

Latin American Tax Newsalert

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Argentina terminates tax treaties with Chile and Spain

The Argentine government has terminated its tax treaties with Chile and Spain. These treaty terminations are significant and may impact existing cross-border structures and/or ongoing planning by multinationals with operations or investments in Argentina involving Chile or Spain.

The unilateral decision to terminate the treaties with Chile and Spain was recommended by an *ad-hoc* commission created in 2011 by the Argentine tax authorities to review Argentina's double tax treaties for potential tax abuse.

The Argentine government formally notified the Chilean and Spanish authorities of the treaty terminations on June 29, 2012. Both notifications have been published in Argentina's official gazette.

The termination of the Chilean and Spanish treaties brings to three the number of income tax treaties terminated by the Argentine government so far this year. As reported previously, in January the Argentines terminated their income tax treaty with Switzerland. This newsalert summarizes some of the key issues following the Chilean and Spanish treaty terminations.

Argentina-Chile treaty

The treaty with Chile was signed in 1976 and entered into force in 1985. Its provisions did not follow the OECD Model Tax Treaty, but rather granted taxation



rights on a source basis, with a full exemption mechanism in the other (non-source) Contracting State.

Some consequences of the termination

The treaty's revocation may significantly impact multinationals that relied on certain favorable provisions for structuring their business in Latin America, particularly with respect to the taxation of dividends and capital gains (which were only subject to tax in the source country). Additionally, payments for technical assistance and/or advisory services rendered outside of Argentina would remain subject to domestic withholding rates up to 31.5 percent.

As an example, dividends received by a Chilean holding company from Argentine subsidiaries will now be subject to full income taxation in Chile (i.e., currently a total 35 percent for earnings repatriated out of Chile) with a limited availability of a foreign tax credit in Chile for those income taxes paid in Argentina. Therefore, for some international structures, Chilean foreign tax credit limitations will likely result in higher income taxes paid in Chile. Taxpayers with Argentine operations held under Chile should carefully analyze and model the potential impact.

On the positive side, the Chilean rule disallowing the deductibility of expenses incurred in Chile to generate exempt income may no longer apply now that Argentine-source income will be fully taxable in Chile.

Note that a 2003 protocol to the Argentina-Chile tax treaty provided a full exemption from the Argentine Wealth Tax, which is an indirect tax imposed on Argentine company shareholders and annually assessed at 0.5 percent of the Argentine company's net book value. As a result of the treaty termination, Wealth Tax relief is no longer available in Chile.

Based on Article 26, the treaty may be terminated from January 1 to June 30 of any calendar year by written notice. By following this procedure the treaty is generally no longer effective for companies with respect to earnings, income, profits, or capital relating to the tax or accounting periods commencing after the date on which such notification was given. Note that Chile and Argentina may have differing interpretations of the effective date of the treaty termination; taxpayers should be mindful of these interpretations.

Argentina-Spain treaty

The treaty with Spain generally followed the OECD model, with some modifications, and, for example, partially limited taxation rights at the source on royalty, dividend and interest payments, as well as capital gains.

Some consequences of the termination

As a result of the treaty's termination, Argentine income tax withholding on royalty and technical assistance payments to Spanish residents may now be subject to rates as high as 31.5 percent. Furthermore, withholding tax on cross-border interest payments may be as high as 35 percent (versus the treaty's significantly lower rates).

Additionally, the treaty's nondiscrimination provisions allowed taxpayers to mitigate certain restrictions established by Argentine income tax law that limit deductions for trademark and patent royalty charges when paid abroad. This feature was significant. Similar to the tax treaty with Chile, the Argentina-Spain treaty provided

full relief from the Argentine Wealth Tax. As a result of this termination, Wealth Tax relief is no longer available.

In accordance with the treaty's termination clause, the treaty should generally be considered terminated effective January 1, 2013 and taxpayers may want to plan accordingly.

For more information, please contact:

Your LATAX team in the United States:

<i>John Salerno</i>	<i>+1 (646) 471-2394</i>	<i>john.salerno@us.pwc.com</i>
<i>Jose Leiman</i>	<i>+1 (305) 381-7616</i>	<i>jose.leiman@us.pwc.com</i>
<i>Eduardo Pupo</i>	<i>+1 (646) 471-7007</i>	<i>eduardo.pupo@us.pwc.com</i>
<i>Julian Vasquez</i>	<i>+1 (646) 471-5883</i>	<i>julian.r.vasquez@us.pwc.com</i>
<i>Ignacio Rodriguez</i>	<i>+1 (646) 471-6450</i>	<i>ignacio.e.x.rodriguez@us.pwc.com</i>
<i>Daniel Landaluce</i>	<i>+1(646) 471-7762</i>	<i>daniel.landaluce@us.pwc.com</i>

Your tax team in Argentina:

<i>Andres Edelstein</i>	<i>+54-11-4850-4651</i>	<i>andres.m.edelstein@ar.pwc.com</i>
<i>Juan M. Magadan</i>	<i>+54-11-4850-6847</i>	<i>juan.manuel.magadan@ar.pwc.com</i>

Your tax team in Chile:

<i>German Campos</i>	<i>+1(56)(2) 940-0098</i>	<i>german.campos@cl.pwc.com</i>
<i>Loreto Pelegri</i>	<i>+(56)(2) 940-0155</i>	<i>loreto.pelegri@cl.pwc.com</i>

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