such as: the most widely used method, types of transactions performed with foreign persons, foreign investment maps, Argentine investments abroad, different foreign persons doing business with the same Argentine person, different Argentine persons doing business with the same foreign person (the latter case being of utmost importance when transactions are made with tax havens).

c. Transfer pricing studies for tax purposes (on hard copy), certified by a public accountant. This requirement has helped avoid difficulties in terms of having a schematic study of all the necessary steps to be taken when applying transfer pricing. A detail and explanation of the following is required: functional analysis, selection of comparables, including the rejected methods, comparability analysis, assumptions used to select the best method, comparability adjustments, determination of the market range and the calculation of the adjustment in favor of the Tax Authority, if applicable. This requirement has favored not only auditing processes, but also the investigation and analysis processes prior to audit selection.

4.Double taxation treaties

In order to be eligible for the benefits stipulated in such treaties – use of reduced rates for source withholdings to the foreign beneficiary – the taxpayer shall submit to the withholding agent a certificate approved by the Tax Authority in the signatory Country where the following should be confirmed: residence and status of effective beneficiary of the foreign person from the respective signatory Country; that the foreign person does not have a permanent establishment in Argentina, and the tax identification information of the person vis-à-vis the foreign tax administration. This provision is set forth in General Resolution No. 3497.

5.Company Reorganization

As per Section 77 of the Income Tax Act, when companies, business assets, and, in general, any type of business and/or operation pursuant to the terms of this section are reorganized, any proceeds arising as a result of such reorganization shall not be subject to this tax, provided certain requirements and conditions are met. According to the law, reorganization should be understood as mergers, spin-offs, and sales and transfers from one entity to another if they are part of the same economic group.

In order to enable this benefit for tax purposes, companies shall comply with the provisions in General Resolution No. 2245 which establishes, among other obligations, the need to communicate said status to AFIP (the Argentine tax authority) as well as to provide certain documentation.

BRAZIL

Specific normative actions both for transfer pricing and foreign source income require few taxpayer documents.

For transfer pricing, the only requirement is that contained in Section 21 of Law No. 9430/96.

For foreign source income, requirements are contained in IV 2 and IV 3 of Section 25 and 2° 26 of law No. 9249/95.

CANADA

Canada currently requires promoters of tax shelters to register those arrangements with the Canada Revenue Agency prior to promoting them. While the registration is not considered to constitute the Agency's approval or disapproval of these arrangements, it does provide an opportunity to review them in their early stages. Promoters who receive consideration before registering a tax shelter are subject to severe penalties.

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CHILE

The normative text established in Sections 60 and 63 of the Tax Code and Section 341 of the Civil Procedural Code, which detail the documents that might be requested of taxpayers with the purpose of either verifying accuracy of their tax returns or merely gathering information.

Furthermore, a description is provided of the evidence that might be used in a court of law.

At present the Chilean tax administration requires all taxpayers that carry out international transactions to provide information on the following tax forms:

Foreign investments.

- Form on the reinvestment of taxable profits carried out by persons who are neither domiciled nor residents in Chile. (Section 74 N° 4 of the Income Tax Law).

- Form about the acquisition of shares, company or representative rights on capital of a legal entity constituted abroad, for the purpose of the penultimate para. of no. 2 of section 58 of the income tax law.

- Form 1850 on additional taxation in the income tax law, which taxes domestic source income obtained by persons who are neither domiciled nor resident in Chile.

- Form on the registration of foreign institutional investors as established in section 18 bis 5 of the income tax law

Investments made by Chileans abroad.

- Form 1851: information regarding permanent investments in foreign companies, the names of the companies or partnerships in which the taxpayer has a part, country of residence, type of investment carried out, including company rights and/or shares and other.

- Form 1852: information concerning agencies or permanent establishments abroad, including the names of the beneficiaries of the investment, country of residence and background information for determining net income, including revenue, interest, costs, taxable net income aggregates and deductions.

- Form 1853: information on income or losses obtained abroad, taxes paid abroad, set against the first category income tax.

- Foreign investors register (RIE): information about investors who set up companies abroad, who have company rights and company shares abroad, and those who own agencies or permanent establishments outside Chile.

Indebtedness.

- Form 1857: Form for stating credit conditions set by foreign or international banking institutions or bank-holding companies.

- Form 1858: Form concerning tax payment due on goods which entered the country, on credit or collection basis.

- Form 1859: Form about bonds or debentures issued in foreign currency by companies that were constituted in Chile.

- Form 1860: Timetable for foreign debt payments.

- Form 1861: Form concerning over-indebtedness.

- Annual declaration1855: on credit transactions for the financing exports that are exempt from stamp duty.

- Annual declaration 1856: on credit granted by foreign or international banks or financial institutions to Chilean financial institutions, with interest exempt from additional taxation, in conformity with b), N° 1, para. 4, section 59 LIR.

Services.

- Form 1854: transactions that are exempt from additional taxation.

- Annual declaration on foreign source income (F 1853).

- Form on income that is exempt from additional taxation, envisaged in the income tax law (Art. 10 of DL 3059), which favors shipbuilding and shipping companies, including domestic tug, motorboat and mooring companies.

Commerce

- Form on transactions in section 59, no. 6 (leasing transactions)

- Forms mentioned in Circular 69 dated November 9th 2002 applicable to contracts regarding goods located abroad or in Chile and still bonded.

MEXICO

The Income Tax Act sets forth several obligations for taxpayers in terms of providing and obtaining specific information and documentation when making transactions with related parties or foreign residents.

Below is a list of the main obligations for taxpayers in this connection:

1. Proof of Residence: Section 5 of the Income Tax Act requires that taxpayers using any double taxation treaty keep a proof of residence of the resident abroad to whom they make payments, with the purpose of proving that payments are made to a resident of a country with which an agreement exists. This information is required under the tax authority's verification function.

2. Proof of Withholdings: As per Section 6 of the Income Tax Act, taxpayers who claim income tax paid abroad shall have the substantiating documentation to prove payment, which documentation consists of the return showing the total amount withheld, duly submitted to the tax authorities of the source country. In the case of countries with which there is an agreement, only proof of withholding is required. This information is required under the tax authority's verification function.

3. Loan Information: In terms of interest payments made abroad, part VII of Section 86 of the Income Tax Act sets forth an annual information requirement to be submitted to the tax authority by February 15, containing information relative to the outstanding loan amounts on any loans granted or secured by foreign residents, as well as the type of funding provided, name of the effective beneficiary of such interest, currency, applicable interest rate and maturity schedule for principal and interest on a transaction-by-transaction basis. This information is required of the taxpayer by law.

4. Statements of Foreign Payments, Transactions with Related Parties and Investments in Territories with Preferential Tax Regimes. Taxpayers are required to submit three additional informative statements, namely on payments made to foreign residents with a wealth source in Mexico (Section 86, IX, a of the Income Tax Act), transactions made with related parties residing abroad (Section 86, XXX of the Income Tax Act) and investments in territories with preferential tax regimes (Section 214 of the Income Tax Act). All three statements are mandatory by law and shall be submitted by electronic means.

5. Transfer Pricing Study**.** Relative to transfer pricing, Section 86, XII of the Income Tax Act requires that taxpayers keep the so-called "transfer pricing study", which consists of obtaining and keeping documents which prove the transactions with related parties to show that the amount of income and deductions have been calculated at market value.

6. Registry of Foreign Banks. Foreign resident banks wishing to chose a 4.9% withholding rate in a country with which Mexico has entered into a double taxation agreement, or a 10% rate when no such agreement exists, shall register in the bank registry, which requires annual renewal. In order to obtain said renewal, they shall provide proof of residence, an annual financial report, amount of loans granted or secured to residents in Mexico, and a sworn affidavit stating that they are the effective beneficiaries of the interest generated by the loans granted. On registering, they shall further prove that they are duly incorporated as banks.

7. Interest on Bonds Placed. Relative to debt placement among the wide investor public abroad, in order to be eligible for a preferential withholding rate of 4.9% on the interest deriving from said instruments, the Miscellaneous Tax Resolution (administrative rules granting benefits to taxpayers) requires several notices be submitted with a detail of the characteristics of their placement.

8. Share Sales. With a view to paying income tax on a net basis, foreign residents shall submit a report on the transaction. When the sale is exempt pursuant to a DTA, only the appointment of a proxy in Mexico is required, in addition to a notice communicating said appointment.

9. Company Restructurings. Likewise, when the provisions set forth in an Agreement are applied in terms of company restructurings, to ensure that benefits are exercised directly rather than via reimbursements, a notice shall be submitted proving that they meet the requirements set forth in the Agreement to grant the specific restructuring benefit.

In addition to the specific information detailed in the paragraphs above, the Federal Tax Code determines that the following elements should be considered:

1. The Federal Taxpayer Registry, which provides information, *inter alia*, on the increase or decrease in taxpayer obligations. Noteworthy among these is the obligation to report when it is no longer a Mexican resident. Notices to the Federal Taxpayer Registry are submitted by the taxpayer on a voluntary basis.

2. Submission of returns used to pay taxes with the primary purpose of reporting the amounts paid, although they also provide useful tax information, such as total income accrued, authorized deductions, taxed events for value added tax and taxes paid abroad which can be credited.

3. Keeping accounting books, pursuant to Section 28 of the Federal Tax Code, which is conceptualized very broadly. It not only includes books and records but also any substantiating documentation, such as invoices, contracts and corporate books, among others.

4. Submission of a tax opinion. This is probably the most important source of all. It is prepared by a certified public accountant, which in principle

guarantees the independence of the review. On international affairs, the public accountant has to report any payments made to foreign residents and the withholding made, in addition to providing an opinion regarding the taxpayer's tax situation, which involves checking that informative statements have been submitted.

II.5.7.2. Additional information requirements for taxpayers who carry out international transactions.

Included hereunder are the additional information requirements for taxpayers who carry out international transactions, and indications of when they are necessary and the advantages of producing the information.

ARGENTINA

With implementation of AFIP General Resolution 1375 a third party information system was created with regard to all economic transactions, whatever their nature, even if free of charge, agreed between residents of the country and representatives of entities or individuals abroad. The representatives of the mentioned entities or individuals abroad must act as information agents and those who take part in such transactions as service providers, including notaries public, banks, stock markets, insurance companies, bureaus de change, etc .

Representatives affected by the regulation, prior to complying with the obligation to inform, must re-register with the Argentine tax administration.

This regime attempts to favor the use of control and auditing procedures, in addition to enabling detection of transactions and transaction implementation mechanisms aimed at tax avoidance and/or evasion.

On the other hand, before the improvement of the macroeconomic general situation and opposite to the evolution of the exchange market especially, there was registered in our country an important abundance of the foreign capitals under different modalities, notable movements of bottoms(funds) being observed towards and from the Republic Argentina..

This way so, it turned out to be fundamental to establish a new regime applicable to the income of currencies to the foreign exchange market in order to deepen the instruments necessary for the follow-up and control of the movements of the speculative capital.

It having in it counts the need to harmonize the adoption of such measurements in the frame of the free negotiability of currencies and the treatment that the capital flows receive.

To such an purpose the General Resolution 1926 is dictated establishes an informative regime respect of funds that join to the country, that enter to the country, of the exterior, originated in such certain economic operations, like:

1. Direct investments contribution in the country.

2. Loans from international agencies.

3. Loans from oficial credit agencies.

4. Oficial credit agencies secured loans.

5. Finantial loans of up to 1 year of term.

6. Finantial loans of more than 1 year of term.

7. Participation sales on local corporations to direct investors.

8. Participation sales on local corporations to portfolio investors.

9. Finantial loan collections granted to non residents.

10. Resident investments repatriation.

11. Finantial guarantees.

12. Non residents other investments in the country.

13. Coverage contracts cancellation collections between foreign currencies.

14. Coverage contracts cancellation collections of commodities prices.

The aforementioned regime of information must be expired for the resident subjects in the country that they deposit to same you add of money the same one for more than Fifty thousand (50.000) American monthly dollars

BRAZIL

Other than the annual income tax declarations for legal entities, additional information must be submitted concerning facts relative to commercial transactions abroad and with regard to branches, subsidiaries and related companies abroad and their results.

CANADA

Canada has extensive reporting requirements for persons carrying out international transactions. For example, all Canadian corporations must annually disclose all related foreign parties together with the nature and amounts of transactions undertaken with those parties during the year.

Some of these forms are:

T106	Information Return of Non-Arm’s Length Transactions with Non-Residents
T1134-A	Information Return Relating to Foreign Affiliates that are not Controlled Foreign Affiliates
T1134-B	Information Return Relating to Controlled Foreign Affiliates
T1135	Foreign Income Verification Statement
T1141	Information Return in Respect of Transfers or Loans to a Non-Resident Trust
T1142	Information Return in Respect of Distributions from and Indebtedness to a Non-Resident Trust

CHILE

See ítem II.5.1.1

MEXICO

See item II.5.1.1.

II.5.7.3. Other regulatory measures

CHILE

Transfer pricing

- Normative:

- 38 LIR.
- 72 del 27/12/2002.
- 3 del 06/01/1998.

Excess of indebtedness:

- 59 N° 1 LIR.
- 24 del 14/03/2002.
- 48 del 26/09/2003.

MEXICO

Mexico’s other international tax regulations are mentioned before. Nevertheless, this section is useful, and describes advances made in this area: the mentioned inappropriate criteria, and concrete tax reform proposals to be submitted to Congress.

As concerns the inappropriate criteria, as from this year, taxpayers are being informed via the Internet about the interpretation criteria that the Tax Administration Service considers as aggressive and inappropriate, and that interpreting and applying the Law in the listed ways has economic consequences, resulting in criminal and tax consequences for those who undertake such practices, in certain cases.

Criteria are not purely international but also encompass deductions, investments, financial system, value added tax, and other. Four published criteria are of international scope. It is noted that publication is aimed at creating an awareness of the risk involved for the taxpayer, as a deterrent measure, and for the taxpayer to be informed of the interpretation criteria used by the Tax Authority. as well as the likely consequences of non-compliance with the criteria.

The published criteria are the following:

1. Thin capitalization.

"When a company re-bases the ratio of liabilities to company capital to 3:1, and to 6:1 for finance sector companies, the interest earned derived from the liabilities agreed with the related parties, which exceed that ratio, are not deductible, in cases where indebtedness is undertaken to reduce the income tax base and/or relocate tax profits and losses."

2. Concealed commission agent.

"Residents abroad constitute a permanent establishment, if they carry out their corporate activities on national territory through a commission agent without powers, who acts on behalf of the resident abroad and signs contracts on behalf of the individual or entity."

3. Fiscal Transparency.

"For the purpose of Mexican tax laws and the provisions of agreements for avoidance of double taxation, foreign institutions with legal personality, recognized as such in their own articles of constitution, which obtain Mexican-source income, or constitute a permanent establishment in the country, are liable to income tax in the national territory and not their individual members, in conformity with ordinary Mexican law, independently of the fact, that for tax purposes, they may not be considered liable to income tax in the country where they were constituted."

4. Migration of intangibles.

"It is considered that an institution with legal personality ceases to exist for tax purposes when it moves effective management headquarters to another country, in conformity with section 12 of the Income Tax Law, with regard to sections 1and 9 of the Tax Code, and applies the provisions envisaged in section 4 of the treaties for avoidance of double taxation, in order to solve the problem of its dual residence, in keeping with the effective management headquarters criterion.

“If this institution has intangible assets that are not recorded in its books, it must apply the market value on their disposal. Market value evaluation can be based on the price, amongst other means, that were sold to foreign third parties, should this be the case.”

The main objective is to audit the application of inappropriate criteria, inasmuch as possible, in order to prevent other cases from occurring.

As concerns tax reforms, thin capitalization rules will be submitted to Congress, with regard to advance accumulation of passive income in countries with very low taxation even when involving signatory countries to an Agreement for avoidance of double taxation and avoidance of migration of intangibles.

CHAPTER III

STRUCTURES AND MECHANISMS USED IN THE INTERNATIONAL TAX PLANNING

III.1. Introduction

The purpose of the present chapter is to offer to the reader some examples of international tax planning used in the different member countries from the Inter-American Center of TaxAdministrations - CIAT-, in order to serve as guide at the time of detecting maneuvers that try to diminish the taxable base of the taxes whose application, collection and determination are in charge of such administrations.

Besides, those legal and administrative measures will be mentioned which have been adopted in the participating jurisdictions, in order to fight the maneuvers or schemes detected by the respective Administrations.

In order to obtain a better understanding of the structures or mechanisms that will be next developed, they have been divided conceptually, under the following paragraphs:

A. Dislocation of the residence or effective venue, with or without reassignment of wealth.

B. Fictitious conversion of incomes

C. Fictitious or harmful decrease of the taxable bases through the reassignment of expenses or incomes

D. Fictitious or injurious decrease of the taxable base through the reassignment of incomes subject to taxation in the source, corresponding to beneficiaries abroad.

E. Deductions by fictitious expenses or debts generated abroad.

In addition, it is important to point out that at the end of this chapter there is a summary that in an easy and quick way helps to localize the examples provided by the Tax Administrations of countries member of the working group CIAT "International Tax Planning Control".

That summary contains, in addition, other classifications that let the reader choose the above mentioned examples from other parameters of assessment of harmful tax planning.

The examples we are going to refer to are included at the end of this chapter in order regarding the summary format.

It is about an amplified version of the classification guidelines that include:

Maneuvers

I. **Creation or use of interposed subjects**

II. **Simulation of operations**

III. **Sub-over invoicing**

Tools

1. **Abuse of preferential regimes**
2. **Abuse of the lack of rules that allow the exchange of information**
3. **Abuse of the rules in order to determine the tax base**

At the same time it is considered of interest to point out that the possibility of detecting different ways of characterizing the framing of the behaviors that lead to harmful tax planning, let us realize that an specific and particular planning typology can obey to a wide range of events that conduct to the unworthy tax behavior.

However, in the following points of this chapter the compiled examples will be grouped and commented as from the first of the classifications above mentioned. It includes the paragraphs A to E, as it is considered they enclose and include the most relevant concepts to distinguish the facilitating situations as well as the effects produced by the harmful international tax planning.

III.2.A. <u>Dislocation of the residence or effective venue, with or without reassignment of wealth</u>

Within the frame of international tax planning, the taxpayer wants to determine means, not always illegal, to reduce its taxable base and as a result of it the collection of the residence country is affected.

It will be for that reason that the analysis made by the different States has like common denominator the jurisdictions with privileged tax treatment.

Of the set of speeches that compose the present work, the obtaining of mechanisms arises like resultant that avoid the decrease of the taxable bases, produced by the use of fictitious legal forms and/or derivation of activities towards strange jurisdictions with preferential tax treatment.

The conclusion of the restlessness raised in this section would be to manage the extension of the tributary power - for example through agreements to avoid the double imposition when direct or indirectly their tributary resources were affected, by means of actions that have as purpose to elude the rules related to the residence.

We must bear in mind that this alteration of the residence by natural or legal persons can include or not the transfer of legal entitlement of its wealth, despite such actions generate to those a fiscal advantage.

In this regard, examples of the traditionally structures used in the international tax planning are exposed next which were approached by the Tax Administrations that conform the Work group “Control of the International Tax Planning”:

III.2.A.1. <u>Fideicomisos or trusts constituted abroad</u>

In the case of the Republic of Argentina, the decrease of the taxable base of the Personal Assets Tax on the personal goods of the natural persons has been verified.

Therefore, it has been possible to observe the transfer of the possession of the wealth located abroad, pertaining to Argentine residents by means of the constitution abroad of a contract with specific characteristics that for the legislation of the mentioned country it fits like a “*fideicomiso*”.

In such sense, the economic reality demonstrates that the true owners of the patrimony in question go on being the Argentine residents, in virtue that they hold the disposition of it. For additional information we suggested to see **<u>Link A 8</u>.**

On the other hand, in Brazil the use of “trusts” both by natural persons and by legal persons has been stated, with the intention of avoiding the tributes or benefiting with the application the most favorable aliquot over the patrimony. The most usual strategies in that country have been observed in the patrimonial transfers “mortis causa”, trough the transfer of such property to the “trust” and thus, decrease the taxable base for the evaluation of the Transfer Tax “mortis causa”.

Additionally, these contracts have been used to hide to the property of goods and rights acquired with resources from an illicit activity or that have not been put under the payment of taxes in the origin country. To such aim we recommended to refer to **<u>Link B 1</u>.**

As noted in section II.3.7, Canada does experience substantial problems with trusts, both domestic and international. This is because trusts are very easy to establish, require minimal documentation and the settlor (the person who establishes the trust) need not reside in the jurisdiction in which the trust is resident. Many financial institutions will act as a trustee for minimal consideration. In this way, it is very easy to establish an entity in a foreign jurisdiction to hold legal title to assets while control of those assets ultimately remains under the control of the resident of Canada.

Canada has recently enacted legislation which will require Canadian residents to domestically report certain income earned by a non-resident trust of which the Canadian resident is a beneficiary. Also, if the non-resident trust has been settled by a Canadian resident, the trust itself may be considered to be a resident of Canada for certain purposes and be taxable in Canada on its income for the year.

However, in Canada some mechanisms of elusion in the community property have been noticed, by means of the constitution - by one of the spouses in favor of the other- of a “trust” in a country with zero or low taxation with which an Agreement To avoid the International Double Imposition has been subscribed , with the aim of taking advantage of tax exemptions understood in the above mentioned agreement. For more illustration see **Links C 1 y C 2.**

Besides, it can be mentioned with regard to the mechanism precedingly exposed, the use of “trusts” on the part of Canadian companies. We suggest to see **Link C 3.**

It is possible to emphasize that also a decrease of the tax base takes place when patrimonies located in Canada, pertaining to non-resident - previous to its change of condition- or on the contrary goods pertaining to a Canadian person that loses its condition of resident, are transferred to a “trust” constituted abroad. See example of **Links C 5 and C 8.**

Finally, difficulties in determining the validity of certain “trusts” have been stated since the lack of legitimacy of the object of such trusts. We suggest to refer to **Links C 6 and C 7.**

III.2.A.2. Organizations off Shore

The participating Tax Administrations have exposed a series of cases in which it is described how the companies located in tax havens have been used, with the aim of diminishing the tax burden in the territories with high or middle taxation. Thus, these Bodies have detailed the legal and administrative measures adopted, in order to fight the diversion of utilities between the different tax jurisdictions.

The objective of these companies is generally the tax saving, which it has been verified through the accomplishment of operations whose utilities are generated in jurisdictions of high or medium taxation but they are derived to territories of zero or low taxation. It is the example displayed by Canada, see **Link C 9**.

In this sense, it is possible to point out that the use of “holdings” companies has been noticed which have as function to have the shares of the rest of the organizations of the economic group.

“Holdings” are capitalist companies, conceived like a financial centre suitable for managing the controlled capital corresponding to stock or operating in economic sectors through the subsidiary corporations, in a unitary strategy

We have bear in mind that the jurisdictions in which “holdings” reside, are countries with more favourable taxation, whose objective is the one to accumulate the yields obtained by all the group for its later distribution, without undergoing the incidence of a double economic taxation when taking advantage of the mechanisms of exemption , that is to say, excepting or paying a reduced rate over both the income and the capital gains that have been obtained outside their territories.

Additionally, they can count on a good network in Agreements To avoid Double, Taxation, reducing the fiscal impact on the transfer of gains, or making possible the access to other centres that have agreements of this type.

The usually verified maneuver, is to interpose a “holding” between related companies. For greater illustration we suggested to see **Link B 2.**

It is also the case of interposed companies located in tax havens, pertaining to natural persons such as actors, musicians, artists, sportsmen, etc., which are constituted with the purpose of transferring the originating income of the activities of these persons, towards countries of low taxation. With this mechanism the taxation of such incomes in the country of residence of the mentioned persons is avoided. See examples **B 6, F 7** and refer to **Link B 3.**

III.2.A.3. Leasing - International mercantile Renting

With regard to this paragraph, Brazil has observed that operations of international leasing have structured by means of the use of captive companies located in countries with more favourable taxation, whose purpose has been, the acquisition of boats, airplanes, jets and facilities of great dimensions, in order to hide income not declared in the mentioned country and to diminish the tax base subject to imposition in Brazil. See example of **Link B 7.**

III.2.A.4. Abuse of treaties

Another variant of the dislocation of venues of effective direction in order to take advantage of the application of Agreements To avoid International Double Taxation is the one displayed by Mexico and Chile that is enclosed in **Link M 5.**

On the matter, the mentioned country has stated that some Mexican taxpayers have transferred its residence to another country with which Mexico has signed an International Treaty, with a double purpose. On the one hand to be taxed in Mexico under the criterion of the source and with it to diminish its tax burden , on the other hand to use the benefits that would exist because of the application of the above mentioned International Agreement.

III.2.A.5. Treaty shopping

For such purpose, the different countries have exposed a series of examples in **Links B 9, C 22 and CH 24**.

Besides, Canada and Chile have observed that their taxpayers have hold in usufruct the benefits settled down in Treaties To avoid International Double Imposition that these countries have subscribed with other jurisdictions, by means of the false declaration of having operated with residents of the mentioned jurisdictions or constituting companies in the mentioned territories. For greater detail it is suggested to refert to the above mentioned examples in **Links C 23, C 24 and CH 25.**

III.2.A.6. Transfer of shares

The transfer of the entitlement of shares can be part of an international tax planning. The use of this mechanism occurs when a stock company, having resources kept away from the margin of the official deed, transfers, without taxation, these resources abroad, generally to localities that offer low or null taxation and with strict rules of bank secrecy. These resources, which real entitlement is not known by the Tax Administration, are assigned for the constitution of a company off-shore which is highly capitalized.

This company, in turn, acquires new shares of the company in the country, promoting with this procedure the return of resources in a seemingly licit form.

In relation to this subject some member countries of the Inter-American Center of Tax Administrations - CIAT-, have detected operations of bargain and sale of shares of companies located in the mentioned country members, by an organization “off Shore”, with non-declared resources from the territories to which the above mentioned Administrations belong, making this procedure that would re-enter the resources with apparent lawfulness. It is suggested to refer to the example detailed in **Link B 14.**

In this order of ideas, Chile indicates that some taxpayers do not pay in this country the tax that is applied on the utility from the transfer of shares or social rights of a company which is non-constituted in that country, but that it has shares of a Chilean company, alleging that the incomes that are generated in the operation are taxed there because of constituting incomes of Chilean source. For a better understanding of the subject it is suggested to visit **Link CH 28.**

III.2.A.7. Diversion of commercial transactions

In reference to this point, we must consider the item expounded by Canada regarding the establishment of schemes conducted by natural people in connection with investments.

In this regards, the local legislation of that country, does not require that natural people declare his rents based on an accrual basis, this allows to take advantage of this form of imputation - perceived - with the aim of avoiding to pay in Canada by its future income, by means of the transfer from its residence to a tax haven. We suggest to refer to **Link C 11**.

III.2.A.8. Diversion of income

III.2.A.8.1. Captive insurance agencies

In Canada it has been observed the diversion of Canadian incomes abroad, by means of the payment of premiums to insurance companies pertaining to the same economic group, located in a jurisdiction of low or null taxation. The insurance company does not pay taxes for its income originated in the premiums in Canada. For a better understanding of the analyzed question please go to **Link C 17**.

III.2.A.8.2. To declare a fictitious permanent establishment

With regard to the diversion of income it has also been verified, the case of legal persons of some countries, who try to evade the tax alleging that their operations are attributable to a permanent establishment - without economic basis- constituted in a jurisdiction of low or null taxation. See examples indicated in **Links C 20, C 21 and CH 23.**

Besides, in the Republic of Chile , it has been noticed a tax planning similar to the above mentioned in the previous paragraph, but in this case the permanent establishment is located in a country with which Chile has celebrated Agreement to Avoid the International Double Taxation. We suggest to remit to the example in **Link CH 22**.

On the other hand, another way of divert income (interest, capital gains, etc.) of a country of high taxation towards other which contains a more favorable tax regime, is the one declared by France. It is described the case of a social transformation of a company constituted in France, in a permanent establishment pertaining to a fictitious company located abroad. In this sense we suggest to see the example of **Link F 4**.

III.2.A.9. Transfer of residence

In this regard, Chile has detected cases of natural people that acquire the residence in countries where there is less tax burden, by means of the permanence in the mentioned country by a period lower to 183 days, without indeed verifying the transfer of the nucleus of businesses, family or of main investments from Chile towards abroad. It is suggested to see the exposed example in **Link CH 21**.

Another example is offered by the Tax Administration of Canada when commenting regarding resident subjects that transfer in fictitious way their residence towards other jurisdictions. We suggest to see **Link C 10.**

III.2.A.10. Transfer of the headquarter of direction of the outside.

The change of a branch of a transnational company occurs, as a rule, for business reasons, that is to say, for the best allocation of factors of production or strategy against its market.

Nevertheless, the change of a branch of a company also might answer exclusively to tax reasons. In this case, the transfer of the branch abroad is used with the aim of reducing the tax burden, especially when the new branch is established in a country of low or null taxation.

If the former country of residence adopts the principle of the universality of incomes, there will be a significant tax economy. For this reason, the country of the former residence will lose the possibility of burdening the profit obtained abroad.

Brazil has observed, that certain companies transfer the headquarter of direction to a country with more favorable taxation in order to obtain a reduction of the global tax burden.

In that sense, it is possible to point out that the gains obtained by related and controlled organizations abroad from companies resident in the mentioned country, do not pay there, since the headquarter was transferred towards another country, remaining in Brazil an entity that, despite of being independent, it will only pay by the rents obtained in that country. We suggest to see **Link B 11.**

III.2.A.11. International transfer of assets

The transfer of resources to abroad with change of legal entitlement is a way of international tax planning that minimizes the tax base of the countries with common tax rates.

In this hypothesis, the resources kept away from the margin of the official deed and that, therefore, were not regularly taxed, are transfer abroad, generally towards countries of low or null taxation, where they are received under the entitlement of interposed persons, which are unknown of the Tax Administration of origin of these resources.

Under the entitlement of a person who is non resident of a country of common taxation, these resources return as investments, enjoying the fiscal advantages granted to the foreign capital.

There exists also the economy of taxes by virtue of which these yields are not covered by the rules of fiscal transparency of the country.

The Tax Administration of the Republic of Brazil has stated that resources have been transferred to abroad, which were obtained in the mentioned country without the appropriate taxation.

Generally, this mechanism is carried out through the transfer of these income on account whose holders are not the true owners of such. Soon this resource can be reinvested in Brazil, with non-resident status, in form of loans, acquisition of companies and social participation. We suggested to see **Links B 15.**

III.2.B. Fictitious conversion of incomes

The accounts indicated in this section have the aim of illustrating the actions carried out by the taxpayers intended to transform the origin of an income into another one, with the purpose of paying the benefits from her to a lower rate.

Like preliminary observation, it is possible mention that unlike the indicated paragraph in section III.2.A. of the present work, it is not so significant the presence of operations and/ or subjects located in countries of low or null taxation, but they have influence in the decision making of the subjects that use these operations, the agreements to avoid double imposition, the administrative rules and the jurisprudence that prevails in each one of the involved countries.

In this regard, the present paragraph includes those situations in where it has been noticed the advantage of the clauses anticipated in the International Treaties to avoid the Double Imposition subscribed by the different countries. One of the forms that acquires this advantage is that of the reclassification of the incomes, in order to profit with the most favourable aliquots contained in the mentioned International treaties.

Also, some variants of fictitious conversion of utilities are described in this point among which it is possible to mention as an example a: unjustified patrimonial increases, the sub capitalization or thin capitalization, the payments by technical attendance, the simulated reinvestment of utilities, etc.

Next, some modalities detected by the Tax Administrations which conform the Work group “International Tax Planning Control” will be developed:

III.2.B.1. Unjustified Patrimonial increase

In this point the Republic of Argentina, describes the situations that fit like “unjustified patrimonial increases”, and also it mentions criteria established by the jurisprudence.

In this sense, the Law N° 11.683 on Tax Procedure of the mentioned country, mentions legal presumptions which based on known facts and circumstances, which by its entailment with which the respective laws predicted as taxable event, allow to induce the existence and measurement of it. Among the above mentioned presumptions we can find the unjustified patrimonial increases. In order to exemplify the developed concept we suggested to remit to the **Link A 6.**

III.2.B.2. International treaties - Rule shopping

Rule shopping is the English term used to designate the action planned by a person when choosing the best clause in an agreement. In this type of planning the aim is to adapt the yields obtained to the way of the convention that presents great fiscal advantage. Unlike the *treaty shopping*, which is used by persons who are non resident in the signatory countries; the *rule shopping* is the hypothesis of planning used by the residents and, therefore, legitimate beneficiaries of a convention.

The aim of this way of planning is to modify the "categories" applicable to the yields or definitions foreseen in the convention. Thus, the rule shopping stems from the improvement of the internal legislation since, in general, the dispositions of the agreement, as for the categorization of the yields, refer to the categorization of the hypotheses of incidence foreseen in the legislation of the country.

This mechanism is frequently used to avoid or to reduce the incidence of the tax withheld in the source, seeking the implementation of the less rate arranged in the convention. The English expression *dividend stripping* is used to define the recategorization of the payment of dividends as payment of interests or as capital profit. In both cases, the tax burden is less than that attributed to the distributed dividends. As many countries do not tax capital profit in the stock shares, it is very usual the transfer to a *holding* company located in a country with a good network of agreements of interests in which value are the dividends gained, but not distributed yet.

In this case, considering that the capital profits, by virtue of the rules of the convention, are not burdened or they are burdened but with limited rates, there is an economy of taxes promoted by the categorization attributed to the dividends. **Links B 10.**

III.2.B.3. Thin capitalization or minimal capitalization

Therefore, using the minimal capitalization it is possible to obtain important fiscal advantages, trying to disguise a contribution of capital by means of the concession of a credit. For a better illustration see the examples of **Links B 13 and M 8.**

III.2.B.4. Diversion of incomes

Canada has observed certain cases, in which resident taxpayers in that country, invest in hedge funds located in tax havens, which are not subject of taxation in Canada. It is observed that later the incomes derived from those hedge funds are reinvested. For greater information we suggest to see **Link C 16.**

III.2.B.5. Payments for technical assistance

In reference to this issue, Chile have noticed that the taxpayers pretend to make payments abroad for technical assitance, without fulfilling the requirements that describe it like being reached with an aliquot minor of that that indeed would correspond to apply to them by the payment of service lendered abroad. For a better understanding we recommend to see **Link CH 1.**

III.2.B.6. Royalties

According to the Chilean Tax Administration it has verified payments to the abroad made by Chilean taxpayers for remittances of utilities or payments of different services, which according to the Agreements To avoid the International Double Imposition, they are taxed with an aliquot greater than that applied to the payment of royalties. That is why, to invoke the payment of royalties is made increasingly habitual in their operations.

By the above mentioned, we conclude that when conceptualizing as royalties, expenses that do not have the character of such, the reality is concealed and the tax burden is altered. In order to exemplify the developed concept we suggest to remit to **Link CH 3.**

III.2.B.7. Investments

Chile stands out that its rules on incomes establishes tax benefits for non-resident subjects that carry out retirements of utilities of Chilean companies and they destine them to reinvestment in another resident company in Chile.

Therefore, Chile has verified that taxpayers without address and without residence in the mentioned country pretend to take refuge in the above mentioned disposition - failing to fulfill with the requirements established in the mentioned tax rule, in order to avoid the payment of the corresponding tax. We recommend to see **Link CH 27.**

III.2.B.8. Payments made to foreign artists

Mexico have noticed that in the remuneration paid to foreign artists who display spectacles in the mentioned country, are incorporated like artistic talent into items to which does not correspond to assign such character, that is why it would not be due to apply to such concepts the specific clauses of the Agreements of

International Double Taxation, regarding artists and sportsmen. We suggest to see the example of **Link M 9.**

III.2.C. Fictitious or harmful decrease of the tax base through the reassignment of expenses and incomes.

In this section, the expository countries through its communications, indicate the damages that face the tax administrations before the simulation of operations that carry out the taxpayers, with a common denominator that it was already mentioned: the tax havens.

Through the jurisdictions, with low or null taxation and significant informative capacity - by means of third people- activities, rents and patrimonies are addressed and the resultant is the decrease of the taxes base even in the States that apply international tax transparency.

In the transnational commerce it is difficult the control and pursuit of the operations if we cannot have the suitable and opportune information and documentation.

For it, after analyzing the tax conduct of the taxpayers regarding the degree of fulfillment of its formal and material obligations, it is an excellent support tool, a sanctioning regime that tries to correct injurious conducts. This regime complements the tasks of investigation and control that the Tax Administration carries out.

In this regard, some Tax Administrations pertaining to the countries members of the Inter-American Center of Tax Administrations - CIAT-, have verified cases of sub-invoicing of the exported goods, through the triangulation of operations.

This operating, generally planned internationally by the companies of a same economic group, produces as a result a reduction of the tax base subject to taxation.

The triangulation of operations is demonstrated when in an international operation interpose one or more countries of low or null fiscal taxation, commonly calls “tax havens”, with the purpose of transferring the true utility of the transaction to a company located in that jurisdiction that offers a preferential fiscal regime. It is suggested to see **Links A 4, B 8, CH 35, M 4 and C 12.**

Additionally, in relation to the shown maneuvers referred to transfer of pricing, they have been detected - among others that:

- goods or services are bought and/ or sell to abroad to different prices that other operations of similar characteristics.

- expenses associated to these operations are imputed in incorrect form.

- payments by technical assistance are deduced without such assistance has been received, etc.

All the examples exposed in the previous paragraph have the aim of transferring the income that would have to be burdened in a country of high taxation and/or diminishing the income subject to taxation. It is advised to observe the examples in **Links CH 32, CH 33, C 26, C 27 and M 6.**

Another mechanism that reduces in fictitious form the tax base subject to taxation, is the interposition of transparent companies of abroad, which control local companies of capital and, at the same time, these belong to natural persons who are resident of the Argentine Republic.

In this sense, it has been notices that the companies abroad diminish their results, computing countable the lost originated by the controlled Argentine companies, including the adjustment for inflation.

Therefore, it has been stated that the resident natural person before mentioned, incorporate to their tax return such results, which in the case – natural person- would have directly participated in the Argentine company, this deduction would not be possible, because of the dispositions established in the Income Tax Act. For a better understanding of the subject, it is suggested to see the **Link A 5.**

Argentina has detected an important number of instruments used like international tax strategy by the different companies that conform the same multinational group. This has given rise to adjustments in favor of the Argentine state treasury. It is recommended to see **Link A 7.**

Besides, the Tax Administration of the Republic of Argentina has verified complex financial structures by means of the use of derived instruments, trusts, etc., which conceal another type of operations that reduce the tax base of that country subject to taxation. See **Link A 9.**

On the other hand, it is worth mentioned the issue exposed by the tax authority of the Republic of Brazil, about those interposed companies off Shore, that work as mediator between subjects located in two or more jurisdictions with high or medium taxation, in order to take advantage of the exemptions that the country with preferential imposition can offer, being its objective to profit by a diminution in the tax burden.

That is to say, that the payments of dividends, interest, royalties, etc., will be made through this interposed company, accumulating the utilities in the country of low or null taxation For further information please see **Link B 4.**

In the same way, Brazil has observed that lending companies of international services are set up in countries wit low or null taxation with the purpose of reducing the tax base of the fiscal jurisdictions of high or medium taxation, through the generation of fiscally deductible expenses by the companies of he same economic group. Please, see **Link B 5.**

France has detected that taxpayers use the methods to justify the transfer pricing between related companies according to their convenience. The purpose of the mechanism, has been that of transferring benefits between the different fiscal jurisdictions, reducing the tax base subject to taxation. In this sense it is suggested to visualize **Link F1.**

Besides, an abusive use in the agreements of distribution of costs that have been agreed between the different related organizations has been verified. Such agreements can cause diverse fiscal consequences, which are described in **Links F2, F 6 and M 13.**

Another variant, with regard to the subject analyzed in this chapter is the one that has contributed France referred to the increase of the percentage agreed for royalties - without a real reason that justifies it - that branches pay to other related company. It is recommended to see **Link F 3.**

On the other hand, the French Tax Administration states that changes in the legal forms of the companies have been demonstrated, which conform he same economic group that does not imply true functional transformations.

Therefore, some cases of French branches have appeared, which in the beginning of their activities support the lost incurred, despite it, when they begin to produce utilities are reconstructed legally transforming into representatives or agents - maintaining the same functions - but transferring the utilities towards their headquarter. For a greater understanding of the subject it is suggested to visit **Link F 5.**

On the other hand, it is worth mention the mechanisms of international tax planning used by the resident headquarters in Chile with stable establishments constituted in zero or null taxation jurisdictions.

In this regard, the Chilean Tax administration has detected that such companies, seeking protection in the little or almost null exchange of information that is carried out with the tax havens, they do not declare in Chile the results generated by the investments situated in such territories. To such aim , please consider the example detailed in **Link CH 13.**

In accordance with the example exposed in the previous paragraph, related to the concealment of the rents originated abroad, it is recommended to see **Links CH 29 and C 13.**

Besides, Chile has stated that resident of said country have imputed in illegal form credits by taxes paid abroad regarding diverse reasons, those that are detailed in **Link CH 30.**

On the other hand, the tax administrations of Canada and Mexico have contributed some schemes related to the location abroad of the collection of rights related to intangible goods and royalties, which have been originated in activities developed in such states and consequently they must have paid in the mentioned jurisdictions. In order to widen this issue please, see **Links C 18 y M 7.**

However, Mexico has verified that the different companies pertaining to a same international group use interposed companies denominated “transparent companies “, in order to defer the payment of the income tax. Please, see **Link M 11**.

In addition, the above mentioned country has observed the creation of fictitious loans between related companies, that in the facts they are true contributions of capital, with the purpose of reducing the tax base subject to taxation or transferring the tax utilities from one jurisdiction to another with smaller fiscal load by means of the deduction of the interests. It is advised to visit **Link M 12**.

III.2.D. Fictitious or injurious decrease of the taxable base through the reassignment of incomes subject to taxation in the source, corresponding to beneficiaries abroad.

The schemes that are mentioned in this section have relation with the diminution of the tax base of the Income tax, through maneuvers aimed at justifying with exemptions established in such rule, operations that are not specifically benefited with these advantages.

In special, the analysis is concentrated in the beneficiaries of abroad and in operations such as investments, social transformations and remunerations by services rendered abroad.

One of the task of the Tax Administration is to impel rules establishing barriers to the deductibility of concepts such as expenses and losses produced by the mentioned operations.

In this regards, it has been verified the incorrect use of the exemptions stipulated in the legislation of the Republic of Chile related to payments made abroad for services that were made by non-resident subjects. For further information it is recommended to see **Link CH 8**.

On the other hand, Chile has observed cases of taxpayers who have permanent establishments abroad and through them they contract debts with the purpose of financing the operations of the headquarters. This international tax strategy have the aim of eluding the Stamp Tax and the Additional Tax that taxes the remittances of interests to abroad, established in the legal norms in force in the mentioned country. To this aim we recommended to see **Link CH 9**.

Another variant that the Chilean Tax Administration has detected in this sense, is about avoiding - by part of the taxpayers- the payment of the tax that is applied on the greater value obtained by the transfer of actions in that country, through illegal use of the exemption stipulated in the legislation of Chile for those results. To such aims it is suggested to see **Link CH 10**.

Chile has also stated that the taxpayers, with the intention of diminishing the tax base subject to Income Tax, do not apply appropriately the rules of monetary correction defined in the internal law of the above mentioned country in opportunity to estimate its investments abroad. See the example detailed in **Link CH 11.**

Mexico refers to the simulation of corporate merger or break-ups to transmit goods to other subjects and thus to avoid the taxation of the operation. It is suggested to see **Link M 3.**

Finally, in **Link M 14** it is stated that the foreign companies send representatives to Mexico, under the denomination of "commission agents without representation", in order not to confront the constitution of a permanent establishment and thus to diminish the tax burden.

III.2.E. Deductions by expenses or fictitious debts generated abroad

The tax planning that implies the production of fictitious expenses or debts is a behaviour that, in general, is used by countries that do not have a system of exchange of tax information and that present strict rules of secrecy on the transactions made in their territory.

In order to reduce the tax burden load, operations are organized which do not demand the domicile or the residence in the country recipient of the payments and that, for their achievement, they do not depend of the substantial existence in this jurisdiction. Thus, this way of planning is commonly used for payments for the lender of services of difficult verification and payments for the development of rights of industrial property of uncertain existence.

We can also notice that, due to the absence of mechanisms of exchange of information, financial operations are structured in order to produce negative results (losses). After these negative results are consolidated the tax base is diminished in the country of residence.

When the exchange of information does not fulfill the pre-selected aims, the tax authorities have their capacity of control limited and therefore it increases the possibility that through injurious practices carried out by taxpayers, the tax bases of the tributes that they administer were diminished

Whether it be through tax havens, jurisdictions that do not have a refined international informative system, or of operations that are implemented through subjects without address nor residence, transactions with the aim of eroding the real tax results through expenses and/or fictitious debts are generated.

The condition of resident or not of a subject in a State, it is important regarding the application of an Agreement of Double Imposition so as to determining the competent jurisdiction to burden the different types of incomes, as well as to impute the expenses that correspond to appropriate to them.

In this regard, in this paragraph diverse examples have appeared that express irregularities regarding the debts and expenses contracted by the taxpayers. On the matter, we have detected that generally different maneuvers are implemented, in operations made with subjects that conform a same economic group.

Therefore, we have stated that the main problem in this sense has been generated through the subscription of contract of technology transference, between residents of the participating countries in the CIAT and subjects of abroad, by virtue of the effective benefit of them has not been able to be verified

Besides, the incorrect advantage of franchises associated to the above mentioned contracts has been verified. To this aim it is recommended to see **Links A 1, M 10 and CH 2.**

On the other hand, the tax administrations have observed some cases of taxpayers who with the intention of diminishing its tax base subject to taxes, they deduce frequently nonexistent expenses of foreign source, informed like derivatives of operations conducted with related entities of abroad. It is advised to visit **Links A 2 and CH 34.**

Additionally, several countries have noticed that taxpayers declare fictitious operations of financing from abroad, with the purpose of compensating the loss which produce the interests paid to the creditors of abroad, with taxable gains. It is suggested to see **Links A 3 and C 4.**

In that sense, Canada has verified a scheme of international tax planning that involves subjects that obtain loans abroad - with high interest rates-, in order to carry out investments in commodities, by which they will obtain a negative result or loss. Thus, the taxpayer will deduce of his taxable rents, the derived interests and losses of the operating above mentioned. For further information see the example in **Link C 14 and C 19.**

With regard to the maneuvers that have carried out the taxpayers through the deduction of losses, you can find in examples **C 15 and CH 12**, the description of some referred examples, as well as strategies that are made through the sale of credit instruments, like with the establishment of companies in jurisdictions with those who the countries members of the CIAT do not have signed agreements that establish the possibility of carrying out exchanges of information.

However, it is possible mention, the example that has exposed Chile in its **Link CH 4,** regarding the royalties paid by resident subjects in the above mentioned country to related subjects of abroad - that simulate to be independent with the purpose of avoiding certain limitations that the internal legislation contains with regard to the payment and deduction of royalties sent to related companies organizations located abroad.

For a greater illustration, as well as the simulation of transactions between related companies, it is suggested to see **Link CH 5**, which deals with the case of some taxpayers who deduce payments made as intangible goods to related subjects of abroad, but that they are imputed like other expenses, since the International treaties that subscribed Chile with other territories, do not contemplate the deduction by such expenses when they are made to companies of the same transnational group.

On the other hand, Mexico has observed certain schemes made by the taxpayers who cause the illegal advantage both in the deductions that are imputed by the payer person and in the tax rates that the non-resident people use.

In this regard, the tax administration of the country before mentioned has stated that non-resident subjects, by means of the creation of related companies in jurisdictions with which Mexico has signed treaties to avoid the international double imposition, they have been profit by the obtaining of aliquots inferior to those which it had corresponded to pay. Please, see the **Link M 1.**

Another variant similar to that mentioned in the previous paragraph, is possible to be found in **Links M 2 and M 15**, which talk about the case of non-resident subjects of Mexico, that through division of the activities that they develop in said country, they avoid to constitute permanent establishments, with the purpose of paying less taxes, or that establishing them, their income is not attributed correctly to them.

In equal sense, Chile has observed operations of loans between companies that conform a same economic group with the purpose of simulating true contributions, paying a smaller rate and to be benefited with the deduction of the interests. It is recommended to see the **Links CH 14, CH 18 and CH 19**.

In addition, when in the above mentioned case, the indebtedness is excessive according to the rules established by the legislation of the mentioned country, the taxpayers are forced to pay a higher tax for interests. Consequently, the resident subjects tend to sub-value the financing or to hide the pre-existing entailment with the foreign creditor, in order to pay a smaller rate of tax. It is advised to see **Links CH 15, CH 16, CH 17 and CH 20.**

Thus, Chile has stated that taxpayers through the creation of organizations in Tax Havens, obtain tax benefits by means of the triangulation of operations and because of the absence of agreements that allow the exchange of information with such countries. In order to extend the information of the maneuvers that take place in this sense, it is suggested to see **Link CH 36.**

Another way to reduce the tax burden through indebtedness with subjects of abroad, is to obtain loans in different conditions from the normal practices of market, specially concerning interest rates, commissions, insurances and other associated expenses. It is advised to observe the example in **Link CH 31.**

CHAPTER IV

TAX ADMINISTRATIONS IN RELATION TO INTERNATIONAL TAX PLANNING

IV.1. Introduction

Traditionally, Tax Administrations developed their competence regarding the application, perception and control of taxes, both in the national or domestic environment.

However, due to the internationalization of the world-wide economy and to the complexity of businesses implemented by the taxpayers in their cross-border operations, Tax Administrations have had to confront a new reality in which their actions do not have to lose neither efficiency nor effectiveness demanded of their mission.

The fact is that international taxation fundamentally has certain own characteristics because of its specificity and of the complexity with which businesses are developed, reason why in relation to this reality the Administrations must necessarily provided themselves with suitable means that allow to compare the skills of the State treasury with that of the taxpayers.

The problems associated with international taxation cannot be put on an equal footing with the domestic ones because the connotations and implications are of different nature.

On the matter it is convenient to notice that the practice of the missions and functions of Tax Administrations in the local environment makes possible to exert control of all the members of the business since all its actors have the power of verification understood in the domestic rules, situation that is totally different in the international environment.

The applicable legislation in that case does not exceed to which it is effective at the level of the fiscal jurisdiction we refer to.

On the contrary, in the international environment transactions are not limited nor surrounded by the borders, whereas the taxable events that derived from them must be controlled and verified by Administrations whose capacity are really delimited by the national limits.

That is why, the challenge that this context imposes over the Administrations is not limited since it becomes necessary to use differentiated control mechanisms, since it is essential:

1. To have a complete knowledge of the methods with which businesses are exerted in the international environment.

2. To enforce domestic rules and principles - e.g. international treaties to avoid the double taxation, rules of international fiscal transparency, compared legislation, international countable rules, etc.-.

3. To apply different procedures of detection of assumption of elusion and /or evasion by means of the macroeconomic study of international productive and financial factors and the respective tax technical definition that not only defines the applicable tax treatments but also makes the elaboration of special risk matrices for the control viable.

All these aspects make clear the importance of the Tax Body of having specially designed structures in order to tackle the international issue, that is why it is very clear the convenience of designing them according to the specificity and complexity that characterizes it.

This subject will be focused next from two important aspects: the organizational structure and the human resources attached to it.

IV. 2. Organizational structure

Trying to determine, in a general and standard way, which is the best option to be taken by Tax Administrations when determining the way in which they will define the structure that must be in charge of the international issues, could show a limited result of the problem.

Thus, we could speak of so many models of organizational structures as existing Tax Administrations.

That would not be peculiar since the organizational structure adopted by each tax jurisdiction, will be fixed by the own characteristics of each State as far as the legally assigned aims, the imposed legal functions, the culture, the internal tax legislation, the effective taxes, the greater or smaller importance of the international operations in the context of the economy as a whole, the type and nature of the cross-border transactions, the behaviour of taxpayers, the occupational training, the available resources, the technological level achieved, etc.

Perhaps the tipology of commerce and international businesses of each country, be the factor that must be considered more carefully when designing the administrative structure that will have to face the control of the international transactions, since it constitutes the more related and opportune parameter in relation to the problem in question to define - in views of the obtaining of the best results, the own characteristics of that structure as well as the ascribed resources and the matters on which it will required the greater emphasis in the training and specialization.

The aspect that could really have a specific mention is that of considering the advantages or disadvantages of that the composition of the organizational structure be formed total or partially in a centralized or decentralized way, within the Tax Administration.

IV. 2.1. <u>Centralized structure</u>

To adopt a centralized structure entails the existence of an only sector within the Administration devoted to the control of the issues related to international tax matter.

Thus, that sector could be responsibly for all the following tasks:

- interpretation of rules, establishment of criteria and consult;
- execution of tax examinations aimed at determining maneuvers, assumptions of elusion and/ or evasion, as well as the analysis of the behaviour of the taxpayers at general and particular level;
- selection of cases to put under tax examinations;
- tax examination itself on the selected particular cases;
- determination and collection of the tax obligation related to the international taxation.

The advantages of this method of organizational structure would be given:

- To have a sector highly specialized in the international matter whose effort is focused on international taxation what would favour, in turn, the greater degree of knowledge that they even allow to bring forward unfavourable situations of contingency for fiscal interest.
- To obtain uniqueness of criteria when applying rules, in issues that are full of controversy.
- To obtain the definition of common strategies of control, uniform verification and tax examinations before similar situations and to be able to carry out corrections from the acquired experience.
- To make specific controls limited to the subjects of international taxation.
- To acquire knowledge not only of the evolution of the recent international businesses but to notice regarding them the behaviour of the taxpayers in order to be able to act through the propitious control mechanisms or through the amendment of administrative rules that discourage the accomplishment of detrimental maneuvers to the State treasury.

- To carry out minors efforts of training because they would exclusively be aimed to the group that compose the centralized unit.

On the other hand a series of disadvantages in adopting a central unit is noticed. These disadvantages would have to be evaluated depending the aims pursued in the tasks of control of the aspects related to international taxation. These disadvantages could be synthesized as follows:

- Lack of diffusion of the international theme to the rest of the verifying and auditing team.

- Impossibility of incorporating the international control into the other tasks of the Administration.

- Limitation of the capacity of control and audit since only the main team would have that task assigned, and with the additional disadvantage that as they are audits that are limited to the international theme, it is possible that other irregularities that lead to evasion in the local plane were not discovered.

IV.2.2. <u>Decentralized structure</u>

In comparison to the previous position, the decentralization of control of the international operations would entail that each decentralized and/ or independent regional unit would have in its sphere of integrated competence the theme of the international taxation. Thus, each regional dependency would have autonomy in the verification, control and audit of the taxpayers who carry out this type of transactions.

In this scheme of design of the organizational structure the following advantages are noticed:

- Expansion of the field of control, since a greater number of official will be destined for the tasks of international control.

- Greater amount of officials trained in the international matter.

- Possibility of integrating domestic controls into the international ones.

- Use of the regionalization regarding the identification of the special features of the typical activities of the zone under control, what would result in a greater knowledge of the behaviour of the taxpayers understood in the specific zone and obtaining a better use of resources.

- Possibility of acceding to a better address of the operation to be controlled regarding the above paragraph.

Without prejudice of set forth in the previous paragraph, it is also worth mention some disadvantages in this type of decentralized structures:

- Need to carry out greater efforts in staff training due to the greater amount of officials affected to the international control.

- Possibility of that the official who must carry out the domestic and international control, before the complexity of the latter, it does not focus the issue with the effort that it really deserves.

- Possibility of that the procedures of the domestic control are not wholly compatible with those of the international control, being able to lose effectiveness the one of international nature.

- Possibility of that different criteria from technical nature be generated in each jurisdiction with the risk of generating a weakening in the task of control of all the Tax Administration.

- Chance of adopting different criteria of setting of priorities in the issues to be put under verification and control, which can give raise to a dispersion of efforts.

IV.2.3. <u>Combined alternative. Organizational partially decentralized structure</u>.

Considering the advantages and disadvantages set forth in the previous paragraphs, it would exist the possibility of taking their strengths from each one of them and of thinking up an organizational structure that combines part of both positions.

Thus it could arise as design methodology a structure that centralizes all aspects related to:

- establishment of general strategies of control;

- macroeconomic research for the determination of risk factors;

- detection of economic and operative variables of businesses which create harmful tax planning and/or of maneuvers of elusion and evasion in the international environment;

- control strategies when determining the sectors and/or taxpayers to be controlled;

- design of control procedures;

- definition of technical criteria applicable to international matter;

- central coordination of the procedures of control in order to obtain unicity of criteria and procedures;

- instrumentation of training regarding its content and the establishment of priorities of the official who will take part in the processes of investigation and control.

Thus, a unit would be created, which had the most highly qualified officials with regard to strategic and technical definitions, specialized researches and coordination and direction of the verification and control tasks.

In this alternative, they would be decentralized:

- the selection of cases to be controlled from the general planning of the central team;

- the tasks of verification and investigation on specific cases;

- the tasks of control of taxpayers of each regional zone,

- the free selection of cases whose assumptions of elusion and/ or evasion are directly related to the particular characteristics of the activities and taxpayers of each regional zone, in order to obtain the best results regarding the above mentioned special features.

In this scheme of partially decentralized structure, we would have a team that as it is highly qualified it would be in better conditions for establishing the guidelines of strategic and technical planning providing necessary logistic and support to all the stages of the process of control in order to tackle it in connection to each taxpayer. This task would be undertaken by the officials of each regional zone so as to extend the field of control and , at the same time, to strengthen the presence of the Tax Administration in all its territory.

IV.2.A. <u>The administrative structure used in controlling international transactions</u>

<u>ARGENTINA</u>

External control is undertaken is taken in a decentralized manner:

- By 26 Regional Directors around the country, and the

- Department of Large National Taxpayer Control

With an increasing number of tasks for international transaction control, teams of specialists in international transaction control were set up, mainly within the Department of Large National Taxpayer Control.

There is within the International Transactions Department (see the next item) a Division in charge of establishing procedures, rules, support and all other aspects of control tasks.

Please see the following item for a complete view of the administrative structure of the Argentine Tax Administration.

BRAZIL

In the environment of Receita Federal of Brazil, the international transactions are treated in a partially centralized way.

The Consultancy of International Affairs is responsible, among other attributions, for the negotiation of the tax agreements and for the prosecution of the exchange of information with foreign tax administrations. The Consultancy also takes part of the studies of the strategies of examination in the international area.

The development of internal rules and the assistance to taxpayers' enquires related to international transactions are powers of the General Coordination of Taxation, which has in the Department of the Income Tax, experts on the international area.

In the field of the Tax Examinations, works related to the international area are decentralized, since the studies and analysis are made in the head office of Brasilia. The researches of unlawful behaviours and the establishment of the strategies for the examination of the international transactions are powers of the General Coordination of Inspection. The control and the evaluation of the procedures of examination are also carried out in the central unit.

Regarding international operations, the Consultancy of International Affairs, the General Coordination of Taxation and the General Coordination of Examination work in an integrated and centralized form, since their determinations and orientation covered all decentralized units.

At national level, 109 units of Receita Federal lead the procedures of audit of international operations. Each unit has an auditors' group that acts together with the taxpayers of the jurisdiction of each body. Nevertheless, due to the concentration of the international operations in the geographical axis Río de Janeiro-San Pablo, specializing units were created composed by experts who work exclusively on international operations. In Rio de Janeiro, the audit of international operations is a power of a Group of Examination that acts in the Office of Examination of Receita Federal. In San Pablo, where the most of the multinational companies is gathered, the Special Delegation of International Affairs was created in 1998, which is the greater decentralized unit of the country, which works are exclusive of the international area

The decentralized units are responsible for the selection of cases and the execution of the procedures, without any participation of the central unit.

Nevertheless, the units must observe the rules and guidelines established by the General Coordination of Examination.

CANADA

Organization of the Compliance Programs Branch of the Canada Revenue Agency

Canada Revenue Agency

Minister of National Revenue

Commissioner, Canada Revenue Agency
- Deputy Commissioner, Canada Revenue Agency

Compliance Programs Branch - Organization as of January 1, 2007

Assistant Commissioner
- Deputy Assistant Commissioner
  - Director General, Audit Professional Services
  - Director General, Compliance Strategy
  - Director General, Enforcement and Disclosures
  - Director General, International and Large Business
  - Director General, Research, Risk & Business Management
  - Director General, Scientific Research & Experimental Development
  - Director General, Small and Medium Enterprises
  - Director, Workforce Development

Tax Avoidance and Tax Shelters

The CRA, which is responsible for administering the *Income Tax Act,* certain Parts of the *Excise Tax Act,* and various other Federal and Provincial/Territorial Acts, operates a program to combat tax avoidance schemes.

Taxpayers are entitled to arrange their affairs to minimize their tax costs. Avoidance occurs when such arrangements subvert the purpose of taxation provisions, and where the legislators did not contemplate the arrangement. They are contrary to the object and spirit of the law and frustrate its purpose. Unlike tax expenditure programs, which give relief to taxpayers who have fulfilled conditions that further the government's specific economic or social objectives, these schemes do not relate to any specific objectives and are seldom seen as furthering the general intent of the legislation.

The objective of the tax avoidance program is to discourage abusive tax-avoidance practices. Its main activities are to detect and examine suspected arrangements or schemes through audits, and to develop policies and procedures to combat them. The schemes are usually complex. When a tax avoidance scheme is identified, Revenue Canada takes corrective action either by way of reassessment or by recommending changes to the legislation.

Tax Avoidance

It is every taxpayer's right to arrange his or her affairs to pay the least amount of tax the law allows. The term "tax avoidance" identifies arrangements that are contrary to the spirit of the law and circumvent its purpose.

The Agency's strategy for dealing with tax avoidance is to identify and understand abusive transactions as early as possible, to use this understanding to identify others where similar schemes are being used, to audit all such transactions as quickly as possible, and to make clear publicly the Agency's position on these transactions to prevent further abuses.

One of the principal tools CRA uses is the General Anti-Avoidance Rule. This rule allows the Agency to challenge transactions, which when taken in context, are contrary to the spirit and intent of the law. In addition, the Agency uses specific anti-avoidance sections of the law and works closely with the Department of Finance to close loopholes.

To fight tax avoidance, early detection is essential. More often than not, these schemes are complex, creative and evolve rapidly.

Once an abusive tax avoidance scheme is identified and audited, the particulars of the scheme are incorporated into risk assessment models. Other returns having similar characteristics are reviewed to identify possible abuses.

Tax Shelters (Investment that reduce or defers part of the income tax)

Tax shelters must be registered with the Agency before being offered for sale. The registration system provides the Agency with an early indication of each shelter. The registration system identifies the tax shelter and ensures proper future reporting including access to books and records. Registration does not in any way ensure entitlement to the benefits flowing from a particular shelter. Agency monitors each shelter. It also reviews each prospectus and security commission report.

In some cases, it is possible to identify, early on, a potentially abusive tax shelter. In other cases, this determination must await the actual transactions since there is frequently a wide divergence between what is said in a prospectus, and what really transpires.

Abusive tax shelters are those where the business activity is misrepresented or where the value of the tax deduction exceeds the value of the underlying asset, meaning that the deduction is too high. An abusive tax shelter may also be one where the method of financing allows an investor to put little cash at risk while claiming a much larger deduction. In some cases, the assets said to underlie a tax shelter may not even exist. In these cases, the Department pursues criminal investigations.

Valuation issues can be contentious. The Agency maintains skilled evaluators who play a key role in ensuring proper valuations. The Agency monitors tax shelter registrations and other information to identify those shelters where valuation is likely to be an issue.

CHILE

The administrative structure for control can be divided into two levels:

Central level: in charge of identifying tax evasion or avoidance situations to be controlled. These situations are found in studies on international transaction regulations, taxpayer activities, monitoring of tax performance, and cross-checking information. Such control or review is effected by means of massive or selective control operations.

Operational level: is in charge of establishing control following the guidelines defined by staff in the above level.

This level is subdivided into:

- 16 Regional Directors, 4 for the Metropolitan Region (Santiago) and the rest in 12 regions around the country.

- 1 specialized area: Large Taxpayers Department.

Control procedure information is attached, wherein three stages are described:

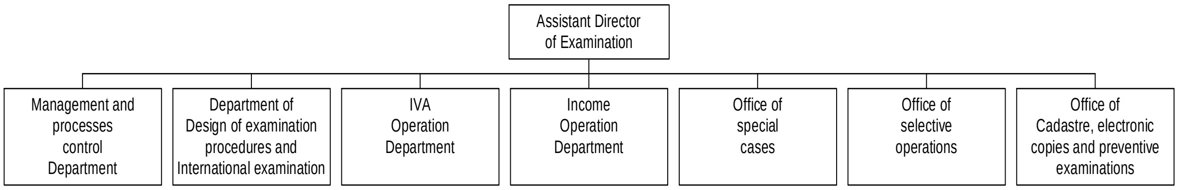
1. Serving process, Sections 11 to 14 of the Tax Code.

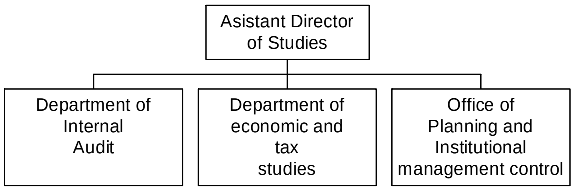
2. Review of the background records, Sections 63 to 64 of the Tax Code.

3. End of the audit.

An organization chart corresponding to the Service of Internal Taxes with the detail of the Subdepartment of Examination and Subdepartment of Studies is included next.

Central Organization: Regional Organization:
National Department Examination and taxpayers' service





MEXICO

The Tax Administration Service effects control over international transactions through the Large Taxpayers Administration.

The Large Taxpayers Administration has three central administrations specializing in international transactions:

1. Central Legal International and Large Taxpayers Regulatory Administration. It is in charge of clearing consultations and issuing permits for taxpayers in connection with their international transactions; it also generates regulatory criteria for the other areas, so as to standardize the enforcement of tax provisions relating to international matters. Approximately 25 staff members.

2. Central International Tax Auditing Administration. It is in charge of supervising the correct computation of the income tax on Mexican-source income incurred by taxpayers residing abroad and stable establishments in Mexico. It also reviews tax credits given for payments effected abroad and enforces provisions regarding Territories with preferential tax regimes; this area is also in charge of information exchange. Approximately 25 staff members.

3. Central Administration on Transfer Pricing. It is still not formally operational, but it is already responsible for Advance Pricing Agreements (APAs) and transfer pricing control audits. Approximately 30 staff members.

IV.2.B. Administrative structure for studies on tax avoidance

The importance of having an administrative structure exclusively devoted to tax avoidance investigation strategies or mechanisms may offer additional advantages in control procedures and a better use of available resources.

ARGENTINA

In early 1998, when the legal reforms which later introduced changes in world income regulation, international fiscal transparency and transfer pricing as regards income tax were still in the making, there was no specific administrative structure available for international fiscal action.

In June 1999, a new administrative structure was set up within the technical advisory area of the Tax Administration, including the International Transactions Department in the Technical Advice Department.

Thus, the new administrative structure came to centralize the tasks of directing, coordinating and supervising actions for analysis, investigation and control of transactions across the country by taxpayers and/or those responsible for companies incorporated abroad or individuals residing abroad who are liable to taxation, on the application of transfer pricing regulations, amongst other aspects.

Specific international control actions are undertaken by operational units in different areas of the country and by the Large National Taxpayers Department, each with regard to the taxpayers within their region.

In the performance of its own specific tasks, the International Transactions Department is a supportive instrument in controlling and supervising cross-border transactions and provides technical support not only in interpreting the tax regulations applicable in individual cases, but also in unraveling complex transactions, so as to determine both the applicable tax treatment and the transfer pricing methodology fitting the peculiarities of each case.

Nowadays the mentioned Department belongs to the General Subdivision of Control depending directly from AFIP and it works in an interrelated with the supervise operative areas of all the country, processing and analyzing information available, establishing control strategies, investigating operations and their probable derivations, carrying out sectorial studies with special information considering the international matter and offering training in specific issues of international taxation, in order to make more effective the operation of the State treasury in the control of the international operations.

Besides, the Department is in charge of advising on international tax matter through the preparation of reports in which it determines the tax technical treatment applicable to specific cases.

Nowadays, researches on 1950 companies that represent 73 economic sectors of the country have been made. Among those companies are, for example, the 1000 more important exporter of the country which assemble 95% of the annual national export.

Such studies were planned on an industry basis, and not only have gathered strategic information about each of the economy sectors, but also contain complete data regarding income tax returns covering all the fiscal years not yet fallen under the Statute of Limitations.

Such studies are also complemented by the determination of a series of economic and financial ratios and indexes applicable to transfer pricing and contain a detailed analysis of the accounted book profit margins compared with the tax profit margins. Deviations for each case are analyzed and on such basis a primary investigation target selection is made. Besides, it may be worth noting that such data are also used to detect other dispersions related to the local market and to select domestic companies in each industry which may be used for comparison.

This layout has allowed the Tax Administration to better allot control time, since the inspector faces each particular case with a number of elements and situations which have been analyzed beforehand in the course of the research and of the technical definitions effected by the above mentioned Department. That allows the controlling official to focus his action on all the aspects related to the evaluations and the data gathered regarding the facts, the supporting documents and the actual transaction carried out by the taxpayer, all of which will allow him to determine whether the tax regulations have been properly applied and, were that not the case, to quantify the missing taxable income and respective tax liability.

Here in after, we transcribe the mission and the functions of the International Transactions Department.

GENERAL SUBDIVISION OF CONTROL

INTERNATIONAL TRANSACTION DEPARTMENT

ACTION

To have jurisdiction over the preparation of technical reports on transfer pricing and international taxation matters and to take on the tasks requested from the General Subdivision of Control regarding operations made by the taxpayers and/or people related to subjects abroad and regarding the problem of its jurisdictional capacity. To have jurisdiction over the formulation of rules and procedures for tax control and assessment, coordinating tax actions developed in all the country.

TASKS

1. To prepare technical reports regarding tax aspects on transfer pricing matter.

2. To suggest the issue of legal rules or interpretive criteria that facilitate the proper determination of transfer prices of international economic operations.

3. To analyze and to evaluate the obtained data to aim the decision making in the functions of application collection and control of transfer pricing.

4. To centralize and to take part in the processes of exchange of information with national and international bodies in issues of their capacity.

5. To evaluate and to give proceeding to the requests of international exchange of information, from and towards abroad, related to matter of its jurisdictional capacity.

6. To have jurisdiction over the development of the models of fiscal audit designed to make easy and to optimize the accomplishment of special controls to taxpayers and/ or people in charge of its international operations.

7. To organize and coordinate the development of rules that regulate the tasks of tax control and assessment, in the scope of its jurisdictional capacity.

8. To organize and to coordinate the economic researches that are necessary with the aim of achieve an optimal fulfilment of the functions assigned to the Department.

9. To Functionally coordinate and evaluate the controls of all the country on transfer pricing and international taxation matters.

DIVISION OF PROGRAMMES AND RULES OF INTERNATIONAL OPERATIONS

ACTION

To have jurisdiction - regarding international operations- over the formulation of rules and procedures for tax control and assessment, In the scope of its jurisdictional capacity, coordinating and analyzing the activities of the supervise and determinative function emerging of such assignment.

TASKS

1. To develop models of fiscal audit aimed at facilitating and optimizing the accomplishment of special controls to taxpayers and/ or related people.

2. To develop and propose the procedures, rules, supports and other elements to apply in the different tasks of control.

3. To have jurisdiction over the development of techniques for the control of taxpayers and/ or related people.

4. To offer the necessary information and attendance to carry out the supervise action over taxpayers.

5. To interact in constant form with the operative areas of all the country, with the intention of maximizing the degree of efficiency of the actions of control of transfer pricing.

6. To develop and suggest work guidelines related to the determination of tax assessments.

7. To have jurisdiction over the evaluation and analysis of the practiced controls and the data obtained from the processes of control with the purpose of setting methodologies of analysis and control mechanisms.

DIVISION OF REPORTS AND TECHNICAL EVALUATION

ACTION

To plan technical reports and information on transfer pricing matter and to carry out the researches of economic and tax character that facilitate the correct determination of the transfer pricing of international economic operations.

TASKS

1. To plan technical reports and information on transfer pricing matter.
2. To make the necessary researches to carry out offers of normative amendments or the issue of interpretive criteria that are entrusted to him.
3. To administer and to operate a data base that allows to verify the fulfillment of the rules of transfer pricing.
4. To compile the information necessary to evaluate results on possible prices of transference matter, determining possible grounds of changes and proposing the liquidation that are deemed conducive.

5. To make researches of economic and tax character of different sectors of activity on the corresponding matter and to apply statistical techniques for the information gathering.

6. To make tax technical researches of the information of transfer pricing filed by the taxpayers and to carry out the analysis of the tax returns of the international operations in order to establish mechanisms to facilitate the selection of the cases that will be put under control.

7. To elaborate statistical studies on liquidations derived from the determinations of taxes as a result of the application of transfer pricing in order to evaluate the fiscal behaviour on the matter through the classification and categorization.

8. To evaluate, to take part and to process the requests of international exchange of information from and towards abroad

BRAZIL

In Brazil, the researches on the legislation and on the taxpayers' behaviours are made in a centralized way in the central unit of Brasilia. The Consultancy of International Affairs, the General Coordination of Taxation and the General Coordination of Examination operate as a whole with the aim of verifying the gaps in the internal legislation and to propose additional measures in order to fight the evasive and elusive practice in the international field.

CHILE

At a central level there exists a specializing unit, the Subdepartment of Studies, which must realize economic - tributary studies, prepare, study and investigate statistics of the tax income, its fluctuations and its relation with the different economic activities, for the effects of interpreting and of explaining its changes.

Furthermore, another unit exists at a central level, the Subdepartment of Examination, which is in charge of the identification of situations or types of evasion or elusion to be controlled which arise from the study of the rules that control the international operations, of the type of activity of the taxpayers (related to the taxpayer' activity), monitoring of the tributary behavior, exchange of information. This control or review consist of mass or selective examinations.

MEXICO

Within the Tax Administration Service no area is formally responsible for studying tax avoidance: however, all areas, as a result of the knowledge gained from in-depth reviews, have developed tax avoidance detection mechanisms. Without a doubt, taxpayer inquiries provide their main source of information.

It is worth noting that the Large Taxpayers area has set up what is known as the Idea Lab, in which the several areas that make up the Large Taxpayers Administration discuss different matters or transactions which could involve tax planning, including international transactions. These matters or transactions are analyzed and discussed. If proposals are supported, instructions are issued to the inspection programming units for instructions to be issued for carrying out an inspection.

Additionally, in the Under-Department of Revenue, which reports to the Treasury and Public Credit Department there is an area that studies issues relating to tax avoidance.

IV.3. Assignable human resources

As it were mentioned at the beginning of this Chapter, the problem immersed in the international taxation, their control and detection of harmful tax planning are of a nature different from which refer to the national control.

When facing the international taxation it is not enough with the dominion and knowledge of the internal legislation of each country. Even Less when the idea is to analyze the international tax planning in order to determine if injurious effects for the local state treasury have been generated from it or not

To deal with the analysis and understanding of the international matter it requires in the first place to have a complete knowledge of the operative modalities of taxpayers, of businesses, of used means of payment, of the location of the contracting parties, of the used instruments or legal figures, etc.

On that level, the fiscal agent who is in charge of the control of this issue, must have a series of special knowledge that allow him to understand the wide range of international operations.

Not only must the fiscal agent have the typical knowledge of the local rules aimed at the international taxation, but also his knowledge will have to include subjects of compared legislation, the special accounting and auditing standards - national and international- the mechanisms of detection of maneuvers, abilities in processing and handling of information, capacity of analysis of the information. The fiscal agent must also have knowledge and experience in strategies of tax planning used by the taxpayers, the understanding of complex operations which in many cases imply real devices of businesses, command of the financial international operations, analytical ability of macroeconomic and microeconomic.

All these requirements compose a specific profile of the agent devoted to the international control, proving the importance that the group devoted to this control is conformed by a set of professionals with appropriate training and that, at the same time, be a multidisciplinary working group that, therefore, be prepared to face the multiplicity and complexity of the aspects associated to these operations.

Therefore, we must take into consideration, the fact that training adopts an important role in this background, being considered that they all efforts made by Tax Administrations to provide their officials with the suitable training in order to manage to have capable human resources for the accomplishment of the entrusted task, will not be few.

On the other hand, we can notice that at the moment of measuring the training efforts by the fiscal bodies, it is important to consider not only the diversity of issues, but specially the magnitude of the economic values in stake and the fiscal interest connected to them.

In such sense, we cannot be unaware of, for example, 60% of the worldwide trade is made between related companies, the growth of the worldwide GDP per capita between 1982 and 1999 – average rate- was of 1.4%, whereas for tax havens this rate reaches 3.3% (source: James R. Hines, “Do tax havens flourish? “Michigan University - October 2004), which it means that it is beyond any doubt both the importance of the control of the cross-border operations and the possibility of harmful tax planning that can be generated through the increasing intervention of the tax havens.

IV. 4. Connections with other national bodies

To carry on with the control of the international operations and their planning, certainly, it requires a strong information contribution that allows to unravel the modality whit which are carried out the financial flows related to them and all other complementary data that fully allows us to know the particularities of them and the elements of the context in which they are developed, in order to make the work of the Tax Administrations more efficient.

In all the countries exist agencies, governmental or not, that have valuable information which, if legal limitations do not exist that prevent it, it can be contributed to the State treasuries in order to contribute to the fulfillment of its assignment.

For that reason, for the fulfillment of the mission and function assigned by the rules to the Tax Administrations, sometimes it is extremely important to count on the assistance of other bodies that provide information, advising and any other type of support, of varied nature, i.e. Scientist, of engineering, industrial, commercial, etc.

On international taxation matter, in a general way, a series of Organizations has been identified which cooperate, with the contribution of the data that state the knowledge and control of the international tax matter, from diverse levels, that is why it is considered that keeping narrow bonds with those organizations produces, undoubtedly, benefits for the State treasuries.

We can mention:

- Central banks. These organizations can offer financial information of all type, from financial movements- from and towards abroad- which allow to identify the persons involved in the transactions to, among others, quotations of loans, interest rates for companies of high- class, information that is of extreme utility to analyze transfer pricing.

  It is also valuable, the contribution of knowledge on certain type of operations which is beneficial for having greater elements of judgment at the time of evaluating the legal and economic nature of certain financial instruments, favoring the boundary of the tax treatment that deserves be assigned to them.

- Customs: Being the Customs the competent Bodies in imports and exports matter, the information they have is of extreme utility to confirm operations, to know the values assigned, to identify the origin and destiny of products, to investigate on the possibility of triangulation of operations through traders or mediators in tax havens or not.

  Some Tax Administrations have adopted the form of Unique Agency so that they have integrated tax and customs control. This scheme has strengthened the handling and availability of information having improved, for example, the computing crosses and the detection of risk zones for the joint or separated control. In this last sense, we have knowledge that integration in Unique

Agency has allowed them to make incursions into tasks of joint and contemporary examination which have produced beneficial results in the level of the involved fiscal interest and in connection to the strong presence of the Tax Body before taxpayers.

- Securities Commissions and Stock Exchange: They are regulating organizations of the stock-exchange activities that perform functions to ensure the efficient and regular operation of the security-markets, to avoid modalities of fraud in the manipulation assigned to create artificial conditions of supply and demand of the prices of the negotiated moving values in the markets.

  They can give valuable information of the types of operations, the dealers, and in the case of Argentina they provide the State treasury with quarterly, annual and consolidated Balance Sheets, of publicly trade corporations.

- Organizations of control of financial activities: It is the case of Brazil that through the Council of Control of Financial Activities pursue the purpose of disciplining and of applying administrative penalties, examining and identifying illicit activities related to the money laundering

- Organisms that exert supervision functions. They are organisms in charge of the regulation, control and examine of certain activities such as insurances, gas, fuels, etc.

  These organizations can offer valuable information of the activity in itself as well as of suppliers and clients of the related persons.

- Chambers of Enterprises: These organizations group companies that are dedicated to certain activity. The information that can give is essentially of market, of operative modality of the sector, of sale levels, of levels of imports and exports. All this information is valuable when it is tried to know the driving of certain economic sector and constitutes an important element for the analysis of transfer pricing.

- National Institutes of Statistics: Generally these bodies are forced to keep secret of statistics, nevertheless, the information of general character that they can contribute can be valuable , such as, data of macroeconomic type of levels of general activity or by sectors of the economy at local and international level, all type of statistics related to the international trade: exported products, destiny of the exports, imports, etc. All this information can be valuable, together with the own information of the Tax Administration, for the decision making regarding the definition of sectors to be controlled and more specifically for determining levels of international activity when controlling transfer pricing.

- Governmental Secretariats: In some countries, there are administrative units of the central power with inherent faculties to certain economic activities that are from interest for the States. For example, stockbreeding, agriculture, fishing, fuels, etc.

These expert administrative units of the economic activities that they have under control can provide relevant information to the State Treasuries regarding international operations, modalities in which the businesses are carried out, conflicting situations of the sectors in commercial, financial and even tax matter. All these aspects can constitute useful information to unravel businesses, to know the details of the activity and even to generate data bases that allow crossovers with the bases of the Tax Administration in their task of control

- Organisms of registries of industrial properties, technology, marks, patents, etc. Without any doubt, these organizations that in certain countries are in charge of the contract registry of the commented nature and in others not only the registry but also the opinion disclosure on the content and reaches of such, they acquire a significant level of importance in opportunity of offering information.

  The knowledge of the type of contract, the intervening persons, the nature of the involved provisions, the amounts and agreed considerations, are excellent data at the time of analyzing the tax frame of the operation and provide substantial elements of examination in order to: evaluate the veracity and proportionality of the derived expenses and income; analyze transfer pricing; determine the effective lender of the contracted service; establish control guidelines; determine indications of harmful tax planning; and to establish, according to the involved magnitude, the importance of this type of operations, to determine whether or not they conform risk activities to be controlled.

- Organisms of Migrations. Since these organizations have under their control the information of the incomes and exits of people, the information that can be contributed to Tax Administrations are relevant to determine all the issues related to the residence of the people order to establish the allocation of taxable matter in the taxes that are charged on incomes.

  Also the contribution of data of the movement of people can give valuable information when determining the veracity of the entries from people to the country for the lender of technological services or of another type that deserve a specific fiscal treatment in conventional internal or international legislation.

ARGENTINA

The Argentine Tax Administration maintains contact with other agencies and entities in its mission.

With regard to international activities, it is to be noted that:

- The Argentine Customs Administration (DGA): Although the DGA and the Argentine Tax Administration make up a single agency –the Argentine Tax and Customs Administration (AFIP) -, it must be stressed that it is very important that they work together in the area that concerns us. Not only in terms of the use of customs databases but also for auditing purposes, carrying out joint undertakings and procedures that have been beneficial.

- The Central Bank of Argentina (BCRA): provides complete information on financial movements, listings, interest paid by large corporations, etc.

- The National Industrial Property Institute (INPI): provides information concerning registration of technology transfer contracts signed with foreign entities or individuals. It bears remembering that if contracts have not been registered, the taxpayer cannot deduct the expense on his or her tax return. It also gives advice on the nature of the technology acquired.

- Department of Foreign Trade and Industry and SMEs under the Economy Ministry: It provides information on sectors of the economy, and statistics on import and export operations.

- Department of Agriculture, Cattle-Farming and Fisheries under the Economy Ministry: provides reference values concerning operations, economic studies, statistics, and technical publications.

- The Foreign Ministry: provides local and foreign information on international trade and economic data.

- National Statistics and Census Institute (INDEC): Although this agency is obliged to maintain secrecy concerning statistical data, it provides us with macroeconomic information on levels of activity by sectors of the national and international economy, and all types of statistical data, which have helped us to study different economic sectors, in order to detect risk areas for auditing purposes.

- Business chambers: have helped us to learn specific information regarding the activities represented and often to know about industrial processes, mechanisms for use, production performance levels, etc.

- Commodities Exchanges: provide us with quarterly, annual and consolidated balance sheets of listed companies.

- National Migration Department under the Interior Ministry: provides information on entries and exits of individuals, permitting us to control residence issues, and also carry out investigations concerning persons who enter the country to render technology services, for example, technical assistance, under technology transfer contracts that should be duly registered.

- Tax and Contraband Investigations Unit (UFITCO): Provides additional information on important cases.

BRAZIL

- COAF – The Council for Financial Activities Control created in Law 9613 dated March 3rd 1998, for control and application of administrative penalties, examining, and identifying illegal activities related to money laundering.

- SUSEP – The Superintendency of Private Insurers is an agency with responsibility for controlling and auditing insurance markets, etc.
- CVM – The Securities and Exchange Commission of Brazil is involved in ensuring efficiency and regular operations in the stock markets, avoiding forms of fraud in manipulation aimed at creating artificial conditions of offer and demand of securities negotiated on the stock markets.
- BCB – The Brazilian Central Bank

CHILE

Agencies with which the Internal Tax Services maintain regular contact:

- National Customs Service
- Central Bank of Chile
- Securities and Exchange Commission (SVS)
- Superintendency of Banks and Financial Institutions (SBIF)
- Chilean Copper Commission (COCHILCO)

MEXICO

Contact is maintained with the different areas of Federal Government, for obtaining information, including the National Banking and Securities Commission, the Federal Consumer Protection Office, the National Geographical, Information and Statistics Institute, Government Secretariat (the National Migration Institute), the Mexican Industrial Property Institute, and others.

Furthermore, our contacts with Petróleos Mexicanos, the parastatal company, are very important as the information received covers service providers, who are usually residents abroad.

IV.5. INTERNATIONAL COOPERATION

IV.5.1. Introduction

The capacity of control of the Tax Administrations in international matter would become very limited without the support that implies the international cooperation.

Before the reality that means - as it was already mentioned- to count on Tax Administrations whose faculties are limited by their borders, while the economic transactions are globalized and world-wide integrated, to control the fiscal fulfillment of the internationalized taxpayers without having the suitable information and the mutual assistance, is an insurmountable barrier.

It is for that reason that it becomes extremely serious the necessity of strengthening cooperation in all its levels between Administrations because it conforms an unquestionable instrument in a globalized world**.**

On the matter, it must be considered that the international cooperation is a tool that allows:

- To equal skills between the taxpayers and Tax Administrations.
- To favor the control of the compliance of the tax obligations.
- To improve the control and discourage of harmful tax planning.
- To conform an effective method so that the countries maintain the sovereignty on their own tax basis.

In turn, the importance of this institute is given by the fact to conform an effective method so that the countries maintain their sovereignty over their own tax basis and ensure the correct distribution of the tax rights.

On the other hand, it is necessary to have legal instruments that grant the sufficient coverage and establish the conditions and procedures that guarantee the operativity of the concrete practices, fundamentally in the exchange of international information.

Regarding this exchange, it is worth standing that the CIAT has designed their own specific model Agreement on exchange of information that tries to surpass the limitations and disadvantages of a unique clause in the agreements to avoid double imposition.

However, it is possible to understand the international cooperation in two differentiated spheres, but not for that reason trying to fix an order of importance that each one of those aspects acquires in the improvement of working of the State treasuries.

In that frame it would be possible to differentiate:

- The mutual assistance
- The exchange of information

IV.5.2. <u>The mutual assistance</u>

Within the international cooperation we must consider the mutual assistance between the Tax Administrations like a useful tool to strengthen the work of each one of them.

In that sense the Administrations would have to understand like beneficial:

- To exchange experiences concerning:

    - Its taxpayers' actions in the sphere of the international taxation identifying the type of evasive maneuvers – e.g. triangulation of operations through tax havens, drafts abroad of incomes concealed under the form of expenses, elusion and/ or evasion maneuvers which are common according to the branch of economic activity, etc.- that undoubtely in many cases generate damages to more than an Administration in which the operators involved in this kind of modalities can belong .

    - The mechanisms of detection of risk zones of elusion and/ or evasion. The maneuvers and transactional modalities developed by the taxpayers to diminish taxtation.

    - The legal and operative measures adopted to fight harmful international planning and the results obtained from them.

- To favor the mutual assistance concerning:

    - To establish strategies of control and examination to face common problems

    - To offer training in those aspects in which the respective Administration has obtained successful results in international taxation matter

    - To integrate data bases whose use can be shared, with statistical and economic data of sectors and other information of tax nature or not, that can be useful for control.

    - To evaluate the issues that could require specific legal treatments in defense of fiscal interest, so that each Tax Administration promotes through the competent authorities, legislative or prescribed modifications.

    - To define control procedures to confront by individual Tax Administrations to limit the development of maneuvers that simultaneously harm them.

Without any doubt the present work is a clear exponent of the objectives that try to be reached through international mutual assistance.

On the other hand it is possible to indicate that one of the relevant topics within the mutual assistance constitutes the training between Tax Administrations which have an important connotation since the fiscal agents must confront common problems and undoubtedly, the experience transmitted by agents of other Administrations has the advantage of the approaches of the subjects from a same nature of necessities and it is an enriching experience because we are in conditions of sharing experiences that obtained the awaited result and the used mechanisms of correction.

ARGENTINA

As concerns training, the Argentine Tax Administration has taken part in courses given by CIAT, the Spanish Tax Administration, as well as events organized by CIAT together with the OECD.

Traineeships have been offered to staff of other CIAT member administrations, in the field of international taxation, in Argentina, with the aim of informing foreign officials about the methods used by the Argentine Tax Authority for controlling international transactions.

The traineeships will be organized to provide information about current Argentine legislation, administrative structure, databases used, investigation mechanisms, control strategies, transfer pricing control, design of risk matrices for selection of audit cases, audit procedures, request for information addressed to taxpayers and commentaries on specific audit cases.

BRAZIL

The Brazilian Tax Administration accelerated the implementation of the mechanisms of mutual assistance in the international field. The increase of the exchange of information with the Latin countries is a priority for the Administration.

The Brazilian experts take part systematically of the events of training carried out in the environment of the CIAT, of the Institute of Fiscal Studies of Spain and of the joint seminars of CIAT and the OCDE.

CANADA

The CRA Chairs the 7 Country Tax Haven Group (Canada, Australia, France, Germany, Japan, the United Kingdom, and the United States of America). One of the key initiatives of this group is to share best practices through regular joint training sessions.

In addition to the training offered through this organization, Canada is a member of the Joint International Tax Shelter Information Center (JITSIC), a newly formed group that will share best practices on dealing with harmful tax jurisdictions and inappropriate tax schemes.

Following is a link to the CRA site about JITSIC, which provides more information about the initiative.

http://www.cra-arc.gc.ca/newsroom/releases/2004/may/0503ottawa-e.html

CHILE

The Chilean Tax Administration has taken part in courses sponsored by the CIAT and the OECD, as well as courses sponsored by the Spanish Fiscal Administration.

On the other hand, the Service of Internal Taxes organized together with the CIAT and the OECD, two international seminars in *Santiago de Chile*, one on agreements for the avoidance of double taxation, and other on application of transfer prices. These seminars were attended by numerous member countries of the CIAT.

Besides, officials of other administrations of the CIAT have been realized interships in Chile, with the aim of informing foreign officials of the methodologies adopted by the Service of Internal Taxes for examination.

MEXICO

The Tax Administration Service has the intention of participating in any course to which it is invited by other Tax Administrations, for staff training, and has always been very willing to offer training to any other Administration, should it so desire, or to take part jointly with other Administrations in training courses, with attendance by our most expert professionals in the relevant area.

Mention must be made of the coordination undertaken with the Organization for Economic Cooperation and Development (OECD), with the holding of many courses, including the course on negotiation of Agreements and another on financial issues.

IV.5.3. Exchange of international information

IV. 5.3.1. Introduction

Before the present world-wide context characterized by an increasing globalization that derived in the increase of the international trade, the opening of the markets, the unthinkable evolution in the communications and computer science, it generates an inevitable reality; the possibilities of the actions of Tax Administrations individually considered when being limited to their respective borders, they are insufficient to effectively approach the control of the tax matter when it involves transactions of international character.

In this scheme, the international exchange of information plays a preponderant and essential roll when is to fix the taxable matter to those cases, among others, in which the economic facts total or partially are carried out abroad, in the assumptions that correspond to attribute incomes to people domiciled in other countries and to even define the imposition base on goods located abroad.

All these situations combined to the increasing mobility of the factors of production, of the capitals and the people and the differences of fiscal regimes in the different jurisdictions, are prone to generate evasion and/ or elusion facts that would be impossible to control without the cooperation in the contribution of reliable and opportune information.

Within this background, the States have noticed the importance of the fundamental tool of the international cooperation that it is the extra border exchange of information.

In order to achieve a greater understanding of the discipline that we are dealing with it is deemed appropriate to quote Professor Pietro Adonnino ("the exchange of information between Tax Administrations").

This author asserts that in the international cooperation between the Tax Administrations of different countries diverse interests are involved that are useful to show up.

In such sense he states that in the first place appear the interests of the States and one will see that these interests are mainly taken in consideration by the diverse rules on the exchange of information: the fundamental interest for the correct application of the tax laws – included those treaties against double imposition- is the one to ensure the collection of the tax income. Then, appears the exigency to preserve some peculiar characters of diverse national legal systems (eg. trusteeship of the secret of certain procedural guarantees), specially regarding fundamental values constitutionally guaranteed; the exigency of protect the interests of the national economy and, therefore, to exclude the communication from those communications that can facilitate the foreign concurrence; the interest (related to the general principles of sovereignty and efficiency of the administrative activity) of limiting the use of people and means in the interest of a foreign administration only in those cases where this use is understood like indeed justified. Under this profile the questions relative to the reciprocity are revealed, the previous exhaustion of the internal means, to the restriction put by the legislation and the administrative practice.

The mentioned author goes on expressing that with regard to the taxpayers at the same time of the interest (concurrent with the interest of the States) to avoid situations of double imposition - or in general, of illegal imposition – appears, in addition, the interest of ensuring a correct acquisition of the information, the discretion of the interchanged information, the interest of not exchanging information that can alter the concurrence in the international trade and the interest to an effective protection against an illegal exchange of information (on the basis of the international rule or to the internal rule): these interest can also contrast with the fundamental interest of the States to the reciprocal exchange of information.

IV.5.3.2. <u>Sources</u>

Traditionally the convention of making international exchange of information comes from the clauses stipulated in the Agreement to avoid the double imposition of ample character.

Thus, as soon as it concerns to the countries members of the CIAT it is possible to consider the models of the OECD, of the United Nations and the Andean Pact.

The evolution and implications in the respective modifications of respective texts to the exchange of information in those models have been widely analyzed by Mr. Claudino Pita in his article "Exchange of information and Tax Administration" – International Seminary on "Aspects of the International Taxation in the Present Context and double Taxation" Santo Domingo, Dominican republic, from 22 to 26/07/2002, whose reading is recommended.

IV.5.3.2.1. <u>Exchange of information from the OECD Model</u>

The current version of Article 26 was approved by the OECD's Committee on Fiscal Affairs on June 1, 2004. Its complete text is transcribed next:

Article 26

"1. The competent authorities of the Contracting States shall exchange such information as is forseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.

"2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

"3.In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public).

“4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

“5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

IV.5.3.2.2 Exchange of information from the UN Model

Article 26 of the UN Model reproduces in general the text of article 26 of the OECD Model with some incorporations, it is the one that is transcribed next:

"1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention, in so far as the taxation thereunder is not contrary to the Convention, in particular for the prevention of fraud or evasion of such taxes. The exchange of information is not restricted by article 1. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State. However, if the information is originally regarded as secret in the transmitting State, it shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes which are the subject of the Convention. Such persons or authorities shall use the information only for such purposes but may disclose the information in public court proceedings or in judicial decisions. The competent authorities shall, through consultation, develop appropriate conditions, methods and techniques concerning the matters in respect of which such exchanges of information shall be made, including, where appropriate, exchanges of information regarding tax avoidance.

“2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) Supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclose of which would be contrary to public policy (public order)."

IV.5.3.2.3 Exchange of information from the Model of the Andean Pact

On the other hand, in this Model the text relative to the exchange of information expresses :

“The competent authorities of the Contracting States shall celebrate consultations to each other and shall exchange the information necessary to solve, in mutual agreement, any difficulty or doubts that could arise in the application of the present Agreement and to establish the administrative controls necessary to avoid fraud and evasion

“The exchanged information in fulfillment of the previous paragraph, it will be considered secret and it shall not be transmitted to any person different from the authorities in charge of the administration of taxes, which are matter of the present Agreement.

“For the purposes of this article, the competent authorities of the contracting States will be able to communicate directly to each other”.

IV.5.3.2.4. Exchange of information from specific Agreements of exchange of information

The international exchanges of information based on the dispositions of the before mentioned Models of Agreement even though they are operative and have total use as soon as they force the Contracting States to offer the pertinent data , they can cause disadvantages in its execution, when not regulating the exchange in detailed form since they do not contain specific forecasts regarding the procedure and methodology to use, terms to produce and to send the information, destiny of the information depending on the different texts that through the years have had the articles of exchange of information within the Agreements to avoid the double imposition.

On the other hand, the agreement in Specific Agreements for the interchange is noticed with greater effectiveness, not only by the fact of being able to establish the reach and the object of interest of the contracting parties but also all the guidelines and specific requirements can be fixed and to extend their assignment when making possible the incorporation of other methodologies of cooperation like the mutual assistance

Example of these advances constitutes the Specific Model on Exchange of information of the OECD and the Model Agreement on Exchange of information developed by the CIAT. The latter is designed to be subscribed both as complement of the Agreements to avoid the double imposition and also by those States that without having the mentioned Agreements of double imposition, they can agree only those related to the exchange of information, as long as their internal legislations admit it.

IV.5.3.3. <u>Scope of the exchange of information</u>

With general character and without prejudice to the particularities of the above mentioned Models of Agreements to avoid double imposition and the special conditions that each State had arranged in the concrete negotiations, the international exchange of information can be used :

1. To avoid the double international imposition.

2. To correctly apply the internal laws as long as taxation is not contrary to the Agreement, thus, the information will be able to be used in those conditions respect to the taxes understood in the Agreement or not.

3. To prevent tax fraud and evasion in the territory with the contracting State, thus with equal reach than that described in the previous paragraph, it covers the taxes understood in the Agreement or not.

4. To be disclosed in the public proceedings or court decisions.

In addition, the information could be referred to both resident people or not resident people in the correspondent Contracting State. Thus the information to be exchanged is not limited by the nationality or residence of the person about whom the information will be provided.

In such sense it is important to emphasize that it can exists a true interest in obtaining information of developed activities in a Contracting state by non-resident people

IV.5.3.4. <u>Limits to the exchange of information</u>

As it is come off the transcribed articles of the Models of agreement to avoid the double imposition, limits to the exchange of information exist in which case the required State or Tax Administration is not bound to offer information:

It is like that when:

1. The type of request of information that was made implied the use of administrative measures that are not in accordance with the legislation and effective administrative practices in both States. This is logical because the exchange of information must have the suitable legal frame that at the same time ensures the procedure, giving him legal certainty and administrative transparency

2. The requested information it is not possible to be obtained under the legislation or in the normal development of the administration of one or of the other contracting State. Evidently the information provision cannot suppose the violation to the legislation in use of the Contracting States nor confirm administrative procedures that were forbidden.

3. In order to provide information commercial, enterprise, industrialist, mercantile or professional secret was revealed or a commercial procedure, or information whose revelation is contrary to the public order. Although this limitation is not debatable, it would be advisable that the Contracting States by the means that have predicted the Agreements, specify the reach of these secrets, the specific rules that regulate them and the situations that will be included in this type of secrets in order to avoid that under the shelter of this institute the interchange in situations that specially have not been protected be restricted.

IV.5.4. <u>Principles that govern the international exchange of information</u>

Exist principles that prevail in the international exchange of information which are immersed in commentaries made up to here.

These principles are recognized at international level and they refer to:

- **Secrecy**

This principle means to transfer the effects of the fiscal secret to the other Contracting State or Tax Administration.

In exchange of information matters the fiscal secret constitutes the base of the mutual confidence and it becomes a condition and requirement that make conditional a beneficial cooperation between countries.

Through the confidentiality it is expected to avoid that the exchanged information can be of common knowledge and consequently to cause an inadequate use.

In the facts through the confidentiality it is demanded that the information is maintained secret in the same form that data of obtained of internal sources.

The violation to the protection of the tax secret, entails the application of the sanctions in force of the country that receives the information.

- **Diligence**

This principle talks about that the international exchange of information must be carried out by means of the use of all legal and administrative means available in the required Administration and this one must unfold its better efforts to execute the request.

That is why, if the requested information is available in the required Tax Administration, this one will have to unfold the legal and normative procedures whereupon it counts to obtain that information, considering in addition that it must produce it even when the required data were not from its interest or necessary for its own aims.

An example of it would be the case that a Tax Administration required information respect to some type of operation that in the required Tax Administration was tax - free. For this last Administration the information to be collected surely does not generate any benefit to it, nevertheless it does not discharge it form producing it and communicating it to the solicitant party.

It is for that reason that the requested party must provide the information even though it is useless for the administration and for the fulfillment of its own tax laws.

In such sense it must be noticed that an efficient and effective prosecution in the provision of information to abroad will result in the promotion of an egalitarian treatment by the solicitant State or Administration, when it is necessary to resort to it to obtain data.

- **Opportunity**

So that the information be useful it must be opportune, therefore it must be quickly implemented because otherwise it could be useless.

Like in the case of the prosecution of the information the production of opportune information foster the generation of opportune data by the other State or Tax Administration.

In many cases it usually happens that the necessity of the information is generated in more or less near moments at the end of the prescription. In these cases it deemed advisable that at the moment for carrying out the information order this situation be specifically clarified so that the team of abroad responsible for its production can act consequently, otherwise the information could be obtained inopportunely.

- **Reciprocity**

Obviously, when a State or Administration makes special efforts to generate information for another State or Administration, it tries to obtain a reciprocal treatment.

The reciprocity can be understood in strict sense or wide sense.

In a strict sense it entails an equality of elements and information to be exchanged, what involves in some cases to carry out a strict control of the volume of produced interchanges.

This modality generates difficulties and evidently the exchange of information can return inoperative.

You must take this situation into account in the assumption of Agreements of Interchange celebrated between Administrations with logistic of data of very different spread. If the reciprocity were measure in amounts of the exchanges made, it is probable that the Tax Administration with less resources did not have access to information of the developed Tax Administration because the balance could not occur which demands the reciprocity measured in strict sense.

However, if we understood the reciprocity in a wide sense, these disadvantages are overcame because it implies to evaluate the balance of a balanced form as a whole, or even better, based on the good faith and the disposition that a Fiscal Administration puts at the service of the other even though the volume of information feasible of being interchanged would be different.

- **In order to carry out a requirement of information to another Fiscal Administration, all local means must be used up.**

We cannot deny that the process of exchange of information requires an effort by the Administration that must provide the information, therefore it is not reasonable that all their administrative scaffolding is started up when the own Fiscal Administration that tries other administration gives information to it , had - through its own means- the possibility of obtaining it by itself.

IV.5.5. Types of international exchange of information

IV.5.5.1. Automatic exchange

It is the exchange of information that is available and it is generally obtained, in a routine form by the emitting country. The information is not related to a single case, it is of massive character.

Therefore it is the habitual and systematic sending of data on specific concepts, such as: interests, dividends, royalties, pensions.

Habitually, in this modality the contracting parties decide beforehand what type of information they wish to exchange through this method, the frequency of the transmission of the data and the means used to such aim.

IV. 5.5.2. Spontaneous exchange

This type of exchange is generated when one of the contracting parties, in the course of the administration of its own taxes, takes knowledge from a piece of information that it considers can be of interest for the other Tax Administration.

In those conditions, the information is transmitted without hoping that the receiving country asks for it.

The effectiveness of this type of exchange depends directly on the ability of the supervise personnel to identify, in the course of an investigation or control the information that can be relevant for the foreign tax administration.

It is expectable and beneficial that the Administration that sent the information in spontaneous form obtains an answer of the country that received it, in order to know if such information was useful. Situation that in affirmative case will generate an incentive so that the supervise agents spontaneously continue providing information.

IV. 5.5.3. Exchange of information upon request

This type of exchange takes place when the competent authority of a contracting state y asks for information to the competent authority of the other contracting state referred to a certain case and taxpayer and therefore it involves concrete and specific questions.

Under this scheme when Agreements of specific exchange of information have been signed, the contracting states usually decide the conditions in which this type of exchange, including the form to carry out the request, the acknowledgment of reception, the terms of answer, the assumptions of extension of terms, the cases in which it will not be possible to emit the required information and its foundation, etc.

IV. 5.5.4. Other types of exchange of information.

IV. 5.5.4.1. Wide interchange of information

It takes place when it does not concern a specific taxpayer but an economic sector as a whole, such as data of determined industry, ways in which operates certain economic sector, financing schemes, market prices, ways of fixing prices, the tendencies of fiscal evasion, effective guidelines of control, etc.

IV. 5.5.4.2. Simultaneous controls

They are a procedure that implies an agreement between the competent authorities of the contracting states with the purpose of examining in simultaneous and independent way (each Tax Administration in its own territory), the tax issues in which the taxpayers has an interest common with a view to interchange any type of information that they obtained in this way.

It is a specially useful methodology to control a same economic set in the matter of transfer pricing and also to identify evasion schemes.

IV. 5.5.4.3. <u>Controls abroad or visits of the represent-tatives of the competent authorities</u>

There are situations in which it can be useful to travel to foreign jurisdictions in order to collect data for a particular case.

These visits must be authorized by the foreign jurisdiction and to be allowed by the laws of the receiving country, otherwise one would take place sovereignty breaches.

Therefore the decision to authorize or not these visits, and in affirmative case, if the presence of foreign tax official requires the consent of the taxpayer, as well as another type of terms or conditions for these visits, it is unique responsibility of each country in special.

The presences abroad can occur in different occasions:

1. To request of the country that needs information, if it considers that that will facilitate the understanding of the investigation or the gathering of information.

2. As an initiative of the competent authority with the aim of reducing the cost that implies to collect the data.

In some countries the qualified representatives of the competent authorities of another country can participate in a tax inspection and this is generally useful to obtain a clear idea of the commercial activities and other relations that a resident person of a country can have with her foreign associate.

<u>ARGENTINA</u>

Argentina is signatory to 17 international agreements for avoidance of double taxation regarding taxes on income and capital. These agreements provide information exchange mechanisms which have been useful in some cases and not so useful in others.

The countries Argentina has entered into agreements on this subject are:

- Bolivia

- Germany
- France
- Austria
- Brazil
- Italy
- Chile
- Spain
- Canada
- Finland
- United Kingdom
- Sweden
- Denmark
- Belgium
- Netherlands
- Australia
- Switzerland

Across these agreements the tax administration has qualified the mechanisms of exchange of information which have turned out to be profitable in some cases and not so much in others.

Nevertheless, exchange procedures have improved in recent years and thanks this information has been obtained that is being used for checking world income and transfer prices, by means of the information exchange mode whereby can be requested or it can be provided spontaneously.

Furthermore, the Tax Administration has a marked interest in promoting this mode of exchange, and Argentina has taken part in the CIAT work group which was responsible for drafting the Information Exchange Model, only recently approved.

Below are Argentine legal sources for international information exchange:

- The network of Agreements for avoidance of international double taxation, and

- The tax procedures law which grants the Argentine Tax and Customs Administration (AFIP) the power to waive tax secrecy rules when it signs international cooperation agreements.

Until changes were made to the income tax law, amended by Law 25.063, which established regulations with regard to world income criteria, as well as other changes, and included the transfer pricing regime, information exchange was not considered very important, and was limited to spontaneous and traditional exchanges made by signatories to the Agreements and the odd cases when an exchange of information was requested.

From then on, cross-border information exchange has played an important role in the Argentine Tax Administration, fundamentally thanks to the Administration's firm decision of to carry out effective control over all related aspects of international operations in order to protect fiscal interests.

In that context and from the new legal faculties granted to the AFIP, it has been recently signed with Spain, Brazil and Peru Specific Agreements on Exchange of information, both first complementary ones to the Agreement to avoid the double imposition and the last one in function to the own faculties of the Federal Administration and the rise of the fiscal secret before referred.

All these specific Agreements were negotiated on the basis of CIAT Model of Exchange of information, that it includes the procedures to make simultaneous controls. There are in via of negotiation other agreements, even with countries with which agreement to avoid the double imposition does not exist, also from CIAT Model.

The Argentine Foreign Ministry network is another channel used by the Argentine Tax Administration for obtaining international tax-relevant information, and in the case of countries that do not have agreements for avoidance of double taxation.

In many opportunities, the assistance obtained has been very valuable, such as when the Foreign Ministry certified the contents of an Internet site, where there was important evidence to support tax claims in a tax audit.

BRAZIL

Brazil carries out information exchanges with all countries with which it has agreements in force for the avoidance of double taxation, as well as with the United Kingdom and the United States, which have reciprocal treatment agreements.

CANADA

The Exchange of Information (EoI) Programs consist of a range of programs meant to facilitate collaborative efforts and the exchange of information between the CRA and foreign tax administrations.

Two factors tax administrations have in common are strong confidentiality provisions and the fact that their powers are restricted to their domestic territory. Through legislative and administrative procedures, the EoI Programs provide for the sharing of taxpayer data with over 80 treaty partners, and provide for travel to foreign jurisdictions for compliance purposes.

The following is a list of the types of programs now undertaken with a short explanation of the collaboration each program provides.

- Specific Requests: The CRA may request specific information on a named taxpayer. The foreign jurisdiction is required to use their administrative powers to obtain the information. The CRA has the same commitment to respond to foreign requests.

- Automatic Exchange: The CRA receives bulk data files that contain information on Canadian residents who receive payments (interest, dividends, pensions, etc.) reported to foreign jurisdictions. The CRA sends similar information to 16 treaty partners.

- Spontaneous Exchange: There is an obligation on treaty partners to identify information that may be useful to a foreign jurisdiction during the course of their domestic audits and to pass it on to their treaty partners spontaneously.

These exchanges may be on individual taxpayers but recently this program has been the source of information on abusive investment schemes.

- Simultaneous Audits and Simultaneous Criminal Investigations: This program allows for the independent but coordinated audit or investigation of related taxpayers.

- Assistance in Collection: The CRA has agreements with a few countries that provides for collection assistance. The foreign country will collect established debts from Canadian citizens resident in that country and the CRA reciprocates in kind.

- Travel: Tax administrations must obtain permission from a foreign jurisdiction before operating on foreign soil. In general, the taxpayer must approve of the visit but jurisdictions do offer the services of their auditors or investigators in some circumstances.

Summary:

In combination, the above-mentioned programs provide a broad range of service that allows for collaboration between treaty countries while protecting the rights of taxpayers and respecting all underlying legislation.

CHILE

Section 6 of the Tax Code, subparagraph 1, entrusts the Internal Tax Service with the administrative application of tax provisions and tax audits, over any other administrative authority or body, and establishes the attributes or powers of the Director and Regional Directors.

The Director of the Internal Tax Service is granted powers to maintain information exchange with tax administrations in other countries, in order to determine taxation that affects certain taxpayers. This exchange of information must be requested through the competent Ministry and must be carried out on the basis of reciprocity, in conformity with the regulations concerning tax returns secrecy.

In the case of double taxation agreements, article 26 of these agreements establishes rules for the exchange of information.

In addition to this, experiences of exchange of information have been made with some countries with which current Agreements of Double Taxation were signed, applying the article 26 of said agreements.

Additionally, Chile has signed two agreements of exchange of information, one with Spain and other with Argentina, the first one is protected under the article regarding exchange of information of the Double Taxation Agreement between both countries, and the second one is based on the article 6 ° subarticle 1 ° of the Tributary Code. Besides, agreements of exchange of information with other countries are still in a state of negotiation.

Procedure of Exchange of Information:

a. <u>Exchange of Information upon request</u>

- Requests of Information

Faced with the need to obtain tax information of a taxpayer, the Service of Internal Taxes requests it through a private writing signed by the Director of this organization.

The private writing is sent to the competent authority defined by the counterpart. The record compiled in Chile, the reasons of the request and the specific information that is requested are pointed out on said writing

- Replies to requests of Information

The requests of information from foreign tax administrations are formally received at a managing level of the Chilean tax administration, that is to say, at a level of the Secretary of the Treasury, the Director of the Service of Internal Taxes or some person in charge designated by the later to fulfil this function.

The document with the formal request is derived at operative levels which are represented by the Area of International Examination of the Department of Design of Examination Procedures and International Examinations, dependent on the Subdepartment of Examination of the Service of Internal Taxes, and the Regional Departments that have jurisdiction on the taxpayer on whom the request falls.

In the area of International Examination the request of information is analyzed and, if appropriate, a plan of action is designed so that the Regional Department executes the respective audit, review or compilation of record.

The Regional Departments receive the plan of action designed and develop the activities within a certain term, after which they generate a report with the obtained results and the compiled record. All the documents are stamped by tax inspectors.

The report and the compiled record are received in International Examination, where they are analyzed for the making of the reply or for generating additional activities.

Once the reply is generated, it is formally sent through a private writing to the applicant tax administration.

b. Automatic Exchange of Information

With regard to the automatic exchange a standard procedure does not exist for the exchange of information.

In negotiations for the establishment of an Agreement on Exchange of Information, the information that will be exchanged in this way is defined, but the procedure as such is established at the moment of the sending of the information.

In the case of Chile, so far, only an exchange of information has taken place, with Spain. In the above mentioned exchange, each Tax Administration generates a computer file, basing on the recommendations of the Manual of Implementation of Exchange of Information of the OCDE, which is sent, in an encrypted way, to its counterpart.

c. Spontaneous Exchanges of Information

Spontaneous exchanges of information have not been produced, nevertheless, the procedure to follow in case that an spontaneous exchange of information arises, is similar to the end of the procedure for exchange of information upon request.

As soon as the records were compiled by the Regional Direction or the Area of International Examination, they are formally sent through a private writing to the counterpart.

MEXICO

In the matter of exchange of information, Mexico has celebrated agreements for the tax exchange of information with the following countries:

1.- Finland	10.- Singapor	19.- Chile
2.- Germany	11.- France	20.- Canada
3.- Ireland	12.- Israel	21.- Ecuador
4.- Netherlands	13.- Norway	22.- Portugal
5.- Denmark	14.- Spain	23.- Poland
6.- Japan	15.-United States of America	24.- Luxembourg
7.- Belgium	16.- United Kingdom	25.-The Czech republic
8.- Italy	17.- Sweden	26.- Indonesia
9.- Switzerland	18.- Korea	27.- Australia

In some occasions the exchange of information is restricted, situation that occurs when in the Agreement the exchange of information is limited to the application of it, without allowing the Contracting States to consult cases that do not involve the application of the Agreement. In the case of the Agreements that it has celebrated Mexico, the exchange of information is restricted in the following countries:

1.- Germany
2.- Switzerland
3.- Great Britain
4.- Japan
5.- Luxembourg
6.- Ireland

Actually, Mexico has solely had effective exchange of information with the following countries:

1.- Finland	7.- Italy	13.-United Kingdom
2.- Germany	8.- Switzerland	14.- Sweden
3.- Netherlands	9.- France	15.- Korea
4.- Denmark	10.- Spain	16.- Chile
5.- Japan	11.- United States of America	17.- Canada
6.- Belgium	12.- Portugal	18.- Poland

The country with which exists more exchange of information is the United States of America.

Combined to above mentioned, exists automatic exchange of information with the following countries

1.- United states of America
2.- Canada
3.- Korea
4.- Denmark

CHAPTER V

EXAMINATION PROCEDURES FOR INTERNATIONAL TAX PLANNING CONTROL

V.1. Introduction

When referring to international tax planning, auditing transnational transactions is the most relevant procedure to counter the harmful effects thereof.

In such regard, we believe it is timely to refer to the statement in the Preface of the CIAT “Examination Handbook. Strengthening the Examination Function in the Tax Administrations of Latin America and the Caribbean”

It states that examination: “Plays a key role in the effectiveness of the agency and is a fundamental instrument in fighting tax evasion by ensuring fair application of the tax system, providing an adequate level of tax revenues and encouraging spontaneous compliance with tax obligations.”

Vis-à-vis the entity we shall address, we should not ignore that the international opening up of the economy brings about for Tax Administrations the need to assume the new dimension and relevance of international transactions and the tax consequences derived therefrom. This vision of reality mandates them to redesign the courses of action they historically undertook in their national performance.

As we have been perceiving in this document’s drafting process, the speed and complexity in the development of international transactions have enabled taxpayers to use a tax planning method that, from the standpoint of this analysis, has favored the erosion of the tax base, whether grounded on zero or low taxation jurisdictions, or jurisdictions with tax advantages based on preferential tax regimes or even, locations with lack of accurate controls of international transactions by the Tax Administration.

In such context, the Tax Administrations, by undertaking international transactions’ controls, shall be able to:

1. Safeguard the national tax base.

2. Discourage taxpayers’ use of harmful tax planning.

3. Restrict taxpayers’ possibility of perpetrating tax evasion maneuvers in the light of the objective risk of being audited.

4. Avoid the unequal treatment between taxpayers who conduct business exclusively at the national level and those who conduct transnational business.

5. Gain, by means of experience in controlling this kind of transactions, enough knowledge in order to anticipate contingencies that imply assumptions of tax avoidance and/or tax evasion and duly adopt the more effective regulations and or audit standards, which serve as tools to prevent the adoption of mechanisms or maneuvers that distort the tax obligation.

6. Finally, foster voluntary compliance by means of a strong Tax Authority presence, as regards international operations' control.

All these objectives play a vital role if we refer to tax planning auditing, since it becomes the fundamental axis to hinder or dismantle schemes and create awareness as to strong controls and their implied risks for taxpayers.

V. 2. Case Selection

This section shall include methodologies, analyses and recommended mechanisms to initiate an international transactions' audit proceeding and their related tax planning practices.

Thus, we shall begin by analyzing the assumptions of harmful tax planning practices and the analysis of the specific risk for transactions' control, as previous stages to the audit enforcement itself.

V.2.1. List of Assumptions on the Use of Harmful Tax Planning

In order to select the cases to be audited, a list of assumptions as to the use of harmful tax planning entails a greater effectiveness in the selection process, not only regarding the transactions suspected of generating tax harm, but also regarding the efficient use of human and material resources for auditing purposes.

The drafting of such list requires previous knowledge of certain events that may underlie harmful tax planning and of the universe of taxpayers involved in order to undertake a more effective transaction-based selection.

Therefore, the following elements are deemed useful in the approach to the list drafting process:

1. Availability of national and international information on specific international business.

2. Economic sectors more likely to resort to harmful tax planning.

3. Most common type of transactions employed in generating tax planning.

4. Knowledge of the national economic, financial and commercial market and its interaction with external markets.

5. Relevance of certain types of transactions in the local market with foreign entities.

All such aspects shall be analyzed in greater depth in the following section. Therefore, we include the assumptions' list submitted by the Tax Administrations participating in the drafting of this Manual as a guide for their identification.

ARGENTINA

Although in Argentina a specific general assumptions' list has not been drafted for the purpose of analyzing international harmful tax planning, priority situations have been identified in order to undertake international transactions' analysis and investigation.

The following assumptions may be enumerated in such regard:

Vis-à-vis the participating entities:

- Local taxpayers conducting business with entities established in zero or low taxation jurisdictions.

- Local taxpayers conducting business with foreign related entities.

- Local businesses that form part of a multinational group whose income and tax statements are null or low (even with significant liabilities) while the larger companies in the group are highly profitable.

- Subsidiaries of foreign companies that conduct economic transactions in our country, with the specific feature that the office in the country of incorporation lacks economic relevance or whose sole activity is to conduct business in Argentina.

- Local exporters with low profitability or tax losses from certain economic sectors, when local taxpayers in the same business are profitable or have different business results.

- Failure to report the extinction of the Argentine resident status to enjoy lower taxation vis-à-vis Argentine non-resident wealth taxes, which entail higher tax burdens.

Vis-à-vis the type of transaction:

- Loans obtained from related companies or entities based in zero or low taxation jurisdictions.

- All types of transactions performed with entities in zero or low taxation jurisdictions, chiefly exports' transactions.

- Assignment of intangibles.

- Exports' transactions with documentation in the name of parties other than the goods' recipients. Transactions' triangulation.

- International "fideicomisos" or trusts' transactions.

- International financial derivatives' transactions.

- Advance payment of commodities' sales, and delivery –exports- within a very long term -8 to 10 years-, the price set at the effective date of the agreement.

- Technology migration: brands, patents, technical assistance.

- Concealment of commercial ties with foreign entities.

- Foreign loans' simulation.

- Foreign loans' simulation from related entities, which are in fact capital contributions. They generate inapplicable interest allowances and translation differentials.

- Back to back loans.

- Under-assessed withholdings on foreign beneficiaries.

- Foreign loans extended when the international lender lacks the economic capacity.

- Simulated extinction of the resident status to avoid foreign source income and wealth tax.

BRAZIL

The practices mentioned hereunder account for confirmed assumptions that taxpayers are undertaking actions aimed at reducing the tax burden, in the view of the Brazilian Tax Administration.

1. Commercial and financial transactions with off-shore corporations based in countries with preferential tax regimes and strict bank and tax secrecy laws.

2. Imports and exports' transactions among related companies based in countries with preferential tax regimes.

3. T-Bills purchase and sale transactions.

4. Remittances and foreign exchange inflow transactions via an alternative system that breach the legal exchange transactions in place.

5. Commercial, financial and assets' transactions conducted by straw parties.

CANADA

The CRA has aggressively worked towards alleviating the effects of harmful and inappropriate tax schemes. JITSIC (see 3.2.3) will allow the CRA to share data about such schemes and those who promote them. Information shared in that forum will augment the knowledge base of the participating administrations, including the CRA.

CHILE

We enumerate some of the identified transactions considered in detecting specific harmful tax planning situations:

- Transactions with tax havens, where they have identified a large production business with partners located in one of the countries included on the Chilean list of zero or low taxation jurisdictions.

- Cases of businesses with sustained losses in time and national or foreign associates that never receive earnings' distribution or dividends or payments of any nature.

- Use of a shell company based in a State that is signatory to a preferential double-taxation agreement, thus simulating that transactions are conducted through this shell company.

- Creation of permanent establishments or agencies in tax havens responsible for making and managing the holding's worldwide investments.

- Simulating indebtedness via permanent establishments or agencies in tax havens to obtain foreign loans for the Parent company, thus avoiding the loan tax and income tax.

- Business disposal or liquidation transactions with the sole purpose of enjoying tax advantages such as the use of unprofitable corporations.

- Use of the resident status in the country or countries with which Chile has entered into a Double Taxation Agreement with the aim of enjoying lower tax rates or exemptions stemming from such agreements.

- Concealment of the business relation in credit transactions with the purpose of evading the Chilean Thin Capitalization regulation.

- Granting credits among related entities in off-market conditions, with excessively extended grace periods aimed at deferring tax payment ad infinitum, off-market rates and fees charged at unusual amounts or outside the regular ranges.

- Service-rendering among related parties. It is possible to detect the inexistence of such services, the lack of supporting documentation as to the transactions conducted or the distortion in the amounts agreed.

- Abuse of franchises as a form of obtaining tax exemptions, by failing to meet the requirements as well as the lack of supporting documentation for transactions.

MEXICO

Based on queries filed by taxpayers to the Legal Affairs department, Mexico relies on a list of assumptions that are normally followed in audits.

Mexico has also detected businesses featuring an indebtedness ratio with related entities and equity capital out of the normal ranges. This entails a significant interest allowance in the income tax assessment, reducing the tax base to the detriment of government revenue. This may be inferred from the tax report that includes the financial statement and income statement, which -among other information- contains the payment of foreign interest. Likewise, such situation is confirmed with the information on loans obtained from foreign residents and the information on payments from national sources of wealth.

Tax planning for the purpose of assigning intangibles in order to erode the tax base is identified in companies upon comparing royalty payments prior to assigning them against the greater payments thereafter. Normally, this occurs in countries that are party to double-taxation treaties, but nevertheless, enforce low taxation on income from foreign sources of wealth. The specific cases are Switzerland, The Netherlands and Luxembourg. This is detected in the information on foreign payments and the expenditures' sub-account stated in Annex 5 of the respective report.

A very valuable source of information indicating the use of harmful tax planning is the statements filed by taxpayers. They enable us to detect in a relatively simple manner, the payments to preferential tax regimes exempted from the applicable taxes thereto. Likewise, we may easily identify the items on income earned by foreign residents, which were exempted from the applicable withholding as provided by the Income Tax Law and the Double-Taxation Agreements.

V.2.2. Specific Risk Analysis for Transactions' Control

When Tax Administrations must conduct audits, such process shall take place in the context of effective and efficient enforcement. Therefore, the adoption of a selection process is required, since it would be impossible to audit one hundred percent of the taxpayers under its administration.

This selection process is fundamentally supported by risk management.

Risk management has been defined as: "…the systematic process in the course of which people and resources are deployed based on risk analysis aiming to achieve an optimum result.", as stated in the CIAT Examination Handbook."

On the other hand, it is worth taking into consideration that risk management is an ongoing ever-evolving process given the changes of different nature that affect it. In our context, such changes may be spurred by new worldwide business alternatives, technological advancements that enable to conduct transactions in forms other than the traditional ones, such as e-commerce, amendments in legislation, international changes in tax criteria, etc.

Such external fluctuations shall bear a greater or lesser risk assessment incidence, whether by generating a new one or modifying those detected by the Tax Administration.

Without intending to delve deeper into risk management administration, but to focus on identifying the risks that relate to harmful tax planning, we deem it is timely to recall the benefits that arise from conducting a structural process in this effort. Therefore, we shall refer once again to the notions in the CIAT Examination Handbook.

The following benefits have been stated there in:

1. Equal treatment and public confidence;

2. Possibilities for central target setting;

3. The ability of matching resources and risks;

4. Effective strategy decisions;

5. It relieves compliant taxpayers from the burden of a tax audit;

6. It improves the use of resources leading to better results;

7. It allows work to be carried out more systematically;

8. It creates more possibilities for communication and cooperation;

9. Decisions shall be based on analysis conducted following a scientific approach;

10. Reviews of various measures of influencing compliance behavior;

11. Alternatives for reducing risks and the relationship between the alternatives;

12. Risk analysis and use of resources to achieve an optimum implementation of the law.

It is relevant to identify the existence of procedures, standardized guidelines or indirect mechanisms to detect risks on which to focus an audit process.

In this regard, different modalities may arise with the purpose of detecting risk factors to conduct specific tax audits and controls. The evolution of IT processes has contributed to enhancing the quality of audits on specific issues by cross-referencing information, moreover in the case of international transactions where taxpayers' tax planning is increasingly complex.

In many cases, the necessary precautions shall be taken, since the foregoing information cross-referencing procedures are conducted based on the information rendered by taxpayers –whether from tax statements or assessments, respectively- which make this a relevant factor in the evaluation of the appropriate factor-ranking according to the notion of risk.

Economic and tax studies by sectors that involve the international transactions' aspects shall also appear as an essential risk-detection aspect, favoring strategic decision-making for the control thereof.

In general terms, such studies, based on the different economic, financial and wealth evaluation mechanisms, may contribute with valuable data as to each sectors' profitability or for each business within a specific economic sector. This, among other possibilities, favors transfer pricing risk-detection.

Another factor worth considering in measuring the risk level is inherent taxpayers' behavior in general terms, their taxpaying capacity, compliance level, cooperation with Tax Administration requirements and the information arising from prior audits.

Finally, we shall underline that given the complexity involved in harmful tax planning control and auditing, risk management plays a relevant role for more efficient selection process of cases to be audited.

ARGENTINA

The elements and systems used by the Argentine Tax Administration to undertake international transactions' control and determine the cases to be audited are the following:

1. Economic and tax studies by sector.

As mentioned in item III.2.B, 73 economic sectors have been subjected to studies and updated, which contain information on wealth, as well as financial and tax information for a 5 to 7 year term.

Such studies include detailed information on 1950 businesses distributed among the 73 sectors mentioned.

Ratios have been assessed for each company, as follows: Gross Income /Sales; Net Income /Sales; Tax Income/Sales; Net Income/Net Worth; Net Income /Assets; Liabilities/Net Worth; Net Worth/Liabilities; Net Worth/Assets; Assets/Liabilities and the profitability ratios applicable in the Transactional Net Margin Method.

Such studies cover related and independent companies.

The behavior of all the companies in the sector is analyzed according to each ratio, in order to determine the behavior differences among the related and independent companies.

All this information, plus the business macroeconomic data enables the detection of the first irregularities and situations that require a further analysis.

Such analyses also identify comparable independent companies in order to enforce the transfer pricing regime.

2. Exploitation of the IT database built from additional international transactions' statements.

The exploitation of the transfer pricing database enables to identify the transaction volumes, by type of transaction, foreign entities –including those based in zero or low taxation countries-, the transfer pricing methods employed in the statements and the existence of favorable adjustments for the administration or not.

The data on which the investigation focuses are determined by the transactions' magnitude, transactions with entities based in tax havens and tax profitability tied to the magnitude of the international transactions performed.

This information, along with the data gathered from studies by sector, allow for a more specific appreciation of the cases that require deeper investigation.

Also, this database enables to identify the transactions which, owing to their nature, are known to be likely generators of harmful tax planning (loans, assignment of intangibles, trademarks, etc.).

3. Use of the other AFIP databases.

With the aim of improving investigations, for example, by detecting unreported international transactions or other elements that favor the selection of cases and put the taxpayer at risk, all the databases available in the AFIP are cross-referenced. Among them, we may mention the foreign beneficiary withholdings' databases, tax statements' databases for all taxes, María System (for Customs operations), etc.

4. Transfer pricing studies for tax purposes.

In addition to the foregoing, we may add the analysis of the information submitted in hard copy to the study of transfer pricing for tax purposes concurrently with financial statements. This enables to analyze the company's economic, financial and tax status, perform a functional analysis, comparability analysis, comparability adjustments and all the other elements that make up the application of the transfer pricing regime.

Therefore, a clearer and more concrete vision is attained on the existence of a potential interest from the tax standpoint to warrant an audit proceeding.

5. Additional information.

Regardless of the foregoing analysis, non-methodological external situations are also examined. For example, business liquidation, market conditions (an economic sector that within a given period became the first world exporter, the prices in Dollars tripled and the taxable income was not modified on the same basis. Transfer pricing adjustments were undertaken).

6. Foreign companies information.

Data from foreign companies with offices in Argentina or public-private partnership is used as additional information for investigation. This collect data is used to create additional information database.

7.Taxpayer's behavior.

Lastly, and as an additional piece of information for behavior assessment, we include an application by the name of SIPER, which may be accessed by the investigation units of this Administration.

Such application tends to optimize the Agency's existing information, using the different IT tools available.

Investigation officials may access the detail of the parameters employed to conclude on a given behavior rating according to categories A, B, C, D and E. Letter "A" stands for taxpayers with the lowest audit risk, and the level increases in the subsequent categories.

Internal users with access clearance above query, may modify the category for taxpayers they deem to have been assigned an incorrect rating based on evidence required to warrant such modification.

The taxpayers' rating process was based on formal and material noncompliance.

Processes are updated monthly according to an operating schedule that determines the date as of which the information has been updated.

The following are the formal noncompliance cases incorporated, among others: *Factuweb* (AFIP Printing House Record), involving taxpayers registered in the

Value Added Tax who have failed to request the printouts of receipts, in spite of their formal compliance with the annual Value Added Tax for the Agricultural sector.

The following are the material noncompliance cases incorporated: Taxpayers not subjected to audits, Preventive audits (stemming exclusively from reports filed and others different in nature from the foregoing), Tax enforcement proceedings, Universal proceedings (meeting of creditors and bankruptcy) and Contentious proceedings, value mismatches detected by the Customs Administration (DGA, as per the Spanish acronym) and rating extended by the Argentine Central Bank.

BRAZIL

With the purpose of verifying distortions in tax obligation compliance, based on certain technical, objective and impartial criteria, the Brazilian Tax Administration has been improving the selection process for taxpayers to be audited.

The internal systems employ data gathered from comprehensive information by activity, filed by the taxpayer as well as third parties in transactions. The information originated in different sources make up a single data base, currently in the DataWarehouse platform, whose searches and cross-references are performed electronically based on parameters indicating potential tax irregularities.

Risk analysis is performed by specifying parameters that indicate a taxpayer's behavior anomaly a priori. Such parameters are in fact intricate filters applied to the database, which serve to filter out the records of compliant taxpayers.

Following is a detail of the most relevant information-gathering mechanisms involved in taxpayer selection for audit proceedings.

Integrated Information Gathering System, Sinco, as per the Portuguese acronym, which enables reception of purchases and sales' corporate invoices. This system processes the exchange of information originated in Tax Administrations from the different States.
Real Estate Transactions' Statement, DOI, as per the Portuguese acronym, geared at capturing statements from Court officials, in charge of recording documentation, from the Real Estate Registry and from Title Deeds and Documents supporting real estate transactions.

Real Estate Business Report, Dimob, as per the Portuguese acronym, implemented to capture statements from construction companies or investors who sell property on their own account and real estate brokers and managers who act as intermediaries in the real estate sale or rental.

Credit card transactions' statements -Decred, as per the Portuguese acronym, the credit card companies provide, through Decred, information on credit card transactions, including user identification, their services and the monthly overall transactions.

Financial transactions preliminary contribution statements, DCPMF, as per the Portuguese acronym, this system, made up by four different statements, enables the entry of financial resources' transactions in savings accounts belonging to individuals in the Country's Banks.

Statement of fees paid to consultants by International Agencies, Derc, as per the Portuguese acronym, this electronic form enables to capture the monthly payments, of any nature, for specialized technical services and consulting services hired.

Notwithstanding, for the international examination area, the available information is insufficient to determine or estimate tax evasion. The first reason for this is the legal restriction preventing the Tax Administration's access to the foreign exchange transactions' records, whose control and audit is undertaken by the Central Bank of Brazil, an independent body from the Brazilian Tax Administration. The other reason is the lack of identification of the entities considered non-residents in Brazil in the internal systems, which are subject to taxation, even if they conduct business in the country.

These two factors prevented the Brazilian Tax Administration from pursuing the creation of international transactions' risk analysis mechanisms.

CANADA

The CRA has relied on an ever-changing mix of indicators to determine the level of risk associated with specific sectors of the Canadian tax base. These indicators are generally unique to individual sectors, and change as the tax schemes become more sophisticated.

The CRA is placing increased emphasis on risk analysis and is currently in the process of restructuring their operations to accommodate an expansion of their risk assessment capabilities. A new Directorate that focuses on the identification of risk factors and the development of procedures and guidelines to deal with high-risk situations is currently being formed.

The new Directorate will expand on the existing risk-assessment program and develop industry specific indicators through projects and on-going consultations with field staff, and our international partners via a number of international tax forums.

CHILE

The criteria on which an audit is based are the following:

- Taxpayer's behavior (irregular).

- Cross-referencing information filed by taxpayers in tax statements.

– Reports.

For example, we have audited the following:

Investments: Investment process, foreign investment administrative formalities, greater value earned in the disposal of shares or entitlements, First Category Tax Credit linked to profit remittances abroad, Payment of Additional Tax on profit remittances, income earned from foreign investments (Articles 29 to 33 of the Income Tax Act, LIR, as per the Spanish acronym) through permanent establishments or agencies and foreign tax credits.

Indebtedness: Quality of the transactions reported on tax statements, interest rates and related expenditures, Stamp Tax Payment (Form N° 24), Payment of Additional Tax on remittance of interest from credit transactions (Form N°50).

MEXICO

Large Taxpayers' Segment and Sub-segment Risk Strategy.

1. Working Group for Large Taxpayers' Risk

The first step was to make up a multidisciplinary group with the representatives of the Large Taxpayers' sub-segments. The Large Taxpayers' sub-segments are formed by:

- Companies that consolidate from the tax standpoint.
- Stock Brokers.
- Brokerage Firms, Foreign Exchange Brokers.
    - Financial groups (overseen by the Audit Administrations for Stock Brokers and Lending Institutions).
- Lending institutions.
    - Banks.
    - Financial agencies.
    - Nonbank banks (SOFOLES, as per the Spanish acronym).
    - Pension fund managers (AFORES, as per the Spanish acronym) and Open-ended Investment Companies specialized in Retirement Funds (SIEFORES, as per the Spanish acronym).
- Nonbank Financial Brokers.
    - Insurers.
    - Guarantors.
    - Other nonbank financial institutions.

- Diverse Large Taxpayers (taxpayers with accrued income equal to or greater than 500 million pesos).

- Government Sector.

- International Tax Audit.

- Transfer Pricing.

The purpose of this was to take advantage of the experience as specialized auditors of the representatives of each Large Taxpayers' sub-segment; that is to say, to start with those who conduct audits (the micro approach), to then reach the overall macro approach.

2. Implementation of the SAT Platform Project Risk Management Model design

The Mexican Tax Administration (*Servicio de Administración Tributaria*, SAT, as per the Spanish acronym) is developing and implementing a project by the name of "PLATFORM", which consists of the interconnection of all the Tax Administration functions, eliminating the existing vacuums, to work on processes based on systems and databases' interaction. In order to fulfill the foregoing, five major strategies have been set forth:

1.- Better Taxpayer knowledge.

2.- Proceedings and Processes' simplification and automation.

3.- Implementation of Risk Management techniques.

4.- Human resources' development.

5.- Infrastructure development.

Within the Tax Intelligence component, called Risk Management, external consultants developed a risk management model made up by two main components:

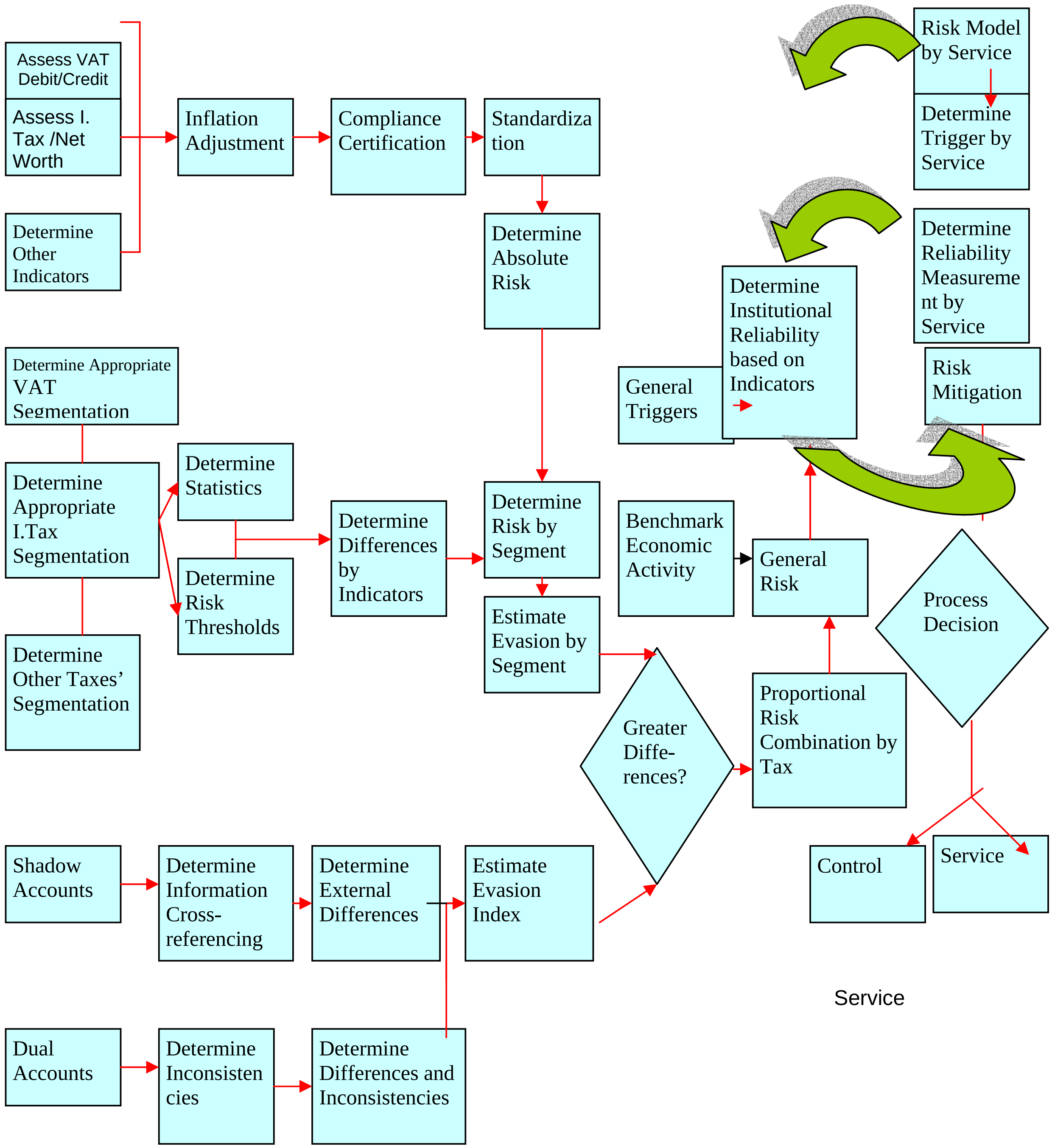
General Indicators:

Debit/Credit (VAT).
Income/Net worth (Income Tax).
Others.

Specific Indicators:

Determine appropriate VAT segmentation.
Determine appropriate Income Tax segmentation.
Determine segmentation for OTHER taxes.

The general structure of the Risk Management Administration Model of the Platform project is the following:



Based on the foregoing, the General Large Taxpayers' Administration defined the second step in its strategy. Based on this model, it developed a macro approach to rely on a reference framework, which in line with the micro experience of specific auditors, would result in the creation of a proprietary risk model to suit Large Taxpayers.

3. Actions to Develop the Specific Large Taxpayers' Risk Model

Each sub-segment, via its representatives, defined and set forth the risk indicators that were incorporated into the first draft of the Large Taxpayers' risk management model. In this first phase, 94 indicators were obtained, in addition to the 14 from the specific Source Verifications and Transfer Pricing Models.

Indicators were classified into general and specific based on the Risk Management Model structure of the Platform project.

A first screening process was undertaken, leading to 84 indicators and finally, in a second screening, 62 indicators that make up the current model.

4. Large Taxpayers' Risk Model Indicators

4.1 Macro Indicators:

The model starts with two "macro indicators" for all SAT taxpayers.

Debit/Credit (VAT). Large taxpayers' purchases are analyzed against sales.

Income/Net worth (Income Tax). Large taxpayers' taxable income is analyzed against the shareholder's equity.

4.2 General Indicators:

We have defined 27 general indicators for all the Large Taxpayers' sub-segments, six for VAT, nine for Income Tax and twelve for other taxes.

The six VAT indicators are:

- Four for refunds:
  - Requests for off-scale balances' refunds.
  - Taxpayers who do not pay VAT or Excises (IEPS, as per the Spanish acronym).
  - Irregular refunds' requests.
  - Undue favorable balances' refunds and compensation.
- Undue VAT credit.
- Off-scale VAT credit.

The nine Income Tax indicators are:

- Non-payment of Income Tax and Asset Tax (IMPAC, as per the Spanish acronym).
- Refunds' increase.
- Losses or inflationary profit.
- Dividend distribution.

- Increase in pension and retirement reserve funds.
- Drawdown of pension and retirements' reserve.
- Fixed assets' Sales.
- Unreported withholdings.
- Tax credits.

The twelve general indicators for other taxes are:

- 9 indicators selected from The Netherlands and Australia.
    - Business management quality.
    - A company's specific risk sectors.
    - VAT and Income Tax partial and additional payments.
    - Consistency of formal compliance in the last 5 years.
    - Official assessments in the last five years.
    - Significant corrections to the field and office visits.
    - Timely SAT information filing.
    - Fraud reported by Large Taxpayers and investigation services.
    - Aggressive tax planning history in the company.
- Off-scale IMPAC.
- Partial payments under 50%.
- Additional Statements.

4.3 Specific Indicators:

We have defined 33 indicators; eight for VAT, twenty one for Income Tax and four for other taxes.

The eight VAT indicators belong to the following sub-segments:

- One for Brokerage Firms.
- One for Financial Groups.
- One for Lending institutions.
- One for Investment Agencies.
- One for AFORES and SIEFORES.
- One for Insurers.
- One for Diverse Large Taxpayers.
- One for the Government Sector.

The twenty-one Income Tax indicators belong to the following sub-segments:

- Three for Stock Exchanges.

- Five for Brokerage Firms.
- One for Foreign Exchange Brokers.
- One for Financial Groups.
- One for Lending Institutions.
- Two for Nonbank banks (SOFOLES, as per the Spanish acronym).
- Three for Insurance Companies.
- One for Guarantors.
- One for other Nonbank financial institutions.
- Two for Diverse Large Taxpayers.
- One for the Government Sector.

The four indicators for other taxes belong to the Consolidation sub-segment.

4.3.1 Specific Risk indicators by sub-segment (33).

Companies with Tax Consolidation (Consolidation):

- Incorrect reduction of the consolidated Asset Tax.
- Winding up of Controlled companies.
- Compares taxable income and tax losses in controlled companies.
- Compares the net worth value of controlled companies against the consolidated Asset Tax Assessment.

Stock Brokers:

- General indicators for Stock Brokers:
    - Deduction of uncollectibles or losses.
    - Withholding under 20%, for wages and salaries, gratuities, bonuses, 13^{th} month and other benefits.
    - 0.5% withholding on the interest paid and 5% on the profit from the sale of shares transactions conducted outside the stock exchange.

- Brokerage Firms:
    - Favorable VAT balances in excess of a limit to be defined pursuant to statistical analysis.
    - Money market sales transactions' losses.
    - Tax losses from sales of shares, the deduction of which exceeds the profit amount from such transaction.
    - Tax losses as of 1999.
    - Financial derivatives' transactions losses (with foreign residents) that require verification as to the applicability of tax withholdings.
    - Book losses in the sales of shares that represent more than 50% of book profits for the same item.

- Foreign exchange brokers:
    - Tax losses as of 2000, since the net income reflects a recovery based on the stability of the Peso against the Dollar and the increase in foreign currency reserves.

- Financial groups:
  - Since their transactions are VAT exempted, the tax credit is deemed a risk factor.
  - Buy backs require verifying compliance with the tax legislation in effect.

Lending institutions:

- Banks:
  - When the Value Added Tax credit exceeds 50% and a 100% credit is fully unwarranted.
  - Global contingency reserves' deductions for the credit portfolio in the overall bank portfolio.

- Financial agencies:
  - Disposal of assets, for the direct or indirect temporary use or employment by individuals that chiefly conduct activities or business that exempt them from the tax obligation.

- Nonbank banks (SOFOLES):
  - Verify that they do not deduct the increase in the reserve created to face losses from delinquent debtors or bad debts.
  - Losses and portfolio amount ratio. A high ratio may indicate that the bad debt assumption is not being verified.

- Pension Funds' Managers (AFORES) and Open-ended Investment Companies specialized in Retirement Funds (SIEFORES):
  - Since the income earned by this type of taxpayers is tax-exempt, a taxpayer Value Added Tax credit amount is deemed a risk indicator.

Nonbank Financial Brokers:

- Insurers:
  - Salvage. Insurance companies that are not transferring VAT to the sale of salvage vehicles owned by individuals.
  - Deferred inflationary profit.
  - Deductible annual inflation adjustment.
  - Technical reserves.

- Guarantors:
  - Claims. Bad debts.

- Other Nonbank Financial institutions (insurance companies, guarantors, bonded warehouses, factoring entities and credit unions):
  - Deduction of bad debts or losses.

Diverse Large Taxpayers:

- Professional services' exports.
- Social security reserves, pension and retirement funds.
- Simplified regime, amendment to legislation in the 2002 fiscal year. Double fixed asset deductions.

Government Sector

- That the withheld VAT tax base is lower than the Income Tax base for individuals conducting business or professional activities. Professional services (fees).

- That the annual tax accounts for less than 15% of the overall compensation and services' amounts defined in Annex 5 "Comparative analysis of the Expenses sub-accounts."

4.4 Specific International Sector Indicators:

International Tax Audit:

- Interest payments made to related foreign parties.

- Related foreign parties' technical assistance and/or royalty payments.

- Source Verifications' Indicators.
    - Product identification.
        - Sensitive products.
        - Recurrent complaints from the different Chambers and/or Associations as to product triangulation.
        - Development of a system to enable the identification of additional sensitive products.
    - Analysis of 3 fiscal years.
        - Retrieval of the information required from the Integral Automated Customs' System (SAAI, as per the Spanish acronym).
    - Obtain statistics from the Information universe.
        - Obtain macro-statistics from the universe, which shall limit the sample content and the search for additional information.
    - Additional information.
        - Information from sources other than the SAAI.
    - Risk profiling.
        - Assign a risk value to each matrix, based on local and international experience.
        - The source risk equals 100% and is broken down according to product = 40%, taxpayer = 25% and transaction 35%. In turn, they are subdivided into:
            - Product: Value Added 25%; Compensatory payment 30%; Difficulty in compliance with Source Rule 25%; Country productive capacity 17% and Percentage Historical Background 3%.

        - Taxpayer: Domestic Taxes' Behavior 45%; Criminal Record 15%; Domicile 15%; Years in Business 15% and Type of Taxpayer 10%.
        - Transaction: Number of units imported 30%; Customs Broker 10%; Unit Value 20%; Country of Import 10% and Import Route 30%.
    - Results' Analysis.
        - The first 100 taxpayers shall be scheduled for a detailed review to determine the existence of a risk criterion neither weighted nor measured.
        - Upon determining taxpayers, they are scheduled for an audit.
        - Based on matrices' results, it is possible to determine whether the audit shall be conducted via a questionnaire or on-site visit, considering the cost-benefit ratio.

Transfer Pricing Audit:

- Results form previous audits.
    - The private sector CIT was calculated for the 1998-2003 fiscal years.
    - Large Taxpayers' CIT collection was re-estimated for 2003 based on the audits' opinions, and their distribution examined.
    - A database was created for 150 foreign multinational groups in Mexico and their revenue amounts were compared against the 20 larges national groups.
    - The transactions from said 150 groups were analyzed against related foreign companies and their individual tax status was examined based on risk indicators.

- Evolution of the foreign multinational groups, 1998-2003.
- Multinational groups according to their tax burden, 1998-2003.
- Tax burden and transactions with related foreign companies, 2002.
- Groups with lower tax burden and greater dependency upon foreign affiliates, 2002.
- Tax burden according to the sector's average, 2002.
- Groups with lower tax burden against the sector's average, 1998-2002.
- Tax burden evolution: three-year period 1998-2000 vs. 2001-2003.
- Companies featuring transactions with affiliates in tax havens, The Netherlands and Switzerland, featuring a low tax burden, 2002.
- Global risk rating for the main multinational groups in Mexico.

5. Large Taxpayers' Risk Indicator Development

5.1 Definition of algorithms in the indicators' formulae:

The formulae were defined for each one of the 62 indicators of the Large Taxpayers' Risk Model, reaching an algorithm or mathematical ratio.

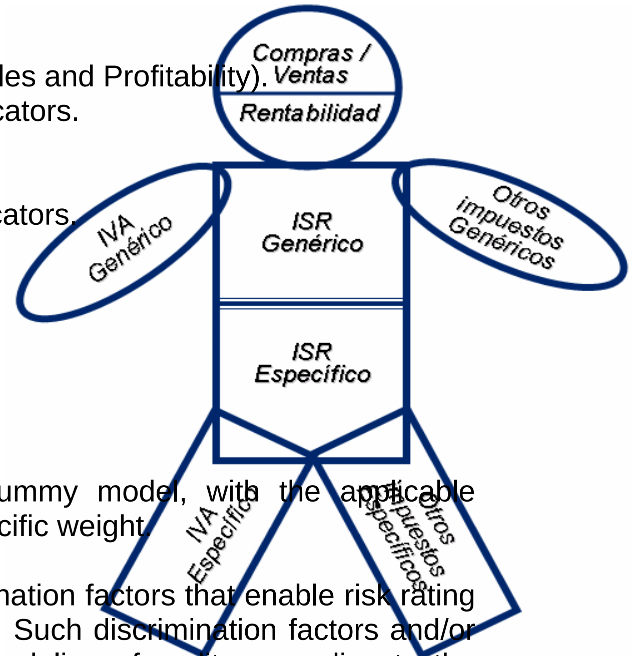
5.2 Determining the information required for the indicators' statistical analysis:

The fields for the tax statements or tax reports were defined as required to implement the indicator by IT systems.

6. Risk Indicator Weighting Strategy in the Large Taxpayers' Sub-segments

The dummy model was defined to determine and weight the relevance of general and specific indicators in each sub-segment and assign a specific weight thereto. The dummy is made up by the following components:

- Head = Macro Indicators (Purchases/Sales and Profitability).
- Upper chest = General Income Tax Indicators.
- Right arm = General VAT Indicators.
- Left arm = OTHER General Taxes.
- Lower chest = Specific Income Tax Indicators.
- Right leg = Specific VAT Indicators.
- Left leg = OTHER Specific Taxes.



Each head of sub-segment shall draft a dummy model, with the applicable indicators, determining their relevance and specific weight.

The foregoing is aimed at determining discrimination factors that enable risk rating for the large taxpayer in all the sub-segments. Such discrimination factors and/or risk ratings shall serve the selection and scheduling of audits according to the installed capacity (available resources).

V. 3. <u>Audit Execution</u>

V.3.1. <u>Evidence</u>

Throughout the whole process in which the parties intend to defend contrary interests, the evidence gathered as well as the validity and weight thereof constitutes a vital element.

In this regard, the issue entails another element, also of great relevance, which is the fact that in the case of international transactions, the evidence to be assessed or provided and the issues to be documented are frequently of a foreign origin.

In this sense it is very relevant to share the experience obtained regarding the conflicts and the solutions adopted as to the evidence provided in international audits' proceedings.

<u>ARGENTINA</u>

Argentine legislation provides for international fiscal policy such as the worldwide income principle, transfer pricing and international tax transparency, which are relatively new therein.

Therefore, we still lack experience as to the arguments aimed at disqualifying certain evidence. In this regard, it is worth highlighting that the audited cases in which taxpayers have challenged adjustments are still being argued in the administrative jurisdiction. No legal proceedings have been initiated yet in such respect.

Notwithstanding, evidence is not the source of the issue in the disputed cases.

In general terms, we shall highlight that pursuant to Argentine legislation, evidence is the proof, according to the means defined by law, of an event or series of events on which the acknowledgement of a right shall depend.

The Procedural Tax Law mandates the taxpayer to submit all the evidence relevant to his right in the administrative jurisdiction, except for new events or as required to consider the outcome of the proceeding to obtain additional evidence set forth in such jurisdiction.

Any individual reporting an event is required to prove it; that is to say he/she bears the burden of the proof. Such situation is of vital importance vis-à-vis international tax policy in the Argentine Tax framework.

The elements of evidence accepted by Argentine tax legislation in tax proceedings are the following:

1. Documentary evidence.

2. Witnesses.

3. Expert witnesses.

4. Reports.

On the other hand, it is worth underlining that, pursuant to current legislation, in order to admit foreign documentation as evidence, it shall be presented in the Spanish language or have been duly translated by a Sworn Translator, and duly legalized with the Argentine Consulate and, if applicable, the Hague Apostille.

BRAZIL

Brazilian legislation admits any element of evidence, provided it has been legally obtained. The rules to produce and use evidence in the tax enforcement process stem from the Civil Code. Pursuant to this legislation, foreign documents, in order to serve as evidence in Brazilian jurisdiction, shall be translated by a Sworn and sometimes, Certified, Translator. The certification requirement may be waived when such documents have been authenticated by the Consulate of the country of origin.

Brazilian international experience recalls no issues as to obtaining and using documents as evidence on a regular basis, except in the cases in which the documents are submitted by the taxpayer, including foreign documents. Notwithstanding, when documents are not voluntarily submitted by the taxpayer, with the exception of countries with which Brazil has entered into an information exchange agreement, the Tax Administration has failed to produce the evidence required from jurisdictions with strict bank and tax secrecy laws.

The alternative found by the Tax Administration that is accepted by Law is to gather matching evidence and circumstantial evidence in the process that shall then be sustained by the Tax Administration. This is what we call presumptive evidence, when in the absence of conclusive evidence on a certain fact, we seek to accumulate different elements that individually are deemed insufficient evidence, but as a whole, converge to attest that a given fact occurred.

In the administrative as well the court jurisdiction, judges have accepted such a legal entity provided in Brazilian legislation. Nevertheless, in many previous cases, the Administration was unable to produce not only conclusive evidence but also the presumptive evidence for the fact it was trying to prove.

CHILE

In order to gather evidence in an audit proceeding involving foreign parties, there are certain tools to consider:

- Information Exchange

Currently, the Internal Revenue Service has strongly fostered the information exchange efforts with other Tax Administrations. The guideline specifically stresses the development and strengthening of effective automated information exchange efforts.

We may define at least three channels for the purpose of strengthening and implementing information exchange programs with foreign Tax Administrations:

a) The first one arises from the power vested upon the Internal Revenue Service Director by the Tax Code, which is based on the reciprocity principle.

b) The second is based on the Information Exchange Article set forth in the Double Taxation Agreements.

c) The third one is based on Information Exchange Agreements. Significant efforts are being made to strengthen this kind of agreements with a view to a more agile and systematized automated exchange process with the Tax

Administrations from the States that have entered into Double Taxation Agreements with Chile.

- Tax Status and Residence Certificates

In the current year, our country has undertaken, among the technological projects, a procedure to facilitate taxpayers' voluntary compliance. Such procedure entails the request and extension of residence and tax status certificates in Chile to be submitted to foreign tax authorities.

There are 2 different general certificates, those that certify that a taxpayer is a resident in the country of issue and those that certify the income earned and taxes paid by the taxpayer in the country of issue.

Based on the assumption that in general terms, all the Tax Administrations rely on such certificates, from the audit processes' standpoint in Chile, we have phased-in the obligation to keep and submit the documentation that certifies the resident-status in other Countries as required, as well as the foreign income earned by Chilean taxpayers.

One of the advantages of the Chilean certification system is that it is an online request and issue formality and according to certain application conditions, the certificates may be issued and become effective immediately. Another aspect worth highlighting is that each certificate carries a verification code that enables the Tax Administration receiving the documents to verify and confirm the authenticity of the certificate issued on the Internal Revenue Service Web site (www.sii.cl).

- Income Tax Statements

In order to maximize and facilitate taxpayers' voluntary compliance, the Internal Revenue Service has implemented e-Administration initiatives for the purpose of filing tax statements and gathering information based on taxpayers' statements. This type of information enables the agency to undertake the timely analysis as to the correct filing of income and facilitates the development of taxpayer's audits. Likewise, it is possible to check the content and truthfulness of income tax statements, with a number and certain background information from the statements, to enable any foreign Tax Administration to validate them.

- Information Rendered by Taxpayers or Foreign Sources

In the verification of the statements of expenses incurred filed by national taxpayers in foreign countries, the former shall be supported with the foreign documents according to the applicable legislation of the respective country, which shall feature, minimally, the service provider's or seller's name and domicile, as applicable, the transaction's nature or purpose and the date and amount thereof and the applicable certification as required by the Procedural Civil Code. Additionally, the taxpayer shall submit the documents translated into Spanish if required by the Internal Revenue Service.

MEXICO

As to evidence gathering, two spheres shall be differentiated in the international arena, firstly, the one involving the applicability of the tax according to national legislation and, secondly, the evidence as to the enforcement of an International Agreement.

In the first case, the purpose of the tax shall be perfectly grounded. Therefore, our audit powers enable us to request, among other documents, contracts, bank account statements, requests for electronic bank transfers, invoices and business records from the location where services are rendered.

Eventually, the information directly obtained from the taxpayer shall require confirmation. Therefore, a comparison is made with third parties in order to determine the applicability of the payments. Among the third parties, we may mention other national taxpayers, government agencies in the country and foreign government agencies via information exchange efforts.

On certain occasions and given the material impossibility for the authority to obtain the information through its own means, legislation has set forth certain presumptions, aimed at placing the burden of the proof on the taxpayer. Such presumptions are explained in item 3.2.

As regards the enforcement of Agreements, since they are exceptional guidelines, the evidence shall be provided by the taxpayer. In certain cases and with the purpose of confirming certain information, information exchange actions shall apply.

V. 3.2. Use of Presumptions

In general terms, tax legislation enables the entity of presumptions as a facilitation tool for Tax Administrations to determine the tax obligation, chiefly in the cases in which taxpayers prove reluctant in providing the necessary elements for the furtherance of such task, to allow the accurate assessment of the magnitude of said obligation.

In effect, to the extent such entity is accepted, all the applicable laws shall set forth the presumptions and their applicability. Therefore, such implementation does not entail Tax Administrations’ voluntary or discretional use thereof, since they are deemed a tool to trace back the taxable income or replace the income statement filed by the taxpayer.

In such context, presumptions shall arise from an actual fact, and be supported on a rational basis, since they are sensitive instruments or, as previously stated, tools to quantify the tax obligation.

Such presumptions may be conclusive- not admitting evidence to the contrary-or relative- admitting taxpayers’ evidence to the contrary.

This entity may prove useful to discourage certain acts that given their nature, are deemed by legislators to spur harmful tax planning practices.

ARGENTINA

Argentine legislation sets forth a number of legal presumptions, some of which admit evidence to the contrary and some that do not.

Notwithstanding, vis-à-vis international tax policy and, more specifically, as a tool to discourage harmful tax planning, there is a single presumption included in the Procedural Tax Law that sets forth that in the case of income originated in zero or low taxation countries, regardless of the nature, object or type of transaction, such income is deemed an unjustified increase in wealth for the local beneficiary.

The cases of unjustified increase in wealth mentioned in the foregoing paragraph featuring more than 10% disposable income or consumed income in nondeductible expenses, account for net income for the year in which they were generated, for the purpose of determining income tax, and if applicable, the tax base for levied transactions omitted in the respective business year in the value added taxes and excises.

Notwithstanding the foregoing notions, the Federal Revenue Administration shall justify the flow of income that the taxpayer expressly proves to have generated in activities undertaken by him/her or by third parties in the respective countries or that stem from duly filed investments.

This standard is of great relevance since, should the taxpayer fail to meet the requirement set forth, the income from zero or low taxation jurisdictions shall not only be levied with income tax, but also excises, which imply the assumption that they arise from sales that were not subject to taxes.

BRAZIL

Brazilian tax legislation on international transactions does not broadly adopt the legal entity of the legal presumption. In the specific case of worldwide income taxation, the only legal presumption in place is the one governing the cash advances made by the foreign controlled or related company for forward sales, whose payment for the remittance of the good or service sold occurs within a term exceeding the good's or service's production cycle.

Notwithstanding, Brazilian legislation sets forth a type of presumption vis-à-vis transfer pricing upon predefining profit margins applied in the methods to assess the adjustment of the taxable income. Except for the methods by the name of Independent Compared Prices (PIC, as per the Portuguese acronym) and Exports Sales Prices (PVEX, as per the Portuguese acronym), the rest, including those defining transfer pricing practices on the interest paid or earned, employ predefined margins, that is to say, profit margins presumed by law.

This is a relative presumption, since the taxpayer may offer evidence to the contrary. In the assumption that their activity is conducted according to a margin different from the one provided by law, it empowers the taxpayer to file and administrative request for the reduction of said margin, to the extent sufficient technical information is filed to support the lower profit margin.

A legislative amendment is being currently considered, with the main purpose of reversing the burden of the proof in the cases of transactions conducted in countries with strict bank and tax secrecy laws.

CHILE

Chilean legislation provides for certain presumptions relating to the international sphere. Among them, for the purpose of enforcing transfer pricing regulations, we may mention the presumption of a relation among companies that enter into exclusivity agreements, joint ventures, preemptive treatment, financial or economic subordination or trusts. Also, companies are presumed related when the transactions are performed with companies chartered in a country or territory included in the Chilean list of tax havens or preferential tax regimes.

For the purpose of Thin Capitalization regulations, the relation presumption and the thin capitalization rules apply on those transactions conducted with creditors headquartered in a country or territory included in the Chilean list of tax havens or preferential tax regimes.

MEXICO

Evidence is only employed when legislation enables to do so and its purpose is basically to reverse the burden of the proof on taxpayers.

As regards investments in preferential tax regime jurisdictions, there are a number of presumptions arising from the fact said countries lack information exchange agreements and the Tax Administration would be unable to obtain such information, if not rendered by the taxpayer. Therefore, such assumptions are fully warranted.

Additionally, we may state the presumption relative to the source of wealth from personal freelance services. It sets forth that the personal freelance service was fully rendered in Mexico if evidence is provided that a part of it was rendered in such country.

V. 3.3. Current Auditing Practices

This item includes a description of the audit cases conducted by the participating Tax Administrations in order to explain the methodologies employed in the process and the outcomes thereof.

ARGENTINA

The Argentine Tax Administration experience vis-à-vis international transactions' control is largely linked to transfer pricing issues.

Investigations started with the analysis of the transactions undertaken with entities domiciled in zero or low taxation jurisdictions (tax havens).

The case screening process started with the analyses by sectors and the cross-referencing of IT data, especially regarding customs, which enabled the detection of the triangulation of commodities' exports via tax havens.

All the audits were successful to the extent they all determined a tax interest of a significant magnitude.

Additionally, based on these audits, laws were amended with a view to discouraging this modality of exports' agreements. Mainly, we achieved a change in the behavior of the sectors involved, which improved their tax assessment and compliance levels.

The transfer pricing audit was also conducted on companies from the automotive industry, laboratories, tobacco companies, and fisheries. In all cases (100%) a favorable tax base for the Argentine Tax Administration was determined.

BRAZIL

The main sources of audits have been the transfer pricing controls and verification of variations in companies' foreign equity interests. In the case of transfer pricing, the comparison of the data obtained from taxpayers against those gathered by auditors have proven the transfer of resources based on the prices agreed. That is to say that almost 80% (eighty percent) of the audits performed by the Administration end with a positive outcome.

CANADA

All Canadian taxpayers with foreign affiliates, beneficial interests in certain non-resident trusts and/or beneficial interests in non-resident discretionary trusts are asked to respond to questions like those noted below with their income tax returns:

Individual Taxpayers

(i) Did you own any controlled foreign corporation at any time during the year?

(ii) Did you, or any controlled foreign corporation of yours, or any corporation or trust with which you are related, have a beneficial interest, at any time during the year, in a non-resident discretionary trust?

Corporate Taxpayers

(i) Did the corporation own any foreign corporations at any time during the year?

(ii) Did the corporation, or any controlled foreign corporation, or any other corporation or trust to which the corporation was related, have a beneficial interest, at any time during the year, in a non-resident discretionary trust?

Trusts

(i) Did the trust own any controlled foreign corporation at any time during the year?

(ii) Did the trust, or any controlled foreign corporation, or any corporation or any other trust to which the trust was related, have a beneficial interest, at any time during the year, in a non-resident discretionary trust?

If a positive reply is given to any of these questions, an additional schedule is required to be filed. For example, if a corporation replies that it did own a foreign corporation during the year, the corporation must provide the full name and address of each of those foreign corporations. If the question deals with a non-resident trust, the full name and address of each trust and of the trustees of that trust will be required.

Also, the Canadian taxpayer must include the financial statements of a controlled foreign corporation with their own income tax return in each year.

Hereunder is a transcription of a Canadian Tax Administration decision.

Saipem Luxembourg S.A. v. Canada (Customs and revenue Agency)

Date : 20040126
Docket : T-306-02

BETWEEN :
SAIPEM LUXEMBOURG S.A. Applicant
AND THE CANADA CUSTOMS AND REVENUE AGENCY Respondent
REASONS FOR ORDER ROULEAU, J.

[1] We hereby request reconsideration of the foreign information and documentation requirement submitted by the CRA to Saipem Luxembourg SA. The Requirement, dated December 6th, 2001, compels the appellant to produce, in compliance with Section 231.6 (4) of the Income Tax Act, RSC 1985, c. 1 (5th Annex), as amended, (the “Act”), as follows:

“… Information, and all the invoices, mail, agreements, contracts as amended, financial statements, accounting books and records, reports, memoranda, address books, working papers, minutes of meetings, telex and fax messages and other documents referring to Saipem Luxembourg SA from fiscal years 31/07/2000 and 31/07/1999."

[2] The appellant challenges the Requirement on the grounds of inadmissibility, deeming them unreasonable, according to the following fundamentals:

A) The wording in the Requirement is irrelevant for the purpose of the enforcement of the "Act". The Appellant is not a Canadian resident and lacked a permanent establishment in Canada in the period involved.

B) Consequently, the wording of the Requirement renders it unreasonable and constitutes a fishing trip, exceeding in full the procedures set forth in the Tax Agreement between Canada and the Grand Duchy of Luxembourg.

[3] The appellant chartered in Luxembourg in 1998 and for tax purposes, is a resident of Luxembourg. Its core business is construction of subsea flowlines.

[4] The appellant owns and operates a number of vessels, including the S7000, the only and probably the most powerful drillship in the world designed for deep-water and ultra-deep water works.

[5] On August 4th, 1998, the appellant entered into a services Agreement with Saipem Limited United Kingdom ("SUK"), a related company, with the purpose of completing a part of Phase 2 of an agreement the latter had entered into with Mobil Oil Properties of Canada to undertake the engineering of the Sable Project. The amount of the agreement was 10.5 million Pounds Sterling.

[6] The Sable Offshore Energy Project is based in Nova Scotia, Canada, as well as the offshore region of Nova Scotia. This includes offshore facilities as well as the onshore facilities required to produce and process hydrocarbons to be eventually placed in the market.

[7] The work involved in Phase 2 was undertaken in Canada in September and October 1998. It took 53 days. Thereafter, the vessel left Canadian waters to complete other work contracted for third-parties in other places in the world. At that point in time, the appellant argues that its contractual relation with SUK, vis-à-vis activities in Canada, had terminated.

[8] Likewise, it argues that in the Fall of 1998, SUK and the project owners consult the appellant as to the availability of the S7000 to be employed in Phase 3 of the project, which they planned would be finished in August 1999.

[9] Therefore, SUK and the appellant entered into a new agreement dated December 14th, 1998 to complete Phase 3 work.

[10] Phase 3 work was conducted between August 15th, 1999 and September 16th, 1999. During that time, the S7000 remained in Canadian waters. Thereafter, the vessel left Canadian waters and no other activities were undertaken in Canada.

[11] On August 17^{th}, 1998, the appellant petitions for an exemption from regulations 102 and 105 of the Income Tax Regulations. With letters dated September 17^{th}, 1998, the CCRA grants the exemptions from both regulations (tax withholding exemption).

[12] The appellant argues that the Tax Agreement between Canada and the Grand Duchy of Luxembourg foresees the exchange of information between the authorities of jurisdiction of each State, to the extent they are required to enforce the Agreements' provisions, and underlines that at no time did the Canadian CCRA official communicate with the Luxembourg tax authorities regarding any matter relative to the appellant's activities.

[13] The matter under consideration is whether the appellant is mandated to reveal the income earned in Canada or not, if we considered it has a "permanent establishment" pursuant to Article V of the Tax Agreement between Canada and the Great Duchy of Luxembourg. The term "permanent establishment" pursuant to section 2 (g) specifically encompasses the following:

"A work or construction work or an installation project when it exceeds twelve months."

[14] The allegation is that both agreements entered into by the appellant involving the S7000 drillship were separate and different instruments, one having been undertaken in September and October 1998 and the other, in August and September 1999.

[15] Additionally, the appellant requests the CCRA to determine, based on the facts and the regulations set forth in Section 173 of the Income Tax Act, whether the appellant had a permanent establishment in Canada; that it is mandatory for the CCRA to do so prior to subjecting a non-Canadian taxpayer to a large scale audit of its worldwide business.

[16] Sub-section 173 (1) of the Income Tax Act, sets forth as follows:

"173 (1) When the Minister and a taxpayer formally agree that a matter of law, of fact, or law and fact combined that arises from the enforcement of this Act, vis-à-vis any adjustment, adjustment proposal, assessment, or adjustment assessment, shall be determined by the Canadian Tax Court, such matter shall be determined by such Court."

[17] Finally, the appellant argues that the Requirement is too broad in its scope, considering the comprehensive activities it conducts on a worldwide basis.

[18] The respondent challenges the appellant's allegations as to the term of its activity in Canada and argues that it lacks the means to verify the information without conducting an audit of the appellant's books and records.

[19] The respondent also argues that the CCRA officials failed to communicate with the Luxembourg tax authorities since such requirement is inapplicable

pursuant to the Treaty, and there is no obligation mandating the CCRA to enforce additional information-gathering techniques prior to issuing the Requirement.

[20] The CCRA also states that the applicability of Sub-section 173 (1), which requires a written agreement on the facts, may not be established without an appropriate audit. The CCRA is not allowed to audit any of the facts argued by the appellant without accessing their books and records.

[21] Section 231.6 of the Act was set forth in 1988 to provide regulations to enable the Minister to gather information or documentation of a foreign source when required to allow the appropriate examination for Canadian tax enforcement purposes.

[22] In the case Merko v. Canada (Minister of National Revenue -M.N.R.) [1991] 1 F.C. 239, Cullen J. of this Court sustained that:

"The letter of the foregoing law is clear in that Parliament intended to vest upon the Canadian Tax Administration strong, broad and extensive powers to ensure “foreign information or documentation”, and continues to state “any information or documentation available or located outside Canada.” To ensure this information or documentation, the Canadian Tax Administration is only required to prove the latter “relevant for the Administration or for the enforcement of this Act.”

[23] Therefore, the point under discussion is not whether the requested information shall be relevant in determining the appellant’s Canadian tax obligation, but whether the information is relevant for the enforcement of the Act.

[24] In this case, the respondent seeks information in order to undertake a general audit of the appellant’s affairs regarding fiscal years 1999 and 2000 with the purpose of proving its Canadian tax obligation. It is obvious that one of the objectives of an audit is to verify information. The fact that certain information is provided by the taxpayer or that it is available from another source is irrelevant.

[25] The CCRA is mandated to verify the appellant’s tax obligation, which compels the appellant to produce its books and records. If after the examination they bear no impact on the Canadian tax obligation and should any information gathered in the audit prove irrelevant, it shall be deemed as such, but prior to such assertion, the books and records shall be made available.

[26] To conclude, I shall refer to the summary of Merko v. Canada (Minister of National Revenue -M.N.R.), as mentioned above:

"Parliament intended to grant broad powers to the Minister under section 231.6 to obtain available foreign information. The Minister shall only prove that such information is relevant for the enforcement or execution of the Act. The taxpayer is protected from the abuse of this norm by the power of a judge to review the requirement. The respondent’s requirement was not an abuse of process and neither has it been deemed an unreasonable request.”

[27] As handed down by the Supreme Court of Canada in McKinlay Transport Ltd. v. Canada, [1990] 2 C.T.C. 103, the requirement to produce information, although broad in its terms, is not deemed abuse of process.

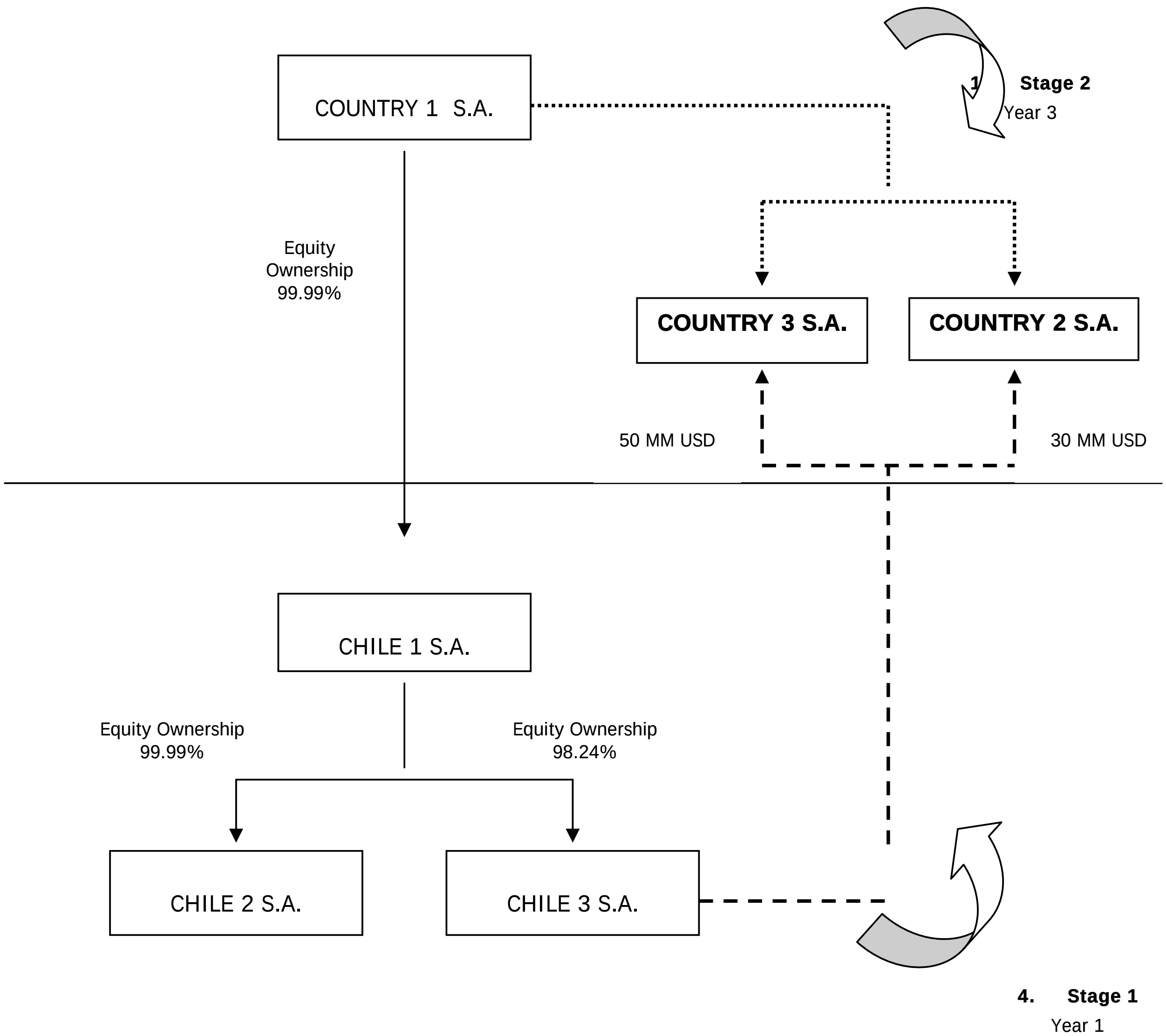
[28] Hereby, the appeal should be dismissed.

Judge
Ottawa, Notary
January 26th, 2004

CHILE

CASE STUDY: Tax losses arising from the sales of shares among related companies.

A. Organizational Structure



B. Transactions conducted by the taxpayer to be audited

1.1 Year 1.

CHILE 3 S.A. performs the following sales transactions with related companies in Chile:

1. It acquires shares in Argentine company COUNTRY 3 S.A. for a 50 MM USD amount.

2. It acquires shares in Brazilian company COUNTRY 2 S.A. for a 30 MM USD amount.

1.2 Year 2.

CHILE 3 S.A. does not make investments in the course of this year.

1.3 Year 3.

CHILE 3 S.A., sells the shares from COUNTRY 2 S.A. and COUNTRY 3 S.A. to COUNTRY 1 S.A., producing a financial loss of 6 MM USD and 50 MM USD respectively. It is worth pointing out that COUNTRY 1 S.A. and CHILE 3 S.A. are related companies via CHILE 1 S.A.

C. Observations on the Shares' Cost of Purchase.

Regarding the purchase of shares of COUNTRY 3 S.A. and COUNTRY 2 S.A., which in principle are deemed to have been purchased at a higher price that the market or book values, the following clarification requirement was notified to the taxpayer:

a) To provide the elements that were taken into account to determine the price of shares bought from COUNTRY 2 S.A. and COUNTRY 3 S.A. The taxpayer was compelled to produce the written documentation that would enable the accurate assessment of the market price for the shares of companies COUNTRY 2 S.A. and COUNTRY 3 S.A., at the time of their purchase.

b) On the other hand, a requirement was issued to clarify, justify and document the business reasons underlying the sale of shares of COUNTRY 2 S.A. and COUNTRY 3 S.A. to their parent company COUNTRY 1 S.A., considering that both transactions produced significant tax losses. Likewise, a requirement was issued to produce the written documentation to enable the accurate assessment of the market price or the fair price of the shares of companies COUNTRY 2 S.A. and COUNTRY 3 S.A., at the time of their disposal.

c) Upon analyzing the background information provided by the taxpayer, and since the case under discussion dealt with publicly traded corporations, we succeeded in determining the shares' prices at the time of purchase and disposal in countries 2 and 3 respectively, determining a strong overvaluation in the purchase transaction prices. The legal grounds provided by the Administration referred to the prices agreed among related companies; the applicable adjustments were made and the company accepted the challenge, paying the taxes, the adjustment, interest and fines applicable.

V. 3.4. Cooperation among Administrations to Perform Simultaneous Audits and Foreign Audits.

Since already it was developed in opportunity to treat the international exchange information one alternatives to take it to the practice it is across simultaneous or joint inspections in the foreign.

The information exchange agreements have the purpose of mutual asistence on the bases of reciprocity, in order to ensure the right tax determination, to prevent and fight, within their respective jurisdiction, fraud, evation and tax elusion, and besides established better sources of information in taxation matters.

It is important to quote the Simultaneous Taxation Agreement entered into between scandinavian countries.

In this point the commentaries of the countries are included in relation to the experiences that could exist in his respective tax administrations.

ARGENTINA

The Argentine Tax Administration has no experience in simultaneous audits.

BRAZIL

Brazil has not participated in joint audits with other Administrations and neither has the Brazilian Tax Administration conducted foreign audits with the approval of local Administrations nor were such audits conducted in the country by foreign Administrations with the approval of the Brazilian Tax Administration.

CANADA

The CRA has actively pursued opportunities for bilateral or multilateral joint or simultaneous audits, most specifically with the United States, Japan, Australia, the United Kingdom, France, and Germany, through our involvement in the 7 Country Tax Have initative. However, we have met with little success for a number of reasons, most pominently is the fact that different jurisdictions are often auditing differnt years.

The Information Exchange Program consists of a number of programs created to facilitate information exchange among the CRA and foreign Tax Administrations.

Hereunder is a list of the types of programs implemented in Canada.

Vis-à-vis the issue under discussion, it points out:

- Simultaneous audits and simultaneous criminal investigations: This program enables to share relevant information on related taxpayers between both tax jurisdictions.

- Data collection assistance: The CRA has entered into agreements with certain countries to provide data collection assistance.

- Trips: Tax Administrations are required to obtain foreign jurisdiction's permission prior to acting in a foreign jurisdiction. In general terms, the taxpayer must approve such visit, but the respective jurisdiction may offer the services of its own auditors or investigators.

CHILE

Although, up to now, experiences of simultaneous examinations with other Tax Administrations have not been had, in the agreements on exchange of information that have been signed and that are being negotiated, an article is included that defines the procedure to follow in case of developing simultaneous examinations.

MEXICO

Exchange of information is effectively used as pointed out in this working paper.