Double Taxation Agreements in Latin America.

Analysis of the Links among Taxes, Trade and Responsible Finance
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INTRODUCTION TO THE PROBLEM

In the past decades, Latin American countries have lived through huge economic fluctuations and critical moments that have recurrently brought about dramatic social costs. The most remarkable feature has been the increase in unemployment, inequality and poverty levels, to the point of being known as the region with the most regressive distribution of income, even when it is not the poorest in the world.

Overall, societies recognize the progressive or regressive role of government spending in relation to their investment priorities, and focus their debate on the Government’s ability for economic intervention. In any case, differences are usually not that clear when the debate hinges on fiscal policy.

Broadly speaking, there is a clear ideological and political divide among countries and economic policies with reference to the fiscal issue. On the one hand, some countries support the concept of a “Minimum State,” where the tax burden should not inhibit persons who, having resources/
capital, are motivated to invest. On the other hand, some support the idea of an “Active State,” with a public sector that plays a promoting, ordering and redistributing role, and where the tax burden is placed on those with the highest ability to pay taxes.

It is remarkable that with governments of different political ideologies in most Latin American countries—including the ones considered in this study—tax structures in recent decades have increasingly been based on indirect taxes (value added tax, sales tax, turnover tax), which are more easily collected but more regressive, given their higher relative weight for the medium- and low-income sectors. In a similar trend all over the world, there has been a reduction in the tax burden and its relative weight in the collection of direct taxes (income tax or property tax), which are known to have a positive effect on the redistribution of income under the principle that those who have more pay more.

It has been recognized that in recent years the most progressive Latin American governments have placed the emphasis on resizing government spending and improving tax collection, rather than on introducing structural changes into the fiscal architecture. This implies a structural imbalance in government accounts, with a perverse parallel phenomenon that prevents a fairer distribution of tax burdens and the overcoming of historical constraints for the government to establish more equitable links among economic development, foreign investment, taxes, trade and responsible finance.

The persistence of fiscal privileges, exemptions and legal loopholes is combined with an important degree of evasion and avoidance. The internationalization of the global economy and the advance in technology have significantly facilitated the flow of goods and services as well as economic (financial and business) transactions.

Therefore, the new conditions also pose limits and challenges from the point of view of taxes and oversight:

- What attitude should Latin American governments adopt with regard to foreign capital?
- What jurisdiction should prevail for the collection of taxes from companies with international operations?
- How can the government prevent the measures adopted to avoid “double taxation”—that is, taxes being simultaneously collected on the same economic asset in different countries—from leading to “double non-taxation”?

Given the purpose and the context for the development of Double Taxation Agreements (DTAs) in different Latin American countries, such agreements represent an important threat to sustaining financing for development and social infrastructures over time. And this is due, in many cases, to the inequitable distribution of revenues, the (very often) insufficient technical support
of the fiscal administration to ensure the effective enforcement of the agreed-upon provisions, and the possible association of DTAs with some grey areas related with capital accumulation, such as tax havens and aggressive tax avoidance efforts by multinational corporations.

The focus on productive efficiency and growth as a univocal road to further economic development has intended to downgrade and discredit the significance of public finance and national tax revenues for the financing of a sustainable and inclusive development model. Thus, they have justified the reduction of capital gains taxes as well as the transfer of the tax burden to domestic consumption. This has led to a more regressive fiscal policy in the region—a factor that increases inequalities and inequities.

PURPOSE OF THE STUDY

In general terms, the purpose of this study is to analyze the impact of DTAs on the government financing system and the tax structure in Latin America, and to open the dialogue to establish more progressive and fairer tax systems in the region.

Specifically, the study aimed at:

a. Understanding the content of the policies within the DTAs signed by some Latin American countries, such as Argentina, Colombia, Ecuador, Nicaragua, Uruguay and Venezuela.

b. Gaining insight into the connections between DTAs, and trade agreements and foreign investment protection treaties.

c. Analyzing the potential benefits and the main disadvantages of DTAs for developing countries, particularly in Latin America.

d. Studying how policies in developed countries might ensure a better distribution of the taxes involved in DTAs for developing countries.

e. Making public policy recommendations from the perspective and in the interest of periphery countries, in order to help improve the tax base of developing countries.

1 Although Nicaragua has not signed any DTA, it was relevant to include it in the study in order to analyze the situation of international taxation from another perspective.
The impact of DTAS and public policy recommendations

In general:
I. The inconvenience of uncritically accepting the OECD model as well as the contradictions it poses for the public interest of a developing country should be acknowledged. OECD developments should be taken into account for the so-called best practices in the fields of transfer pricing, harmful fiscal competition, transparency and the automatic exchange of information, but considering their insufficiencies, weaknesses and suitability for Latin America.

II. The paragraph above should lead to the recognition of the significance and convenience of the UN model. It is very important to (critically) undertake the task of drafting recommendations and standards on issues such as permanent establishment, the fight against capital flight, tax evasion and avoidance, international cooperation in fiscal areas and the strengthening of tax administrations in developing countries.

III. Regional regulations should be promoted and enforced for the negotiation and execution of DTAs among the member countries of the Union of South American Nations (UNASUR, by its Spanish acronym) and of the Community of Latin American and Caribbean States (CELAC, by its Spanish acronym). These regulations could define principles and procedures, as well as a negotiation framework supported by the expertise of national tax teams, to give this topic the formality and significance it deserves. Such principles and procedures should prioritize source-based taxation rather than residence-based taxation.

IV. There is a need to encourage a UNASUR model of DTAs from the perspective of Latin American countries. Thus, it would be possible to rethink the experience of the Andean Pact model from the 1970s, particularly its source-based approach as a driving principle of the regional tax policy. The UNASUR model, for instance, could be a model to overcome the limitations of the existing models, as a halfway point between the UN and the OECD models.

V. Regional trade integration and growth should be promoted at UNASUR level, accompanied by intra-regional tax regulations that should not increase economic asymmetries, but rather reduce them by encouraging fair trade relations.
VI. In this respect, it is necessary to promote the issue from within the Working Group on Financial Integration (GTIF, by its Spanish acronym) of UNASUR, connecting taxes to regional tax policies, trade and responsible finance.

VII. Tax administrations should aim at carrying out a regular annual revision of DTAs clauses with reference to the tax planning strategies developed by companies. That is, the regular revision of the content of DTAs should be adjusted to the actual results of tax practices, so that the agreements to “avoid double taxation” do not end up leading to “double non-taxation” or eroding the tax bases of developing countries.

VIII. The regular revision of the impact of DTAs on Latin American tax structures must be understood as an initial step to debate the set of regulations and international treaties that protect foreign investment, such as the need (if any) to continue with BITs, the use of capital movement controls, and other legislation on FDI. Therefore, it is necessary to make headway with a comprehensive tax reform that should modify the essentially regressive structure of today, the general architecture of which has been maintained without substantial changes since the neoliberal decade of the 1990s.

IX. It is necessary to promote and coordinate positions and actions in Latin America to demand more information, tax and customs transparency on trade and financial transactions and movements. Various common initiatives should be analyzed, such as the following:

i. Coordinate campaigns on the meaning of tax avoidance/evasion mechanisms and debates on and dissemination of specific cases.

ii. Link the creation of alternative tax proposals to broader debates on economic models and regional integration complementarity.

iii. Study the feasibility of having social organizations put forward a customs and tax information model agreement not only to offer an alternative instrument in the event DTAs are cancelled, but also to overcome the major limits and restrictions to information transparency.
X. Finally, tax and fiscal policies should become essential tools for wealth and income redistribution processes, as well as for financing for development and social infrastructures; they should not turn into vehicles for higher concentration of wealth and exclusion that lead to increasing social unrest. However, for any change and transformation to be introduced, full citizenship should be exercised in areas and issues such as taxes, tax policy and tax justice. This implies that the following must be ensured:

i. Conditions of transparency
ii. Access to information
iii. Participation in the drawing up of public budgets

These measures are a prerequisite for the development of effective monitoring and evaluation processes by civil society and its different organizations, as well as for the construction of truly fair and democratic tax systems.
Latin America is currently going through hectic times as it strives to build its own fair and participatory models. These are times of quest, of success and failure, of steps forward and backward, but above all, these are times filled with hope.

Not so many years ago, towards the end of the 20th century, numerous social organizations and movements had put the issue of Foreign Debt at the center of their agendas and struggles. Demanding the cancellation of debt on account of its being illegitimate and odious became the banner of thousands of social activists across the world and more strongly in our continent. The complexity of this issue drove us to set out on a more serious study of the operation of the financial system and the economic policies that had governed and still governed the countries in the region.

During this second stage, that coincides with the establishment of popular governments in almost all Latin American countries, we began to put forward the idea of what came to be called “a New Regional Architecture,” which delved into highly
important issues, such as the creation of a regional currency or a unit of account for trade transactions, a contingency fund and a bank owned and run by the countries in this part of the world: the Bank of the South.

The most ambitious proposals envisaged a bank in which all Latin American countries could consolidate their own reserves so that they would not have to place them in banks or bonds of Northern countries.

The exploration of these matters led us to examine another key subject for our peoples: the financing of their own development. On the one hand, the so-called “international cooperation” has been largely questioned, as it was nearly always a strategy of the “donor” countries to further their own interests and the source of most of our region’s foreign debt. On the other hand, the nature of the development model proposed to our peoples was also questioned, as it was, to a large extent, the culprit of our huge social inequalities and the compulsive destruction of “Mother Earth.”

Various sectors began to insistently raise the need for looking into these issues in more depth with a systemic approach in order to bring to light the implications and connections of these aspects, which despite being different, were inherently interrelated.

In the last few years, the analysis of financing issues urged social organizations and movements to begin to consider the question of tax revenues as something not only important but also essential.

In this reflection we began to discover the historic and structural depravity underlying the administration of fiscal accounts in the countries of the region and how such administration had been one of the most important causes of a deep cultural, political, social and financial dependence.

Tax mismanagement, or rather, tax management in the interest of a few, is not new in Latin America. The history of our region can be told from the point of view of tax abuses, first by the Spanish Crown, and then by the oligarchies that took control of the pro-independence movements and betrayed their best ideals. As usual, these abuses did not only favor the rich by granting them tax benefits and exemptions but also transferred the tax burden to the poor working minorities. Moreover, tax collection was used to further concentrate wealth and plunder peoples.

Time has gone by and methods have become more sophisticated, but the concept has not changed substantially. New mechanisms have been put into
practice and, for a long time, neither social movements, nor the people as a whole were aware enough of the serious risk posed by these procedures.

The combination of this way of dealing with tax matters and a financial system that operates with almost full autonomy and under no effective regulations has led us to a crisis that is clearly and constantly destroying the raison d’être of our economies and making governance and peace very difficult. Thus, different civil society networks have started to look at these issues with more seriousness and urgency.

At the global level, Latindadd, Eurodad and Afrodad have focused their attention on the issues related to the financial system and the operation of tax havens, which are presently spread all over the world. The Red de Justiça Tributária de América Latina y El Caribe [Tax Justice Network of Latin America and the Caribbean] is becoming an increasingly powerful forum for advocacy and monitoring, but also for making proposals and fostering engagement.

This publication is one of the tools made available, firstly, to social movements and activists from all over the globe so that they may become aware of what these crimes are about, how they are committed and how they deprive our peoples of the possibility of growing with justice and equity.

Secondly, this piece of research is made available to academicians, politicians, communicators and social leaders from all sectors. It is essential that we all learn more about these issues in order to know how we can change this reality that has turned into a rising threat.

Thirdly, we offer this research to government officials: to ministerial teams but also to legislators and judges, so that they can have another tool to strengthen democracy and the rule of law in the region.

Finally, we wish to thank all the authors of this publication, all those who contributed to making it available to you, and especially, to Esteban Serrani and Adrián Falco, who worked so hard to bring it to fruition.

Those of us who are part of Red Latindadd reaffirm our commitment to continuing to strive for a better world that respects all individuals, a world based on Human Rights as indivisible and all-embracing rights, a world that furthers peace among peoples and for each person.

Alberto Croce, Popular Educator
Director of Fundación SES
Coordinator of the Commission for Development Financing at Red Latindadd
Double Taxation Agreements (DTAs) are fiscal policy instruments used in the international tax policy context. However, these agreements have not been the object of thorough studies from the perspective of developing countries. And this is because these bilateral agreements are meant to ensure that international investments are not taxed twice; that is, that transnational companies do not pay taxes in the country where income is produced (usually a developing periphery country) as well as in the country where the capital originates (normally a developed core country).

DTAs have undergone significant development in the last decades, particularly since the 1970s, when as a result of trade liberalization and financial deregulation policies tied to a massive flow of speculative capital into periphery economies, there was rapid global economic growth as well as an increase in international trade and globalization of production, markedly emphasized by financial factors. As a consequence, the legal scope of these agreements is increasingly broader; so much so, that they include a series of political aspects that often overlap with other agreements, for instance, bilateral investment treaties aimed at “promoting”
In this regard, there is growing concern among civil society organizations, both in core and periphery countries, as to the fact that DTAs currently in force may be mechanisms to prevent the adoption of fiscal policies that are progressive and favorable to the most vulnerable populations in developing countries. The power asymmetry between developing and developed countries means that these agreements are very often used as a mechanism intended to disproportionately benefit the most powerful countries, the vested interests of transnational companies, and/or private investors, to the detriment of the national and sovereign interests of developing countries.

Based on the aforesaid, and in light of the growing demand of the civil society of Latin America and the Caribbean for research into fiscal issues, we present this work that thoroughly examines six national case studies in relation to the links among DTAs, the operation of national tax structures and foreign direct investment (FDI) in the countries included in the research.

Thus, experts from Latin America address the subject of DTAs and analyze present and future difficulties, actual situations and potential scenarios, the advantages and disadvantages of signing these agreements, and then offer some fiscal and economic policy recommendations in order to positively influence decision-makers at the governmental level.

**Introductory Chapters**

The first chapter of this book, written by Esteban Serrani, offers a conceptual overview of the general framework applicable to the analysis and study of DTAs. By means of problem questions the author introduces us into the historic debate on the links among financial liberalization, international trade and FDI in Latin America and the Caribbean. Also, it provides robust economic data that, from a historic point of view, allow us to have a broad understanding of the ups and downs of the Latin American economy over the years.

The second chapter introduces us into the history and principles of DTAs as well as into the arguments for and against the competing agreement models (OECD / UN). It also opens up the discussion on the relevance of having a regional DTA model that represents the interests of developing countries. Thus, it tries to answer a key question that is raised throughout the book: *Why is it important to analyze DTAs?*
National case studies

Argentina:
The research conducted by Jorge Marchini (UBA, Argentina) has been divided into several stages. Right from the beginning, Marchini reconstructs the link between the neoliberalism of the 1990s and the review of DTAs in this decade, addressing, along the way, the issue of capital flight and protection of FDI in the neoliberal days. Moreover, he analyzes the Argentine tax system by making a description of collection and taxes. Finally, he delves into the details of DTAs, their implementation, their principles and the agreements terminated by the Argentine government.

Colombia:
The Colombian case is described by Christian Moreno (CIASE, Colombia), who offers a contextual analysis of global economic transformations. He also gives an account of the changes introduced into the field of tax and fiscal policy and how FDI was boosted in his country. Finally, he analyzes signed DTAs, their advantages, the obstacles they pose for development, and their impact on tax administration.

Ecuador:
The Ecuadorian case is examined by Evelyn Cevallos Pulley and Fausto García Balda (Jubileo 2000 Red Guayaquil, Ecuador) under the coordination of Juan Carlos Campuzano. This piece of research takes the various principles applied by DTAs as a starting point and then goes on to describe the fiscal structure of Ecuador and provides a detailed review of signed DTAs. As in the other case studies, it examines a relevant DTA and ends with some public policy recommendations and guidance.

Nicaragua:
The research led by Adolfo Acevedo Vogl and Brenda Marvelli Alfaro Ortiz (Coordinadora Civil de Nicaragua, Nicaragua) introduces a new dimension of the topic. Nicaragua has not signed any DTAs with any country in the world. This fact leads to the analysis of whether or not it is convenient for the country to join the DTA network, with conclusions being revealed throughout the research. After examining the role of DTAs in economic and legal relations at a global scale, the authors analyze the changes to the Nicaraguan taxation system aimed at creating a more progressive fiscal system.

Venezuela:
This chapter shows different approaches to the same issue. On the one hand, it provides a historical account of DTAs and the list of countries with which
such agreements remain effective. On the other hand, it specifies the various methods used to enforce the agreements. Finally, it examines the controversial agreement with the USA and offers a set of important recommendations.

**Uruguay:**
The chapter on Uruguay completes this important set of proposals and questions put forward by civil society. In its first pages, the chapter walks us through the country’s historical evolution in terms of financial liberalization and market deregulation. In this regard, a section is included on the liberal treatment of capital and investment. Also, the Uruguayan tax system is examined along with the DTAs signed by Uruguay, and a set of public policy recommendations is provided.
Economic Globalization, Neoliberalism and Foreign Direct Investment in Latin America

General Framework for Studying the Impact of Double Taxation Agreements

Esteban Serrani

1.1) Debt crisis, economic transformations and financial recovery

In the aftermath of the Second World War, a new international financial architecture emerged as a result of the agreements reached in Bretton Woods. Conceived to regulate post-war capitalistic economic relations, this architecture was underpinned by the rising institutions— the IMF and the Bank for Reconstruction and Development (later the World Bank)—, by a tariff agreement designed to regulate international trade, and by a group of regional financial institutions that would give momentum to national development activities. However, as it was natural in the global recession of the 1970s, this financial architecture faced deep economic, technological and ideological transformations as a result of the “fall of structuralist development economics and the rise of neoliberalism.” Against the backdrop of the prevailing general stagflation, the boom
of “easy” access to foreign currency in international markets and the scientific and technological changes brought about by the replacement of the old Fordist industrial system by cybernetics and information technology led to a rapid deregulation of the international financial system. A period characterized by State intervention as the engine of development came to an end and a free trade-driven economic vision emerged with a special focus on trade liberalization and financial deregulation.

This vision would materialize years later in the policies coming out of the Washington Consensus in the form of a new theory of economic growth (Meier, 2001) in response to the constraints identified by neoclassical monetarist interpretations with respect to the exports substitution model of the late industrialization experiences of periphery countries. The new theory of growth especially focused on the problem of the scarcity of foreign currency in the context of imbalanced growth led by imports substitution. From this perspective, the limits to industrialization were set by constraints on the balance of payments, external imbalances caused by tariff protection, and the lack of dynamic exports along with the fiscal deficit resulting from a “large” State. Neoliberal economists explained that this general lack of equilibrium stemmed from the performance of an “inefficient State” that was unable to regulate the existence of monopolies or the monopolistic forms of economic action (Harberger, 1983; Krueger, 1974). They added that government intervention in the economy had brought about huge distortions in markets, thus forcing economic agents to compete for public revenue on the basis of short-term strategies. For these economists, the solution to the problem of debt and growth lay in having “the right policies” anchored in the neoclassical economic theory. From this viewpoint, what renders a country underdeveloped with no sustained growth is the poverty of public policies (Williamson, 1990) and not the vicious circle of poverty (Myrdal, 1960).

Indeed, as from the mid-1970s, and more emphatically in the aftermath of the 1982 debt crisis, the “right” policies translated into neoliberal structural reforms. The set of allegedly universal public policy recommendations, presented as general guidelines to quickly achieve economic growth by means of exports, fiscal stability and microeconomic efficiency, are well known by all. After the debt crisis, the international financial community intensified its pressure on highly indebted countries so that they could achieve trade surpluses and, consequently, meet their foreign commitments. Export-related activities were given priority over substitution-based industrialization, and

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2 A diagnosis of the debt crisis reveals, at least, four key structural causes: a) excessive level of indebtedness with resources being used, in many cases, to cover public deficits rather than to boost the productive structure in a context of persistent trade deficits at devalued exchange rates; b) bank loans granted to government agencies without proper risk assessment or a financial viability analysis, c) severe impairment of the economic activity due to the fall in raw material prices along with the appreciation of the dollar as a result of the rise in US interest rates, and finally d) the decline of international demand for manufactured goods (Dornbusch and Makin, 1990: 9-10)
government intervention in the economy was replaced by the “market forces.” Hence, all sorts of international instruments were created to favor capital flows, foreign direct investment, international credit and international trade, such as free trade agreements (FTAs), bilateral investment treaties (BITs), investment protection treaties, double taxation agreements (DTAs), and tariff and tax exemption or tax credit treaties. This was combined with the abolition of treaties designed to collect export duties, the lowering of standards in health and safety legislation and the passing of laws tending to labor flexibilization, among other measures.

Nevertheless, despite the multiple profound neoliberal reforms undertaken in the region and the international instruments adopted to accelerate economic growth (and despite the 1.8% fall in the per capita GDP in 1981-1985), the per capita economic growth in the following decade amounted only to 1.2% (1986-1995), while in the 1960s and 1970s, the region had reached average rates of 2.5% and 2.4%, respectively (Correa, 2001: 90).

The capitalistic financialization model that emerged in response to the 1970s economic crisis, which was based on technological innovations that succeeded in separating risk from liability, thus contributing to the downgrading of the quality of lending and causing more fragility (in the economy not only of periphery countries but also of highly industrialized countries), clearly reached its limits towards the second half of the 1990s.

As a result of trade liberalization and financial deregulation tied to the massive flow of speculative capital into emerging economies, there was rapid global economic growth (comparatively high in relation to the global stagnation of the 1980s) as well as an increase in international trade and the globalization of production, markedly strengthened by financial factors. But this also led to the unleashing of a number of chained economic crises in the mid-1990s and early 2000s: Mexico, Russia, Brazil, Turkey and Argentina. Indeed, despite the undeniable growth of technology and production in the successful late industrialization experiences of the Asian Tigers3 (Wade, 1999), these countries collapsed financially by 1997 and 1998. Given their geographical or sectoral character (Rapoport and Brenta, 2010), these experiences had a stronger impact on some production sectors, thus paving the way for the expansion of information technology, the financial sector and telecommunications—in short, the expansion of private capital over state-run companies.4

3 Hong Kong, Singapore, Taiwan and South Korea.
4 Ffrench-Davis (2009) mentions at least three main factors to explain the systematic trend towards the New Development Theory crisis of the neoliberal accumulation model. First, weak or scarce government regulation of expanding economic sectors, such as stock markets, new businesses created under the umbrella of reforms, international investment funds and commodities and derivatives markets. Second, the development of speculative investments, whose appreciation processes were reduced to incredibly short periods of time, and which did not only tend to dissociate stock operations from the real economy but also generated high capital market volatility in periphery countries, thus triggering the successive “trust” crises. Finally, neoliberalism promoted a procyclical macroeconomic approach aimed at accelerating
In the new century, the deepening of the capitalistic financialization model did not only cause financial speculation to focus on the production of raw materials in the real economy but also spread the crisis to the large industrialized economies of core countries. During the early 2000s, several investment funds and dot.com companies, such as Enron or Worldcom, went bankrupt as the speculative climate prevailing in the globalized economic model opened the door to all forms of financial fraud, which only in a few cases were legally punished. This climate extended throughout the decade until the burst of the subprime mortgage crisis, which some authors called “the great recession” (Ugartech, 2012). However, this was not the main source of global financial vulnerability. Other factors included: first, the growing current account deficit that the US maintained for twenty years both in the private (1990s) and the public (2000s) sectors; second, the emergence of leverage between financial innovations and the American real estate market bubble, which grew on the basis of the “faulty perception that high prices would continue to rise indefinitely” (Ffrench-Davis, 2009: 60). However, the creation of speculative bubbles in connection with real estate assets in the developed economies of core countries unleashed a painstaking speculative wave in natural resource derivative markets, which showed a steep upward trend in 2002-2008, and remained high, at least, until early 2013. Thus, the subprime crisis and the spread from the United States to the most financialized Eurozone economies became really noticeable in countries such as Portugal, Ireland, Greece and Spain.

So, considering this broad framework, and after more than four decades of global neoliberal economic and financial transformation, which is the most general framework for studying certain international taxation instruments in terms of their impact on regional trade and on direct foreign investment? In other words, which global developments may help us thoroughly understand the impact of DTAs as taxation instruments that deepen the international division of labor, which tends to exacerbate the inequalities between core and periphery countries?
1.2) The South finances the North: international trade, foreign investment and international taxation

In the field of international taxation, DTAs are a direct consequence of the long economic globalization process and the internationalization of trade transactions. Overall, it could be stated that DTAs are part of a set of legal instruments that seek to provide “legal certainty” to foreign direct investment (FDI).

The issue at stake, which triggers the coming into effect of DTAs as legal bilateral instruments to regulate international taxation, is what happens when two or more tax jurisdictions claim for themselves the right to tax a given income. Indeed, as the next chapter will explain, DTAs try to address the problem that arises when two or more co-existing tax jurisdictions (national States, for instance) want to levy taxes on the same income generated by the same company.

So, what is the global trade and FDI framework in which DTAs should be studied as taxation instruments applicable to investment flows and transnational companies?

An analysis of the international dynamics of trade over the last 25 years (Figure 1.1) shows a fall in trade transactions among the countries of the North along with an increase in the share of exports from the South to the North: in two and a half decades, exports almost doubled, going from 12% to 21%. However, in recent years South-South trade increased fourfold as a result—to a large extent—to the high demand for raw materials and energy from the BRICS (Brazil, Russia, India, China and South Africa).

These recent trends evidence the change of direction in the tactics of the central powers, rooted in economic strategies that supported the financial globalization of the past decades. However, the signing of DTAs between northern developed countries and southern developing countries was more the reflection of the situation of 1985 rather than that of 2000. In this regard, DTAs became instruments to “attract” FDI to developing countries, since most of the DTAs signed between developed and developing countries (as described in the national research studies) were signed only up to the mid-1990s.
When delving into the general dynamics of international trade and examining specifically the goods and services exports-imports ratio in the last three decades, it is clear that there were surprising cyclical fluctuations tied to the accumulation strategies of large global companies.

Based on UNCTAD\textsuperscript{5} information (Table 1.1), while in the 1980s the balance of trade of developing countries was barely positive, that of the developed countries recorded a US$19 billion deficit. In that period, South America had a surplus of nearly US$10 billion, almost equal to the aggregate of Latin America. However, in the 1990s, the equation changed and developed countries had a high positive balance underpinned by the large exportation of capital that paved the way for full trade liberalization and neoliberal reforms in periphery countries. In contrast, developing countries recorded a growing deficit as a result of the mass inflow of capital into the South from the North as a consequence of the opening of trade and the financial deregulation promoted by the neoliberal reforms from the 1980s onwards. Finally, in the last decade, the total trade in goods and services recorded a surplus for periphery countries and a high deficit for the countries of the North (which were immersed in an unprecedented financial speculation wave). In the last decade, South America attained a positive balance driven by the rise in raw material and energy prices.

\textsuperscript{5} United Nations Conference on Trade and Development.
Table 1.1. Total balance of exports and imports of goods and services, in million US$ at current prices, 1980-2011

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<td></td>
<td>Million US$</td>
<td>Percentage</td>
<td>Million US$</td>
</tr>
<tr>
<td>World</td>
<td>-15962</td>
<td>100</td>
<td>53171</td>
</tr>
<tr>
<td>Developing countries</td>
<td>2011</td>
<td>-13</td>
<td>-16137</td>
</tr>
<tr>
<td>Transition countries</td>
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<td>-12</td>
<td>2263</td>
</tr>
<tr>
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<td>67045</td>
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<tr>
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<td>-71</td>
<td>-18522</td>
</tr>
<tr>
<td>Caribbean</td>
<td>-2112</td>
<td>13</td>
<td>-2510</td>
</tr>
<tr>
<td>Central America</td>
<td>3123</td>
<td>-20</td>
<td>-10684</td>
</tr>
<tr>
<td>South America</td>
<td>10349</td>
<td>-65</td>
<td>-5329</td>
</tr>
</tbody>
</table>

Source: Prepared by the author based on data from the United Nations Conference on Trade and Development (UNCTAD).

Nevertheless, the specific analysis of the dynamics of goods (excluding services) (Table 1.2) reveals an evident deepening of asymmetrical relationships between the developed countries of the North and the developing countries of the South. This is shown by the significant increase in the negative balance derived from the dynamics of foreign trade in goods of the developed countries vis-à-vis the global dynamics:

- In the 1970s, the global balance was US$-18 billion, compounded by a US$-46 billion deficit in developed countries and offset by the positive dynamics of developing countries.
- In the 1980s, the world’s balance of trade in goods amounted to US$-67 billion, with developed countries contributing a US$-95 billion trade deficit, which just as in the 1970s, was offset by the dynamics of the economies of periphery countries.
• In the 1990s, the global deficit continued to increase to a total of US$-97 billion, made up by US$-76 billion from developed countries and US$-21 billion from southern countries. This situation can be attributed to the hegemony of the neoliberal ideology, which tended to generate economic concentration processes and encourage financial capital appraisal strategies.

• In the 2000s, out of the US$-254 billion at the global level, developed countries recorded a deficit that more than doubled that amount (US$-704 billion), which, as in the 1970s, was largely compensated for by developing countries with a considerable contribution from South America to trade surplus.

### Table 1.2. Total balance of exports and imports of goods, in million US$ at current prices, 1970-2011

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Million US$</td>
<td>Percent-age</td>
<td>Million US$</td>
<td>Percent-age</td>
</tr>
<tr>
<td>World</td>
<td>-17959</td>
<td>100</td>
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<td>100</td>
</tr>
<tr>
<td>Developing countries</td>
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<td>-166</td>
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<td>-36</td>
</tr>
<tr>
<td>Transition countries</td>
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<td>10</td>
<td>4324</td>
<td>-6</td>
</tr>
<tr>
<td>Developed countries</td>
<td>-46074</td>
<td>257</td>
<td>-95530</td>
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</tr>
<tr>
<td>Developing countries in the Americas</td>
<td>-4820</td>
<td>27</td>
<td>10474</td>
<td>-16</td>
</tr>
<tr>
<td>Caribbean</td>
<td>-1539</td>
<td>9</td>
<td>-5282</td>
<td>8</td>
</tr>
<tr>
<td>Central America</td>
<td>-2953</td>
<td>16</td>
<td>1981</td>
<td>-3</td>
</tr>
<tr>
<td>South America</td>
<td>-329</td>
<td>2</td>
<td>13775</td>
<td>-21</td>
</tr>
</tbody>
</table>

Source: Prepared by the author based on data from the United Nations Conference on Trade and Development (UNCTAD).

6 UNCTAD defines the exports-imports balance of goods and services as the credits and debits of goods and services as reported in the BOP current account. Goods include general merchandise, products used for processing other goods, and non-monetary gold. For a transaction to be recorded as “goods,” there should be a change of ownership from/to a resident of a local country to/from a non-resident of a foreign country. The BOP based on statistics of trade in merchandise (related to the transfer of ownership between residents and non-residents) is usually not comparable to ECIM data based on trade in merchandise (principle of crossing the physical border) due to the differences in concept and definition. In some countries, these differences can be significant. Trade in services is the result of intangible actions such as transportation, travel, business services, royalties or licenses.
Based on the aforesaid, we can state that most exports from developed to developing countries were related to investment in services such as electricity, water and gas, passenger transportation and communications, goods transportation and storage, banking, engineering and construction, among others. But above all, developed countries exported capital. That is, there is solid evidence to support the hypothesis that the raw materials and the goods of developing countries are at the disposal of the core countries so that they can maintain their consumption level and “modernity” status.

Along these lines, South American countries experienced an exponential increase in their balance of trade in the 1980s (following the recovery from the traumatic crises of the 1970s, but mainly in the 2000s, driven by the megacycle of high commodity prices). This behavior was not replicated in the rest of the countries in Latin America.

Yet, what is the process in developing countries that is associated with the growth of exports and the dynamics of international trade, which reproduce the international division of labor between developed and underdeveloped (or dependent) countries? And in this connection, what are the repercussions in the South?

This dynamics of international trade enabled the disposal of the international financial surplus through the explosion of FDI in developing countries (Figure 1.2). Investments flourished thanks to the set of neoliberal structural reforms introduced in the 1970s and reinforced in the 1990s (privatization of state-run companies, market opening and financial deregulation), which were supported by the large international financial institutions (World Bank, IMF, IDB, etc.) and consolidated financial globalization and the global power asymmetry favoring the market over the State.

**Figure 1.2. FDI flows into developing countries, in million US$, 1970-2011**

![Figure 1.2. FDI flows into developing countries, in million US$, 1970-2011](image)

*Source: Prepared by the author based on data from the United Nations Conference on Trade and Development (UNCTAD).*
So, although it is true that it “makes no sense” to apply the same tax twice on the same income of the same company for the sake of furthering international trade, what is the international framework in which DTAs and their impact on the periphery countries should be studied? How does the direction of capital flows affect the tax collection capacity of developing countries?

And in this regard, how are FDI flows organized in the world? What are the main capital-exporting regions? Ultimately, how are conditions in international economic negotiations imposed in the era of financial globalization?

The evidence on FDI flows in the world shows the prevailing relationship between the North and the South. Despite preaching on financial deregulation, the opening of trade, BITs, Free Trade Agreements (FTAs) (and the entire set of legal/economic tools designed to foster the free circulation of capital) favor the multilateral nature of capital flows; the global dynamics of the last four decades contrasts with this long held idea (Table 1.3):

- In the 1970s only 1 out of every 3 dollars going from the North to the world came from the South (18 billion against almost 6 billion);
- In the 1980s, the ratio was 4 dollars to 1;
- In the 1990s, the ratio was 3.5 dollars to 1;
- And in the 2000s, it was approximately 2 dollars to 1.

### Table 1.3. FDI flows by originating region in million US$ (annual average by decade) and percentages, 1970-2011^8^  

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>World</strong></td>
<td>23969</td>
<td>92900</td>
<td>402598</td>
<td>1311726</td>
</tr>
<tr>
<td>Developing countries</td>
<td>5921</td>
<td>20599</td>
<td>118531</td>
<td>447879</td>
</tr>
<tr>
<td><strong>Mil-</strong></td>
<td><strong>US$$</strong></td>
<td><strong>Million</strong></td>
<td><strong>US$$</strong></td>
<td><strong>Million</strong></td>
</tr>
<tr>
<td><strong>Per-</strong></td>
<td><strong>centage</strong></td>
<td><strong>centage</strong></td>
<td><strong>centage</strong></td>
<td><strong>centage</strong></td>
</tr>
<tr>
<td>1970-1979</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>1980-1989</td>
<td>100</td>
<td>22</td>
<td>29</td>
<td>34</td>
</tr>
<tr>
<td>1990-1999</td>
<td>100</td>
<td>29</td>
<td>34</td>
<td>34</td>
</tr>
<tr>
<td>2000-2011</td>
<td>100</td>
<td>29</td>
<td>34</td>
<td>34</td>
</tr>
</tbody>
</table>

7 That is, South-North, North-South, South-South or North-North.

8 The technical definition of how FDI flows are accounted for is given by UNCTAD as follows:
- Flows of FDI comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to an FDI enterprise, or capital received from an FDI enterprise by a foreign direct investor. FDI has three components: equity capital, reinvested earnings and intra-company loans. - Equity capital is the foreign direct investor’s purchase of shares of an enterprise in a country other than its own.
- Reinvested earnings comprise the direct investor’s share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not transferred to the direct investor. Such retained profits by affiliates are reinvested.
- Intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliated enterprises.
- Data on FDI flows are on a net basis (capital transactions’ credits less debits between direct investors and their foreign affiliates). Net decreases in assets or net increases in liabilities are recorded as credits (with a positive sign), while net increases in assets or net decreases in liabilities are recorded as debits (with a negative sign). Hence, FDI flows with a negative sign indicate that at least one of the three components of FDI is negative and is not offset by positive amounts of the remaining components. These are instances of reverse investment or disinvestment.
In this regard, the international division of labor, associated with the dynamics of international trade and the movement of transnational capital, organizes and differentiates capital-exporting countries (usually wealthy countries of the developed North) from those rich in raw materials (usually poor countries of the developing South).

In fact, it could be asserted that while the developed countries are net exporters of capital to the South, developing countries are net exporters of profits to the North, which are used to finance capital flight from globalized companies and the high demand for goods and services of countries in which both working and high classes have great purchasing power. In this respect, Latin America only accounts, on average, for 10% of the global capital flows from the last two decades, but what does that 10% represent? Or in more general terms, what are the characteristics of the flow of resources from Latin America to the rest of the world, especially to developed countries?

To capture this dynamics, ECLAC calculates the net transfer of resources using the aggregate of long-term credits, both public and private, and FDI. To this end, ECLAC uses the concept of net resource transfer, understood as the sum of all outlays minus amortization and interest payments, plus all FDI outlays minus profits and depreciation transferred to the head office, both public and private. All in all, the figure resulting from the net resource transfer is only made up of two added variables (external credit and foreign investment) and given its simplicity, it makes it possible to see the long-term contribution of foreign investment to Latin America’s economic growth (Ugarteche, 2008).
Table 1.4. Description of the dimensions of net resource transfer according to ECLAC

<table>
<thead>
<tr>
<th>Item</th>
<th>Inflows</th>
<th>Outflows</th>
<th>Partial Result</th>
<th>Final Result</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Credit (public + private)</strong></td>
<td>+ Credit outlays</td>
<td>Amortization and credit interest payments</td>
<td>Total funds through credit</td>
<td>Net Transfer of Resources: Total Credit + Total FDI</td>
</tr>
<tr>
<td><strong>Foreign Direct Investment (FDI)</strong></td>
<td>+ FDI outlays</td>
<td>Profits and depreciation transferred to the head office, public and private</td>
<td>Total funds through FDI</td>
<td></td>
</tr>
</tbody>
</table>

Source: Prepared by the author based on data from ECLAC.

Overall, upon analyzing the statistics gathered by ECLAC, it becomes clear that the cycles of net resource transfer to Latin America were merely in sync with the large economic transformations of the last three decades (Figure 1.3). In the 1980s, amidst the “foreign debt crisis”, the net resource outflow was US$-18 billion, which caused a large economic depression with a slump of the GDP in the region. In the following decade, after the opening of capital accounts, the deregulation of the banking system, the liberalization of trade and the privatization of state-owned companies, a positive trend—contrary to that of the previous decade—began and financial instruments (the Brady bonds) were created to solve the problem of debt payment in the short term (Ugarteche, 2008). Although positive transfers were not stable throughout the decade, in the 1990s a positive balance for US$16 billion was achieved.

Figure 1.3. Net transfer of resources abroad, Latin America, in million US$, 1980-2011

Source: Prepared by the author based on official figures taken from the database of the
By the 2000s, the largest agribusiness and industrial companies operating in the main Latin American economies had become fully foreign-owned. Additionally, there was a strong oligopolistic concentration of markets providing strategic supplies for the operation of the rest of the productive machinery in the region. Against this backdrop, there was a record outflow of resources from Latin America to the world for a total amount of US$24 billion. This was explained, above all, by the economic transnationalization of Latin America, a process through which a small number of foreign companies increasingly gained more economic power and concentrated market control in national Latin American economies. As observed in Figure 4, the transnationalization of economies was the result of market liberalization and neoliberal financial deregulation. These large corporations were granted tax reductions in developing countries and “exported dividends and revenues” from the South to the North. The cases of Argentina, Brazil and Uruguay are a clear reflection of a much broader process that spread throughout the region and revealed the importance of transnational companies for the economic and tax structure of periphery countries, especially in South America.

Figure 1.4. Transnational companies as a percentage of leading companies in MERCOSUR countries, 1992-2000

Note: Number of TNCs over the total number of leading companies
Source: Prepared by the author based on data from Prensa Económica y Mercado (Argentina) and Éxame (Brazil) magazines and MC Consulting (Uruguay).

In fact, most of these resources were not taxed in southern countries. Thus, they provided a great mechanism to transfer resources from the South to the North, from the developing world to the developed world, from the poor countries to the rich countries.
Therefore, it is vitally important to study their impact on financing for the development of developing countries and, in particular, of Latin America, on the transfer of resources abroad, and on the mechanisms that enable the South-North capital flow.

In this regard, studying the DTAs in relation to the tax accounts of six Latin American countries such as Argentina, Ecuador, Colombia, Nicaragua, Uruguay and Venezuela, provides a sufficient level of geographical, political and historical depth, extent and representativity in order to make an initial approach to find out the impact that this international taxation tool has on our vast continent, as well as its contribution to the improvement or the impairment of the longed-for and much-needed tax justice in our territory.
Bibliography


What are Double Taxation Agreements?

History and Principles

2.1) Introduction

Since early 20th century, the United Nations Organization (UN)\(^9\) has included on its agenda the design of mechanisms aimed at eliminating or reducing double taxation on income, stressing the importance of cooperation on economic, financial and fiscal matters. The concern for double taxation dates back from the period between the two big wars. After the First World War, both the country of residence of the beneficiary of an income generated in another State and this other State (i.e. the country of origin or source of the income) would tax such income at high tax rates. Double taxation became a relevant issue that needed to be addressed somehow, particularly in view of the fact

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9 Paper written by Jorge Marchini (UBA, Argentina), Christian Moreno (CIASE, Colombia), Evelyn Cevallos and Fausto García (Jubileo 2000 Red Guayaquil, Ecuador), Adolfo José Acevedo Vogl and Brenda Marvelli Alfaro Ortiz (Coordinadora Civil de Nicaragua, Nicaragua), and Adrián Falco (Fundación SES, Argentina).

10 The so-called “League of Nations” was founded on June 28, 1919. It was the predecessor of the United Nations Organization, which was created on October 24, 1945. For practical reasons, we will use the name United Nations or UN to refer to the League of Nations.
that, by rule of the application of taxes by both States, the tax burden basically did away with any profit resulting from cross-border investment activities. The efforts to come up with a legal tool that would provide a solution for potential double taxation in the world intensified during the first half of the 20th century, especially in the 1970s, when in the context of a global economic crisis the need arose for unblocking in some cases and energizing in others the movement of capital with a view to boosting profitability. In this regard, DTAs came into the scene as international legal instruments that first spread quickly to relations between developed countries and then (in the 1980s and 1990s) extended widely to negotiations between developing and developed countries. While in 1980 there were some 700 DTAs signed among States all over the globe, ten years later there were more than 1,100, and by the beginning of the new millennium the number had grown to more than 2,100 DTAs (FitzGerald, 2002:70).

2.2) The competing models: the source or residence debate

The Brussels Financial Conference\(^{11}\) requested the intervention of the UN for a period of 25 years approximately (1921–1946). As a supranational body, the UN focused its efforts on finding solutions to avoid or counter double taxation with the aim of applying them throughout the world. At any rate, its most important output was a model agreement designed to avoid double taxation.

The first model agreement for eliminating double taxation in relation to the income tax that was drafted by the UN dates from 1929. According to it, the country of origin of the income (source) had to eliminate some taxes applicable to certain types of income and the other country (residence) was fully empowered to levy taxes on the total income amount. In other words, the source country would transfer its taxation power to the beneficiary’s country of residence, thus “eliminating double taxation.”

Later, in 1943, a second model convention was drafted in Mexico, known as the “Mexico Model,” which clearly showed the influence of non-European countries. Nine experts from Latin American participated in its drafting.

\(^{11}\) This was one of the two attempts by the United Nations (the other one was the Genoa Conference in 1922) at restoring monetary stability in post-war Europe.
That is, perhaps, the reason why the source principle was more preponderant in this draft.

Finally, the model agreement drafted in London in 1946, known as the “London Model,” had significant input from European countries, which was reflected in the preponderance of the residence principle. None of these three models was unanimously accepted.

Since then, two positions emerged:

• That of developing countries, with preponderance of the **source principle**—i.e. the country where the wealth was created or where the assets were located was to have pre-eminence when levying taxes.
• That of developed countries, giving preference to the **residence principle**—i.e. the investors’ countries of residence were to be given priority at the time of levying taxes on income generated by capital investments made by their residents in the source country.

The 1951 and 1967 resolutions of the UN Economic and Social Council recognized the right to levy taxes in the source country and recommended that countries should enter into bilateral treaties in order to minimize their sacrifice, as the ultimate goal was to foster economic development. In this regard, the UN Model Convention was conceived as a tool to be used in negotiations between developed and developing countries.

However, due to strong pressure from the developed countries, the model agreement that eventually prevailed and on which most of the agreements signed were based was the one devised by the OECD’s Committee on Fiscal Affairs in 1991, which was modified in 1994, 1995, 1997, 2000, 2003, 2005 and 2010. This model reflects the interests of developed countries. The first version of the UN Model Convention dates from 1980 and was mainly based on the 1977 OECD Model Tax Convention.

Although at face value these agreements seek to “avoid double taxation and prevent tax evasion,” they do not always do so. Large conglomerates of accounting and law firms structure the investment of multinational enterprises around the benefits gained after the implementation of these agreements. Thus, it is necessary to discuss and agree on a legal tool that takes into account not only the needs of developed countries but also those of developing countries. Signing agreements created without the input of capital-receiving countries is neither possible nor desirable, and palliative measures such as the granting of tax credits for the tax paid in the source country are not useful either.
2.3) Why is it important to analyze DTAs?

The development of these international taxation treaties is closely linked to the advancement of the neoliberal economic and political project, which sought to put a stop to and provide a solution for the critical problem of excessive capital accumulation in the 1970s. Within the framework of national tax structures, the development of DTAs appeared as an integral part of the generalized trend towards the reduction of the tax burden on capital and its shift towards labor (Fitz Gerald, 2010: 4), which affected Latin American economies rather intensely (Giraldo, 2009). In contrast, taxes on foreign trade (and more generally, taxes on different types of transnational capital flows) lost importance and the focus of attention shifted towards the value added tax and fundamentally regressive tax structures. DTAs pose several problems in terms of the specificities of their design and the way in which tax collection is distributed among the contracting States. Such design and distribution result from confronting the interests of States with traditionally capital-exporting economies, which are relatively strong in the international political arena, and those of countries with less developed economies, which have a lesser leverage ability. One possible cause of some countries’ “inability” to negotiate may be the composition of their national elites, which take on—by consent and/or by coercive action—interests and policies that conflict with the needs of their own countries. Among countries with a similar level of development, from an income distribution standpoint, the signing of DTAs does not raise any problem. Indeed, they can become significant international cooperation instruments, strengthening economic and commercial relations between countries of the same region. However, the existence of marked power asymmetries among States leave weak States and small economies in a vulnerable position, and the signing of DTAs with developed countries may pose a serious risk to them as long as these treaties tend to be established on the basis of the residence principle. Relying on an aggressive international policy, the governments of developed countries—as representatives of (net) capital-exporting economies—have pushed for the adoption of the residence principle in economies like those of Latin America. Thus, they have kept for themselves a higher level of revenues, as the capital gains made outside their borders are taxed exclusively by them (despite the benefits obtained by their companies in the economic and political environment and systems where the income is generated). All this happens in the context of an (induced) structural dependence in light of foreign direct investment and foreign trade flows, which push for the establishment of taxation, investment protection and free trade agreements.12

12 Countries with emerging economies (such as Mexico and Argentina) (Fitz Gerald, 2010: 6) have
The already precarious situation faced by developing economies as a result of government indebtedness, balance of trade deficits, FDI in extractive sectors and speculative management of financial capital, is compounded by the fact that the governments of periphery countries are deprived of vital fiscal resources, given the higher value that tax revenues represent, marginally, for countries with small economies (Fitz Gerald, 2010). Hence, by distributing revenues between the source country and the country of residence of the investment, the DTAs eventually generate a net transfer of resources from the South to the North. Consequently, regressive tax systems emerge and combine with the inequalities and inequities created in other spheres of economic activity.

It should also be noted that in addition to the unequal dynamics that DTAs can create through international (and national) lawful channels, their development is partially linked to illegal procedures, as some tax treaties are signed between States, which are exactly that, and tax havens, which pretend to be so. Such a linkage opens the door to wide areas of opacity in transnational capital accumulation, given its role in banking and financial secrecy, in distorted transfer pricing, in tax evasion and in tax fraud.

Moreover, the complexity of the provisions of DTAs and international tax law, as well as the technical difficulties and the low availability of resources that may affect tax administrations in low-income countries offer an opportunity for multinational companies to carry out the so-called “tax planning” (SOMO, 2008: 6-9). Although it is kept at a level of relative legality, tax planning results in aggressive tax avoidance, which brings about a profound problem of ethics and political legitimacy.

Signing international taxation treaties in the form of DTAs that do not give priority or cater to the needs of developing countries could become a significant obstacle to the financing of their development and social infrastructures:

- Because of the unequal distribution of revenues.
- Because of the connection of DTAs with grey accumulation areas (avoidance, capital flight, tax havens).
- Because of the lack of technical capacity of tax administrations to ensure the effective implementation of the adopted principle (source or residence).
- Because of the complex network of DTAs at a global level, which facilitates the tax planning process.

recently tended to adopt residence-based taxation systems in an attempt to stimulate the investment of their nationals’ companies in other countries, thereby receiving tax resources.

13 Tax planning consists in the establishment and selective distribution of affiliates, businesses and operations in various jurisdictions with the aim of reducing the aggregate amount (and the amount in each country) of payable taxes.

14 While tax evasion consists in attempts by individuals and organizations to evade taxes by illegal means, tax avoidance entails the utilization of ambiguities and indeterminacies of tax rules and regulations to reduce the taxable base.
The focus on productive efficiency and growth as a univocal road to more economic development has led to the marring and (induced) discredit of the significance of public finance and national tax revenues for the financing of sustainable and inclusive development models. Recent economic history offers us grounds for acknowledging the significance of examining these resource transfer mechanisms. For many years, different social scientists have upheld that the underdeveloped Far South was no less than the great source of resources for the imperialistic exploitative North. In that regard, many research studies confirm the hypothesis that it is the South that economically supports the North. The opportunity to shed light on DTAs as gears of the complex global legal and economic machinery is, undoubtedly, the big first step towards the consolidation of a regional economic system thought and conceived by and for Latin America.
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Double Taxation Agreements in Argentina

Jorge Marchini

3.1) From the boom of neoliberalism to the beginning of reversion of double taxation agreements (DTAs)

Argentina is the second largest country in Latin America (after Brazil) and the eighth largest in the world (2,791,810 km2). It is rich in natural resources (in the agricultural, forestry, mining, and water sectors), exhibits a broad urban and industrial structure and has a population of more than 41 million inhabitants¹⁵ with a high education level.

In the early 20th century, Argentina was among the most booming economies in the international arena. However, since then and for decades, the country has faced recurrent economic and political crises that turned it into a case study given the contrast between its remarkable potential and its difficulties.

In particular, from the 1960s onwards, like most Latin American countries, Argentina has dealt with recurrent fiscal and current account crises. In the mid-1970s, a military dictatorship came to power seeking to “radically change Argentina’s economic structure” with pro-market policies but eventually led the country to an economic and financial debacle that reached its peak with the so-called “debt crisis” of the 1980s, when, at the request of lending organizations, government spending was dramatically cut down and tax pressures were increased so that financial services could be paid off.

The crises and the need to create a favorable framework to turn around the economy and address the absence of growth and investment led Argentina to become, in the 1990s, an exemplary case of application of neoliberal policies. This included moving towards agreements and decisions to open up the economy to foreign investors and signing various Bilateral Investment Treaties (BITs) and Double Taxation Agreements (DTAs) for the purpose of attracting international investment.

At the beginning of the 21st century, a new crisis burst out as a result of the failure of the most extensive neoliberal experiment, causing a huge popular and social reaction and giving rise to a new political stage and a noticeable change of course and economic postulates.

The so-called “K era” in Argentina is part of the “post neoliberal” wave that spread across several Latin American countries with distinctive basic characteristics:

1. It favored social policies not only by focusing on emergency support measures but also by giving priority to employment access and consumer market development.
2. It advocated the role of the State as a basic factor to achieve harmony between an economic model and social and political dynamics.
3. It promoted a financial decoupling policy by means of reserves accumulation, public debt restructuring and debt reduction.

In the last few years, Argentina has attained sustained economic growth, which has enabled the country to remain remarkably uncoupled from the global situation and the persistent effects resulting from the 2007/2008 international crisis.18

16 Speech by Economy Minister José A. Martínez de Hoz, April 2, 1976.
17 Name given to the consecutive presidential terms of office of Néstor Kirchner (2003-2007) and Cristina Kirchner (2007 to this date).
The positive effect of the rise in international prices of raw materials was not the only reason for this disconnection. Still, increasing prices have undoubtedly brought about:

- A significant improvement in exports and the stabilization of the balance of payment;
- A historic volume of Central Bank reserves, and
- Higher tax revenues due to the growing economic activity and, in particular, to the introduction of higher taxes on exports, which has led to the partial redistribution of an exceptional differential income from the naturally highly competitive agricultural sector to the public sector.

Repaying the “social debt” and activating and increasing production, consumption and investment were part of the countercyclical state policies, which did not follow the traditional orthodox logic that continued to demand time and again that the economy “be cooled down” and that the State take on a passive role and refrain from offsetting imbalances and inequalities.19

Anyway, a striking fact is that ten years after the above-mentioned changes no profound tax or regulatory reform has been undertaken in Argentina to reverse fiscal regressive behavior and prevent capital flight, which are also connected with tax evasion and tax avoidance.20

The seriousness of the negative phenomenon of tax revenue and savings suction and inhibition can be clearly seen in illicit capital outflow estimates21 and the recognition of the growing size of Argentine capital placed offshore, considering that, except for the reserves of the Banco Central de la República Argentina [Central Bank of Argentina] (BCRA, by its Spanish acronym), such capital is mainly privately-owned and most of it has been neither registered nor reported for tax purposes.

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19 “Instead of economic adjustments, they were able to apply policies mainly aimed at protecting people’s jobs and income. This action was decisive for Latin America to become one of the first regions to experience economic and employment recovery.” Elizabeth Tinoco, Regional Director of the ILO Office for Latin America and the Caribbean, making a statement in Buenos Aires. She also recalled that at the peak of the crisis in 2009, the regional urban unemployment rate rose from 7.3% to 8.1%, and that in late 2010, it fell back to 7.3%. ILO Press Release, July 12, 2011.


Table 3.1. Argentina, international investment position, in million US$, 2001-2011

<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL ASSETS OFFSHORE</th>
<th>BCRA RESERVES</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>131797</td>
<td>14913</td>
</tr>
<tr>
<td>2002</td>
<td>131282</td>
<td>10476</td>
</tr>
<tr>
<td>2003</td>
<td>143814</td>
<td>14119</td>
</tr>
<tr>
<td>2004</td>
<td>153796</td>
<td>19646</td>
</tr>
<tr>
<td>2005</td>
<td>161418</td>
<td>28076</td>
</tr>
<tr>
<td>2006</td>
<td>177511</td>
<td>32037</td>
</tr>
<tr>
<td>2007</td>
<td>206100</td>
<td>46176</td>
</tr>
<tr>
<td>2008</td>
<td>210700</td>
<td>46386</td>
</tr>
<tr>
<td>2009</td>
<td>223777</td>
<td>47967</td>
</tr>
<tr>
<td>2010</td>
<td>237240</td>
<td>52190</td>
</tr>
<tr>
<td>2011</td>
<td>251338</td>
<td>46376</td>
</tr>
</tbody>
</table>

Source: Instituto Nacional de Estadística y Censos [National Institute for Statistics and Censuses].

3.2) The Argentine tax system

Argentina is a federal country, and according to its National Constitution, the power of levying taxes is shared by the National State and the Provincial States, although it is the former that concentrates the greatest taxing power while the latter receive a share of the revenues from national taxes through a tax allocation system called “federal tax revenue–sharing system” (coparticipación federal in Spanish).

The Federal Government is responsible for collecting income tax, tax on personal assets, value added tax (VAT) and indirect taxes throughout the national territory.

Tax administration and oversight fall under the responsibility of the Federal Administration of Public Revenue (AFIP, by its Spanish acronym). Argentina does not have a revenue code and the various tax categories are regulated by separate laws, which are frequently amended.

In Argentina, resident businesses and individuals are subject to payment of income taxes on income generated both locally and abroad. In contrast, non-resident businesses and individuals are obliged to pay taxes on the income derived from their operations in Argentina and on their foreign trade.
transactions made from the country. In some specific activities (e.g. news agencies, insurance, commercial use of films produced abroad, international transportation, etc.), legislation provides for a given percentage to be considered as presumptive income.

The tax rate applicable to income earned by business organizations (corporations, limited liability companies, limited partnerships) and the subsidiaries of foreign companies domiciled in Argentina is 35%. For other forms of organization or individuals, the tax must be paid by each person according to a gradual rate scale that ranges from 9 to 35% depending on the amount of taxable income. Those who receive income (companies or individuals) in the country but do not reside in Argentina are subject to tax withholdings. The rate is usually 35%.

In the case of resident businesses and individuals, any income tax (or similar tax) paid in another country can be used as tax credit for the purpose of income tax payment up to a given statutory limit, while the income of Argentine residents derived from stock of companies that invest abroad (offshore companies) is subject to a 17.5% rate.

The Argentine-sourced income of non-resident businesses and individuals (through branches, representation offices, etc.) is subject to a 35% withholding tax rate unless there are any provisions stipulating otherwise in a tax agreement signed by Argentina with the relevant country. The law sets presumptive net income percentages for the calculation of the applicable 35% withholding. There is also an indirect tax applied on personal assets (also commonly known as “property tax”). This tax is levied on all assets located in Argentina or abroad owned by individuals who reside in Argentina and all the assets located in Argentina that belong to Argentine residents abroad. It also includes the stock of Argentine companies and trust funds, excluding financial funds (companies are taxed through their shareholders/beneficiaries).

The applicable rate ranges between 0.5% and 1.25%. Certain assets (such as securities, real estate not used for business purposes, etc.) located in Argentina and owned by foreign companies are regarded as property owned by individuals and are therefore subject to a 2.5% rate.

Indirect taxes, which are usually not covered by DTAs but nevertheless have a strong impact on the tax structure and conditions, include the value added tax (VAT). The applicable standard rate is 21%, but for certain services (communications, electricity, etc.) the rate is 27%. Also, a 10.5% rate is applied on some food products, such as fresh produce, or on rentals, interest on loans granted by Argentine financial institutions, plant and equipment (specifically enumerated), newspapers and magazines, passenger transportation, and others. For foreign trade transactions, as Argentina is a MERCOSUR member, it applies tariffs on imports (common tariff applicable to all extra-regional countries), but it has its own export tariffs, which are higher in the case of commodities (grains and oilseeds, mining, petroleum).
3.3) The significance of investment protection

A clear illustration of the neoliberal thinking of the 1990s was the conception that the investment capacity was restricted by low levels of revenues, savings and financing, and that there were no chances for substantial, modernization-driven investments. The solution put forward to overcome this double hurdle was to open the market to more direct investment from other countries. The proponents of this solution asserted that with a guarantee of monetary stability (through the introduction of the “convertibility system” in 1991, i.e., pegging the peso to the US dollar on a one-to-one basis) it would be possible to transfer resources from the industrialized countries that had excess capital. They claimed that the investment and accumulation process could be accelerated with the inflow of foreign capital in a mass privatization process along with the supply of the foreign currency resources needed for the importation of technology and machinery from the industrialized countries. These flows could take the form of debt or of Foreign Direct Investment (FDI).

With small changes, this line of argument prevailed as one of the cornerstones of the discourse of the International Financial Institutions (IFIs) for more than 60 years. But it was in the 1990s that more progress was made in the search for more appealing and stable conditions to attract and facilitate foreign investments through the introduction of laws favoring the signing of bilateral investment treaties (BITs).22

The main reason for BITs to come into existence was the need to protect the investments made by investors who were nationals of one signatory country in the territory of the other signatory country. Along these lines, any violation of the agreed-upon terms is considered as a breach of international law according to the pacta sunt servanda23 principle. Thus, any dispute arising in relation to the investment has a special protection, granted by the treaty, so the investor is doubly protected:

a. The State of which the investor is a national has a legal international bond to the State in which the investment has been made, so in the event of a dispute, the investor may require the assistance of his/her/its own State.

b. Likewise, this type of treaty offers the possibility of settling disputes between an individual and a State, a situation that is impossible or at least extremely difficult to deal with outside the framework of this kind of agreement.

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22 Law No.21,382 passed by the National Congress in 1993, still in force.
23 The principle that states that all agreements must be fulfilled.
Consequently, the investor is authorized to resort to an international arbitrator or an international arbitration body to settle his/her/its dispute with a State, thus placing the public and the private interests on a virtually equal footing, despite their different international legal status.

During the 1990s, with the declared intention of protecting investments and in the hope that this would further economic modernization and internationalization, Argentina signed BITs with the following countries: Austria, Armenia, Australia, Bolivia, Bulgaria, Canada, Croatia, Cuba, Chile, China, Denmark, Ecuador, Egypt, Finland, France, Germany, Great Britain, Hungary, Indonesia, Israel, Italy, Jamaica, Luxemburg, Malaysia, Morocco, Netherlands, Peru, Poland, Portugal, Romania, Senegal, South Korea, Spain, Sweden, Switzerland, Tunisia, Turkey, Ukraine, USA, Vietnam and Venezuela.24

Although in general these BITs did not include special tax privileges, they did provide for the right of companies from signatory countries to receive the same treatment as national investors and the right to the free transfer of profits. This implied the possibility of classifying operations (sales, income) and their tax position according to the company’s interests.

Additionally, Argentina is a member of the Multilateral Investment Guarantee Agency (MIGA), of the Overseas Private Investment Corporation (OPIC) and of the International Centre for Settlement of Investment Disputes (ICSID), all of them dealing with the right of foreign investors to submit a dispute with the National State in arbitration forums or extraterritorial courts even in relation to tax matters.

Following the 2001 crisis, the country did not sign any other BIT. The main reason for this change of attitude was the fear that new agreements could multiply the number of actions brought against the country in view of the large number of cases filed by foreign investors in international courts on grounds of alleged non-compliance with BITs by Argentina,25 as well as the evident failure to meet the initially set expectations.

The facts showed a different picture. Not only did the promised modernization process prove to be limited but also the net transfer of capital resources (FDI inflows minus remittance outflows) was often negative, as it can be observed in the table below.

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24 Beltramino, Ricardo (2010).

25 With 46 claims filed since 2001, Argentina is the country with the largest number of disputes submitted at the International Centre for Settlement of Investment Disputes (ICSID), which is one of the World Bank’s agencies. According to the records of the United States Securities and Exchange Commission (SEC), 12 of these disputes were dismissed or the parties withdrew or abandoned the action after negotiating a private settlement with local authorities.
Table 3.2. Argentina, FDI – profits and dividends, in million US$, 1992-2001

<table>
<thead>
<tr>
<th>YEAR</th>
<th>FDI</th>
<th>Profits and Dividends</th>
<th>YEAR</th>
<th>FDI</th>
<th>Profits and Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>3265</td>
<td>924</td>
<td>2002</td>
<td>2776</td>
<td>230</td>
</tr>
<tr>
<td>1993</td>
<td>2088</td>
<td>1501</td>
<td>2003</td>
<td>878</td>
<td>633</td>
</tr>
<tr>
<td>1994</td>
<td>2622</td>
<td>1799</td>
<td>2004</td>
<td>3449</td>
<td>2286</td>
</tr>
<tr>
<td>1995</td>
<td>4112</td>
<td>2094</td>
<td>2005</td>
<td>3954</td>
<td>3895</td>
</tr>
<tr>
<td>1996</td>
<td>5348</td>
<td>2080</td>
<td>2006</td>
<td>3099</td>
<td>4939</td>
</tr>
<tr>
<td>1997</td>
<td>5507</td>
<td>1920</td>
<td>2007</td>
<td>4969</td>
<td>5241</td>
</tr>
<tr>
<td>1998</td>
<td>4965</td>
<td>2293</td>
<td>2008</td>
<td>8335</td>
<td>6094</td>
</tr>
<tr>
<td>1999</td>
<td>22257</td>
<td>1616</td>
<td>2009</td>
<td>3306</td>
<td>6627</td>
</tr>
<tr>
<td>2000</td>
<td>9517</td>
<td>1609</td>
<td>2010</td>
<td>6090</td>
<td>7159</td>
</tr>
<tr>
<td>2001</td>
<td>8005</td>
<td>258</td>
<td>2011</td>
<td>7183</td>
<td>7380</td>
</tr>
</tbody>
</table>


In contrast with the view that justified the introduction of a liberalized body of laws and the signing of BITs and DTAs, there has been a growing belief that the legislation in force in Argentina has served the opposite purpose to that it had been created for, along with a warning regarding other negative consequences of FDI when this is not part of an economic and social development strategy.26

3.4) Argentina and DTAs

The Argentine legislation adopted various criteria to determine the tax responsibility and linkage between national and foreign individuals and legal persons.
The source or territoriality criterion was used until 1992, when the situation changed dramatically with the introduction of the *residence* criterion into the legislation on income tax.27

26  De Lucchi, Juan Matías, Arceo Enrique (2012).
27  Law No.24,073 (Official Gazette dated April 13, 1992).
The old section 1 of the Income Tax Law established that all income obtained from an Argentine source by natural or legal persons, irrespective of their nationality, domicile or residence, was subject to this tax. With the passing of Law No. 24,073, the old section 1 was replaced by a new one, which in its first paragraph reads that “all income obtained by natural or legal persons is subject to the emergency tax established herein.” In its second paragraph, the Law highlights that the persons referred to in the previous paragraph who are residents in the country pay taxes on the total amount of income obtained in the country or abroad. Finally, the third paragraph states that non-residents pay taxes exclusively on their Argentine-sourced income. The income from a foreign source was left outside the purpose of the tax, and the method used was that of exemption, as only the income from an Argentine source was levied; however, at present, a mixed criterion is applied:

- On the one hand, the tax is levied on the income from Argentine and foreign sources obtained by the persons considered tax residents under the Law, and
- On the other hand, non-residents only pay taxes for the income earned from an Argentine source as set out in Section 5; as a result, the scope of the taxable income is broadened and consequently, tax collection increases.

The residence criterion was not actually applied until six years later, in 1998, when the concepts of resident, foreign source and tax credit for similar taxes paid abroad were introduced. It should be considered that the definition of these concepts is essential not only when enforcing a DTA but also to know what items are subject to taxation.

The Law currently in force defines a resident of Argentina for tax purposes in the following manner:

- An Argentine national, either native or naturalized, except for those who lost their resident status.
- Aliens who obtained their permanent residence status in the country or who have no such status but have legally been in the country for twelve months.

In the past century, as from the 1970s, Argentina signed 19 bilateral DTAs, of which only 14 are currently in force. These are the ones signed with Australia, Belgium, Bolivia, Brazil, Canada, Denmark, Finland, France, Germany, Great Britain, Italy, Netherlands, Norway and Sweden.
## Table 3.5. Argentina, DTAs in force.

<table>
<thead>
<tr>
<th>Country</th>
<th>Argentine Legislation</th>
<th>Effective As From</th>
<th>Taxes Covered</th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Law No.25,238</td>
<td>1999</td>
<td>Income</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Belgium</td>
<td>Law No.24,850</td>
<td>1997</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Bolivia</td>
<td>Law No.21,780</td>
<td>1978</td>
<td>Income and Property</td>
<td>State where the paying company resides</td>
<td>State where the credit is used</td>
<td>State where they are originated</td>
</tr>
<tr>
<td>Brazil</td>
<td>Law No.22,675</td>
<td>1982</td>
<td>Income</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Canada</td>
<td>Law No.24,398</td>
<td>1994</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Denmark</td>
<td>Law No.24,838</td>
<td>1997</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Finland</td>
<td>Law No.24,654</td>
<td>1996</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>France</td>
<td>Law No.22,357&lt;br&gt;Law No.26,276</td>
<td>1980</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Germany</td>
<td>Law No.22,025&lt;br&gt;Law No.25,332</td>
<td>1979</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Italy</td>
<td>Law No.22,747&lt;br&gt;Law No.25,396</td>
<td>1983</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Mexico</td>
<td>Law No.25,830</td>
<td>2004</td>
<td>Income</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Law No.24,933</td>
<td>1997</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Norway</td>
<td>Law No.25,461</td>
<td>2001</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Great Britain</td>
<td>Law No.24,727</td>
<td>1996</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Russia</td>
<td>Law No.26,185</td>
<td>2006</td>
<td>Income and Property</td>
<td>In both States</td>
<td>In both States</td>
<td>In both States</td>
</tr>
<tr>
<td>Sweden</td>
<td>Law No.24,795</td>
<td>1997</td>
<td>Income</td>
<td>State where the paying company resides</td>
<td>State where the paying company resides</td>
<td>In both States</td>
</tr>
</tbody>
</table>

Source: Federal Administration of Public Revenue (AFIP, by its Spanish acronym), April 2013
Among the DTAs signed by Argentina, two groups can be identified:  
• One comprises the agreements with Chile and Bolivia, which adopted the Andean Pact Model,\(^2\) comparable to the United Nations’ conception of giving priority to the source principle.  
• The other comprises the agreements signed with the rest of the countries, which adopt the OECD Model and apply the principle of residence to tax income and assets.

The main difference lies in the treatment granted to the income derived from the provision of personal services. The agreements with Bolivia and Chile, signed in the 1970s, set forth that irrespective of the nature of the income, revenues or profits (including those derived from real estate), the tax shall be applied only in the country where such income, revenues or profits have their source of production (save for a few exceptions identified in the agreement itself), regardless of the residence status of the persons and of the place where the contracts were entered into.

Regarding the Property Tax, it is recognized that assets will be taxed in the country where they are located.

The rest of the agreements signed by Argentina apply subjective criteria for the purpose of taxing income, usually granting a priority right to levy taxes on income in the source country, but sharing the total tax amount with the residence country of the income beneficiary, which is obviously more appealing for investing countries.

As for real property, the general rule is that the income earned by a resident of a contracting State from assets located in another contracting State may be levied by the latter.

The basic difference between DTAs lies in the range of persons they cover, the applicable jurisdiction or the chosen model convention:
• Limited to residents: Germany (1976), Brazil (1982), Great Britain (1997)
• Andean Pact Model: Bolivia (1979), Chile (1986).

\(^2\) Decision 40 of the Andean Pact
3.5) DTA Notices of Termination

In March 2011, the Argentine government decided to create a “Double Taxation Agreement Evaluation and Revision Commission” with the purpose of analyzing and evaluating the international double taxation agreements that were already in force or those expected to be signed by doing a “periodical follow-up of their tax implications and advising on their termination, renegotiation or continuation thereof, as appropriate.” Argentina issued a notice stating its intention to terminate its agreements with Austria (26/06/2008), Switzerland (16/01/2012), Chile and Spain (29/06/2012), as it considered that they created conditions for income tax avoidance and generated a significant fiscal cost for accrued but not collected taxes.

One of the main effects of the notice was the elimination of the Property Tax exemption. This tax began to be levied at the general applicable 0.5% annual rate.

In relation to the agreement with Chile, Argentina cited tax avoidance activities and referred to the use of “investment trusts” [sociedades plataforma] included in an agreement signed between the administrations of Eduardo Duhalde (Argentina) and Ricardo Lagos (Chile) in 2002, which exempted certain benefitted companies from paying taxes in both countries as they were considered non-residents. This situation was ironically called “double non-taxation.”

In challenging the agreements signed with Austria, Spain and Switzerland, the most frequently adduced reason was “treaty-shopping,” i.e. tax avoidance through the creation of companies in one of the contracting States in order to obtain tax benefits.

In 2002, at the peak of the breakdown of the Argentine economy, the property tax regime was changed: the tax was now also applicable to corporate shares and equity, and non-residents were thus subject to tax. This was because collecting this tax was highly complex and difficult to control for the national collection agency (AFIP) when Argentine corporations had foreign shareholders. Thus, the decision was made to apply this tax on the stock value of local companies (regardless of whether their shareholders were nationals or foreigners) at a 0.5% rate, and such companies were defined as “surrogate liable persons.”

Meanwhile, the DTAs signed during the booming period of the neoliberal...
strategy, together with privatizations, underpinned the assumption that the key to economic development was to encourage foreign investment by granting more incentives, including tax benefits. Thus, it was established that the residents of signatory States that were shareholders or partners of an Argentine company would not be required to pay property taxes for their holdings.

According to the investigation on the DTA with Spain conducted by the Double Taxation Agreement Evaluation and Revision Commission, the method used to avoid paying the property tax in Argentina was that of endorsing Argentine shareholders’ holdings through the so-called “Holding Companies” [Entidades de Tenencia de Valores Extranjeros – ETVEs, by their Spanish acronym]. This is a type of company allowed in Spain whose main purpose is to allow non-residents to channel and dilute the holding and management of equity in various entities. As ETVEs were granted certain tax privileges by the Spanish tax administration and were exempted from tax payments, they became tax avoidance vehicles.

Outstandingly, the abuse of the regime enabled by the double taxation agreement with Spain was no secret to anyone; on the contrary, it was blatantly promoted by large companies specializing in “tax planning” and openly presented and described in books by well-known experts and public courses. Among the companies that used this formula to avoid paying taxes, the “Commission” report mentioned companies such as the French corporation Danone, the US retailer Wal-Mart, the Chilean retailer Cencosud, the Brazilian oil company Petrobras, the car manufacturer General Motors, the Swiss cement company Holcim, the US chemical company Monsanto and large Argentine groups like the steel company Techint and the food company Aceitera General Deheza.

All of them declared their equity ownership through a holding company in order to channel their investments and operations in Argentina and be exempted from the tax in Argentina. This was combined with the advantages granted to Spanish companies with investments in the country; such was the case of Telefónica (telecommunications), Repsol (oil) and BBVA and Santander (banking).

Total tax avoidance by engineering through the DTA with Spain was estimated at over US$60 million only in 2011, which accounted for more than 8% of the annual revenue in that period from taxes on personal assets. In light of the findings of the ad hoc Commission, the Argentine government


31 Lukín, Tomás “Negocios Argentinos bajo Bandera Española” [“Argentine Business under the Spanish Flag”] - Página 12 newspaper, August 19, 2012.
tried to negotiate with the Spanish authorities the introduction of a provision into the 1994 DTA to prevent fraud, as the one included in the agreement with the USA, but the proposal was declined. Consequently, Argentina notified its decision to cancel the agreement in mid-2012 and on January 1, 2013 the agreement was effectively terminated.

In March 2013, the head of AFIP, Ricardo Echegaray, said that an understanding had been reached with Spain for the signing of a new DTA that would “restore the balance to prevent the agreement from being used abusively,” and that similar agreements were being negotiated with Austria and Switzerland. The new agreement with Spain, which would be retroactive to January 1, 2013, although it has to be approved by the National Congress, provides for a special “anti-abuse” memorandum whereby AFIP could refuse to grant the benefits available to ETVEs if the company fails to demonstrate that it is 100% Spanish-owned.

The urgency to move forward with the renegotiation of the terminated DTA at the beginning of the year came essentially from the Spanish side, because many Spanish companies that had significant investments in the country in the utilities sector (Telefónica – telephony, Iberdrola – electricity) and the banking sector (Santander and BBVA) were asking for a new agreement in order to reactivate some tax benefits in connection with royalty and interest payments. Without an agreement, they would have to pay a 35% income tax rate, but “the regulatory framework and the legal certainty” arising from the new agreement would allow them to cut that down to 15%.

In the case of Chile, the decision to terminate the DTA, which became effective on January 1, 2013, was also linked to the findings of the Commission. The mechanisms identified were different from those unveiled with respect to Spain. In this case, they had been supported by a change introduced in 2002 into the original 1976 Argentina-Chile DTA under the Duhalde administration. With this change, Chilean shareholders that owned Argentine corporations were granted the additional benefit of being exempted from paying property taxes in Argentina. This was a benefit that had also been included in the agreements terminated with Switzerland and Spain. Companies of different origin took advantage of this benefit to avoid paying this tax in Argentina and registered their investments as owned by a Chilean-based holding company. Some of the beneficiaries included the Canadian mining company Barrick Gold, the American companies General Motors and Procter & Gamble, Coca-Cola, and the large Argentine groups Pérez Companc and Arcor.

Another mechanism investigated by the Commission was the purchase of Chilean bonds and stock by Argentine investors to avoid not only the property tax but also, and more importantly, the income tax. In 2008, the authorities

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had already brought to light the purchase of Austrian bonds, which led Argentina to challenge the agreement with Austria. The termination of the DTA with Austria brought about a mass transfer of investors to Chile. All in all, around US$1 billion in investments were moved to Chile. Among the Argentine investors that bought Chilean securities were Aluar, the largest aluminum manufacturer in Argentina, the online sales company Mercado Libre and banks Macro and Patagonia.

According to Commission sources, in 2011 tax avoidance through tax engineering with Chile accounted for a US$75 million loss for the Argentine tax administration. Unlike the progress made with Spain, Austria and Switzerland towards the renegotiation of their DTAs, so far there have been no successful negotiations with Chile.

Finally, it is worth highlighting the significance of terminating the provisional DTA that Argentina had with the Swiss Confederation since 1997. Switzerland is a developed country whose legislation is particularly liberal with regard to financial transactions. There are several large Swiss companies operating in Argentina. The investigation revealed other illicit activities, such as the avoidance of income tax payment on royalties for the use and/or exploitation of copyrights, patents, trademarks or know-how by transferring them to Swiss subsidiaries (a clear example was that of the tobacco company Philip Morris) and, even more serious, the triangulation of foreign trade transactions among related companies by reporting more profits to the “buying” company, thus avoiding paying millions of dollars in income tax in Argentina. Given its tax advantages and its financial secrecy policy, Switzerland has been one of the countries most frequently used for the triangulation of offshore sales made by the main grain, mining, petroleum and oil trading companies of Argentina, which make unreal operational flows go through free economic zones (mostly through Uruguayan free economic zones).

The team of economic experts acknowledges that the figure is low when compared to the Income Tax amount evaded by large companies, but emphasizes that this is clear proof of the “impunity and obscenity with which large economic groups operate.”

At any rate, by narrowing down its perspective on DTAs, Argentina seems to be shifting its focus and limiting the scope of its international instruments to tax and customs information agreements, like the ones it has with Spain (customs, 2001 and taxation, 2004), Peru (customs and taxation, 2004), Brazil (customs and taxation, 2005), and Chile (exclusively customs, 2006), Monaco (2009), Italy (2010), China (2011), Ecuador (2011), Guernsey (2011), Jersey (2011), Bermuda (2011), San Marino (2012), Cayman Islands (2012), Costa Rica (2012), and Uruguay (2012). Additionally, it is in the process of formalizing agreements with India and Isle of Man.

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34 See detailed information in http://eoi-tax.org/jurisdictions/AR#agreements
3.6) Conclusions

I. As mentioned above, in recent years the Argentine government has begun to revise the agreements it has signed to avoid double taxation. The reports of cases related to the agreements signed with Austria, Chile and Spain led to the termination of those DTAs. It has not been made clear whether termination of other DTAs will follow or whether they will be replaced by another type of agreement (e.g. renegotiation with exemption elimination, use of the UN model, agreements limited to information exchange, etc.). Anyway, it may be assumed that, under the current administration, the agreements signed with other countries will continue to be terminated on the basis of the need to increase tax revenues and ensure more transparency and better control to prevent tax avoidance and evasion activities.

II. In Argentina, there are no information systems or publicly-funded and/or academic systematic research on the effects of DTAs on tax revenues (e.g. assessment of taxes accrued and collected with or without agreements, consistent tax evasion estimates, tracking and comparison of tax information and practices of the main multinational companies in various countries, little permanent exchange of information between tax agencies and signatory countries, etc.). There is still a prevailing political view, backed by the spokespeople of the economic and financial Establishment, that it is not advisable to make private information transparent and publicly available as this could be an inhibiting or discriminatory factor for investment decisions.

III. Tax evasion in Argentina has historically had enormous significance. As recently stated by AFIP Director Ricardo Echegaray: "We have all been cheating for 200 years. Tax evasion is a practice carried out not only by them. It also happens in large companies, which use tax havens to triangulate their transactions. This also happens in soccer, where commissions for player transfers are not declared."35 Although tax systems in Argentina and in other countries of the region have been improved and modernized, they still have a regressive architecture (larger incidence of indirect taxes: VAT, turnover tax, foreign trade, etc., and as for direct taxes: income tax, assets/property, etc. with a stronger impact on fixed-income sectors.)

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Chapter 3

IV. Argentina has implemented an exchange control system. Over the last period, exchange controls have tightened due to the growing concern for maintaining balanced external accounts without reducing Central Bank reserves. These restrictions have also brought about more maneuvering and less transparency. It is widely known that there are “parallel” markets: one for legal transactions and another for not allowed transactions, which are actually illegal but are used across the board, leading to tax evasion and capital flight. The president of the Financial Information Unit (UIF, by its Spanish acronym)—a government body responsible for controlling money laundering—has commented on this problem: “The richest portion of the society keeps its money outside the financial system and does not provide a clear explanation about the source of that money. This trend can only be reversed, in the short term, by reinforcing regulations governing foreign exchange transactions and, in the long term, by urging people to be aware of the implications of the crime of money laundering.”

V. Under existing legislation, the transfer of funds to and from Argentina must be made in accordance with Central Bank regulations. There are restrictions for transfers related to investments, interest payments and other transactions that require the use of foreign currency. Indeed, the Central Bank requires submitting certain documents in order to grant approval. Likewise, in order to prevent fund inflows from being used speculatively, 30% of such funds may be frozen in the form of a non-remunerated mandatory deposit (not accruing interest) for a year. This requirement is not applied to fixed asset and inventory investments. Residents (individuals or companies) outside the financial sector may have access to the exchange market to buy up to US$2 million a month.

VI. Argentine legislation provides for special tax incentives for certain activities such as mining, forestry, software production, biotechnology and biofuels. It should be noted that there is a “duty free” zone in Tierra del Fuego (an island in the southern tip of the country) that offers special incentives to some activities (e.g. electronics manufacturing) and free economic zones in different parts of the country, which are suspected of being home to non reported/parallel foreign trade and/or financial transactions with negative tax implications.

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38 See, for instance: “Argentina investiga evasión fiscal en comercialización ilegal de soja de USD .1.000
VII. Finally, a central issue whose debate is still pending in Argentina, though it has often been anticipated in recent years, is the implementation of a tax reform in line with the proclaimed objectives of strengthening economic growth and reversing the regressive dynamics of income distribution. Such reform should address improvements in tax collection capacity, the structural imbalance of the tax system and tax income distribution between the federal government and the provinces. From a social and political point of view, the specific open debate on the existing misstatements and maneuvers hidden in DTAs should not be separated from the general perspective of putting forward a much needed comprehensive and progressive tax reform.

VIII. As observed in other Latin American countries, there has been no significant debate in Argentina so far on the potential benefits and adverse effects of DTAs. This could be attributed to the fact that, in the last few years, the country has undergone a period of expansion with intense public economic activity backed and financed by high export prices, but, at the same time, it could also be due to the fact that the public opinion’s attention and the political debate have shifted towards other priority issues. This could change in the face of modifications at the national and international levels, especially when considering the huge size of capital flight in the last few years, which also hides behind a non registered economy and, therefore, one that evades taxes.


3.7) Recommendations and potential lines of action for national tax policy advocacy

I. Argentina has opened a new perspective for the analysis and debate of alternatives to DTAs. The decision made by the government to revise the existing agreements with the creation of the “Double Taxation Agreement Evaluation and Revision Commission” led to the investigation that brought about the termination of the DTAs with Chile and Spain. Still, despite its positive contribution to the investigation, the structure of the “Commission” is quite limited (a total of three officials, one for the Ministry of Economy, one for the Ministry of Foreign Affairs and another one for the Federal Administration of Public Revenue) and it has no participation and/or institutionalized relationship with other sectors of society (its sole responsibility is the submission of partial reports and one annual report, though it is not clear whether they will be made public). Social movements should demand more transparency and a formal channel for contributions, reports and proposals.

II. DTA revisions cannot be isolated from the more general need to debate on the continuity of BITs, the control of capital transactions and the revision of legislation on foreign investment, so as to move towards a comprehensive tax reform that reverses the country’s basically regressive structure, whose general architecture has been sustained with no changes since the neoliberal decade of 1990s.

III. The recent changes in the country’s economic and financial framework, which have prompted the introduction of controls on foreign currency transactions, have objectively created new conditions and demand paying more attention to the use of DTAs and other practices. Examples include the use of “tax havens” for the underbilling of exports and the overbilling of imports, and for “tax planning”; capital flight; and tax avoidance and evasion in light of the existence of an official exchange rate for established transactions (foreign trade, services and other payments) and an informal/parallel market that attracts speculative and/or illegal activities such as the underbilling of exports and the overbilling of imports.

IV. It is necessary to promote and coordinate positions and actions in Latin America centered on the demand for more information and tax and customs transparency in trade and financial transactions and operations. Various common initiatives should be analyzed:
i. Coordinating campaigns on the meaning of tax avoidance/evasion mechanisms and debates on and dissemination of specific cases,

ii. Linking the creation of alternative tax proposals with other social movements’ campaigns (debt audits, transparency and democratization of public administration, challenging of BITs, etc.) and with the broader debate on economic and regional complementarity models for regional integration,

iii. Studying the feasibility of putting forward a model customs and tax information agreement, with the support of social organizations, not only to offer an alternative tool in the event DTAs are cancelled, but also to overcome the major limits and restrictions to information transparency, and to detect maneuvering through the DTA models and information agreements in force today.
Bibliography


Double Taxation Agreements in Colombia

Analysis of the Links among Capital Flows, Taxes and Financing for Development

Christian Moreno

4.1) Introduction

Since the 1980s in the international economic scenario and since the 1990s in Latin America, there has been a proliferation of tax treaties to eliminate double taxation. Briefly and preliminarily defined, they are basically legal devices in the area of international taxation that ensure favorable environments for a more massive and profitable transnational flow of capitals, since they define a distribution of the tax burdens applied by the States (the parties to a treaty) that eliminates double taxation.

The historical sense of Double Taxation Agreements (DTAs) is determined by the dynamics of global political economy. The overaccumulation crisis experienced by the global economy since the early 1970s has been the turning point for an essential transformation in the trend of capital flows (productive, commercial and financial). The management of the crisis, that is, the creation of profitability spaces for the capital overaccumulated in developed
countries (as centers of capitalist activity), has implied a generalized process of structural reform in national economies (and particularly in the periphery), in view of their subjection to various forms of transnationalization, denationalization and privatization. The neoliberal project promotes the massive flow of capitals avid for profitability, through the dismantling of functions, rights and spaces of the Nation State, as well as the liberation and private appropriation of assets previously devalued or acquired at a very low cost. These transformations are expressed in trade liberalization and financial deregulation policies, as well as in the construction of more attractive environments for foreign direct investment (FDI). In the Latin American context, and in the specific area of fiscal policy and national tax scheme design, this is expressed in three related factors with a concrete and unique form in the case of Colombia, where the neoliberal project has advanced notoriously in various sectors of the national political economy.

In the first place, governments set out to restructure their tax revenues, dramatically reducing the importance of taxes applicable to international trade and attaching higher structural significance to the income tax (particularly in developed countries) and to the value added tax (especially in developing countries), thereby dismantling protectionist tax models related to (more or less) emerging national industrialization projects.

Second, the objective dependence on foreign investment and foreign trade flows, as a partial result of the (more or less) marked processes of deindustrialization and the strengthening of primary commodity export models and revenue-based models, has promoted fierce and generalized tax competition among developing economies to attract transnational investment flows to their territories, generating a decreasing trend in the rates applied on capital gains.

Finally, the increased mobility of capital worldwide and the geographical dispersion of production (with multinational companies that disseminate their subsidiaries), as well as the higher sophistication of the financial infrastructure, have created great difficulties for developing countries as to their need to record capital gains and levy taxes on them, given the generalized weakness of their Governments in terms of technical capability and the efficiency and transparency of their tax administration. This is translated into an inability to guarantee fair volumes of taxation on cross-border and national capital gains, and to levy taxes on the assets that owners residing in their territories maintain abroad. Capital flight and tax avoidance and evasion thus become chronic problems in developing economies.

All of these factors combined have led to a structural process of suffocation of an important component of the sources of tax revenues in developing countries (capital gains), which has shifted the tax burden to indirect taxes, and particularly to domestic consumption. This has consolidated regressive tax schemes, directly affecting social equity and the distribution of income and
wealth, and reducing the possibilities of public financing for social development. This is, precisely, the context for the recent proliferation of DTAs, and the issue, of course, is not the neoliberal nature of DTAs (which have existed worldwide since the early 20th century), but rather the significance they acquire in the context of the neoliberal project and the transformations that turn them (in specific settings and with more or less emphasis) into instruments for their expansion and development.

During the last decade in Colombia, a consistent set of institutional and legal policies and mechanisms has emerged that strongly promotes the growth of FDI and better conditions for its profitability. Indeed, in recent years there has been a proliferation of DTAs fully related to the economic activities that may be subjected to income tax; in the past, they were exclusively restricted to international maritime and air transportation companies. In the development of these agreements the Colombian government followed the model of the Organization for Economic Cooperation and Development (OECD), that is, the residence principle. Under these conditions, the execution of DTAs in Colombia is not only an integral part of its policy to attract FDI (by establishing lower levels of overall taxation on capital gains) but also, due to the country’s condition as a (net) importer of capital, a driver of a notorious imbalance in revenue distribution with governments whose economies export large volumes of capital to the country.

This paper consists of six sections. The first section is this introduction. The second section describes the recent transformations undergone by the national tax structure, and the third is a definition of the political economy of DTAs, according to the general progression of the neoliberal model in the country and the new trend of foreign investment in the last decade. The fourth section presents some institutional and legal aspects of the agreements, describes (through a matrix) those that are currently in force in Colombia, and elaborates on some ideas on the agreement with Spain. The fifth section describes the obstacles and opportunities posed by DTAs for inclusive, equitable and sustainable social development in the country, and presents sets of recommendations and lines of action. Finally, the last part presents the conclusions of the study.
4.2) Recent transformations of the national tax structure

The neoliberal project has advanced significantly in Colombia during the past three decades. The 1990s, in particular, represented a significant moment for commercial liberalization, privatization of state assets and financial deregulation, and the first decade of the 21st century was clearly marked by the growth of FDI, which has reached historical figures. In the same decade, the Government promoted free trade agreements (FTAs) and, recently, there has been an increase in the execution and negotiation of DTAs and Reciprocal Investment Promotion and Protection Agreements (APPRI, by its Spanish acronym). The general movement has strengthened a primary commodity export and revenue-based model, highly dependent on and exposed to transnational flows of productive, commercial and financial capital.

In such a context, the tax structure has undergone transformations, resulting in a greater trend towards regressiveness and, more specifically, towards the displacement of the tax burden from capital to labor, which is consistent with the general trend of neoliberalism towards a structural redistribution of wealth and income. These transformations (in various proportions and with different nuances) are part of three related processes that have developed in Latin America in recent decades, and are linked to the economic policies promoted by multilateral organizations headed by the IMF (Giraldo, 2008) (Giraldo, 2009).

In the first place, the participation of taxes in foreign trade (medium tariff level) has been reduced, in accordance with the context of liberalization and more international commercial competition. Second, direct taxes have become less progressive, particularly the income tax, through the reduction of caps on higher rates and the increase in lower rates, which make the differential considerably smaller, and the decrease in the taxation levels of capital gains. And, related to that, there is an upward trend in financial deregulation and the financialization of global economy, through the elimination or reduction of taxes on international financial transactions. Finally, (indirect) taxes on domestic consumption have become structurally more important, especially the value added tax (VAT)—introduced in Latin America in the 1980s to substitute for sales tax—, whose rate and taxable base have been increased. These taxes have thus become a main source of revenue for the central government41 (Giraldo, 2009, pages 167-168).

41 In Latin America, already in 1990, VAT (and equivalent taxes) were, as a percentage of GDP, almost three times the level of direct taxes (Giraldo, 2009, p. 168).
These transformations in the Latin American context were particularly obvious in Colombia. In recent decades there has been a deeper trend towards redefining the tax structure, by redistributing tax burdens while increasing and expanding their incidence. Thus, tax revenues of the Central National Government (CNG) increased from a little over 8% of GDP in the mid-1990s to almost 14% at the end of the first decade of the 21st century, displacing the burden, in particular, to indirect taxes, which now represent, on average, almost 60% of total revenues (20%, around US$7.4 billion in 2010\textsuperscript{42}, above indirect taxes).\textsuperscript{43} The higher increase in indirect tax revenues occurred even despite the decrease in taxes on foreign trade (also indirect) and in conjunction with the lower increase in the income tax. Tariffs accounted for slightly over 5% of revenues (CNG), whereas in 1994 they accounted for almost 11% and, as a percentage of GDP, they have stayed below 1% since then. Thus, the growth of indirect taxes became clear with the introduction of VAT, which accounted for a little over 2% of GDP in 1990 and reached over 6% in recent years. This growth was supported not only by the gradual increase of the general rate, which went up by 6% since its creation in 1986 at a 10% rate, but also by the constant growth in the taxable base, as a result of which only a few goods are excluded now and, in fact, certain food products (and goods) that are part of the basic food basket are taxed (at lower rates).\textsuperscript{44} On the other hand, the lower proportion of direct tax revenues is derived from the lower relative growth in income tax revenues. This trend may be observed despite the different dynamics of the last decade: the 30% rate in 1990 reached a maximum of 38.5% during the Uribe Administration as a result of the (10%) overcharge (temporarily) introduced to the already established 35% rate (which settled at 33% in 2008). These changes were combined with the (temporary) introduction of property tax, basically intended to finance the huge military spending.

The movement of the trend, that is, the increase in direct taxes, is not exclusive to Colombia; in Latin America as a whole, this situation is explained by two phenomena: on the one hand, the difficulties and fiscal pressures suffered by economies (in the case of Colombia, derived from spending on security and defense, and from public debt service, which account for almost half of the

\textsuperscript{42} The values –here and hereinafter– of equivalences between both currencies (Colombian peso and dollar) are estimated on the basis of the average exchange rate (for the respective year) calculated by the Banco de la República [Bank of the Republic].

\textsuperscript{43} Data based on statistics from official sources (DIAN—Colombian Tax and Customs Authority— and Ministry of Economy).

\textsuperscript{44} The diversity of VAT rates in Colombia has been a permanent target for criticism by the Colombian technocracy that describes it as an anti-technical tax structure (Clavijo, 2007): before the tax reform in 2012 there were seven different rates —from 1.6% for products in the basic food basket to 35% for luxury items,— which have now been reduced to only three (0%, 5% and 16%).
National Budget) and, on the other hand, the advent of alternative governments in the region (Giraldo, 2009, p. 172). However, in Colombia the return to the long-term trend is reflected in the substantial reduction established by the tax reform of the Santos Administration, bringing the rate down to 25%. While the Government itself has emphasized the neutrality of the reform (i.e. that it will not affect the general volume of revenues but only restructure them, it has recognized that the reduction will cost the country, only in 2013, around US$4.45 billion45 (Robledo, 2012).

Simultaneously with the trend described above, and particularly in the last decade, the Uribe administration designed a costly scheme of tax benefits (deductions, exemptions and special tax treatments), in the context of policies that privilege foreign investment as a source of economic growth.46 Income tax benefits include the following: an (initial) 40% deduction (that goes down to 30% with Law No. 1370 of 2009) in the payment of tax for the reinvestment of profits in real productive fixed assets, which, although eliminated as from 2011, was maintained for firms that had entered into legal stability contracts including the provision referring to the deduction; exempted income; and tax discounts.47 As another important component of tax incentives, the free economic zone regime imposes a 15% rate for income tax, among other provisions.

The fiscal cost48 of income tax-related benefits has been experiencing a rapid growth in recent years, from a total of US$914 million (in current values) in 2004, when the deduction for reinvestment of profits was introduced, to over US$4.48 billion in 2010, when that provision was removed. Throughout these seven years the cost amounted to almost US$19.4 billion, which accounted for almost one fourth of the (annual) National Budget. In the mining sector (the most dynamic sector in terms of FDI flows), this benefit has represented, on average, more than 30% of the annual fiscal cost associated with corporations (around 6 trillion for that period). Finally, despite the elimination of the deduction for reinvestment in 2011, the global fiscal cost for this year was almost 6 trillion, only 30% lower than the previous figure.

This policy along with the trend towards a reduction of tax rates have strongly contributed to a slower progression of the income tax in the country, and a

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45 Around eight trillion pesos.

46 “Colombian tax legislation contemplates several benefits that involve different economic purposes, among others, regional development, job creation, the promotion of some economic sectors, environmental protection and preservation, the encouragement of national or foreign investment and the promotion of exports.” (Ministry of Finance and Public Credit, 2012, p. 135)

47 Whereas the first two affect the taxpayer’s taxable base, the last one reduces the tax recognized directly.

48 “The fiscal cost is the revenue that is not perceived by the National Government as a result of any of the contemplated benefits. Thus, when calculating this cost, a determination is made of the tax value that would have been generated if the benefit had been part of the taxpayers’ taxable base”. (Ministry of Finance and Public Credit, 2012)
stronger regression of the tax regime. The burden has constantly moved to
domestic consumption, thus reducing the burden on capital. This is, undoubt-
edly, a condition that contributes to the marked level of income concentration
in the country. Fiscal policy, therefore, becomes a powerful instrument to
ensure the strengthening of the neoliberal model with the inequalities, inequi-
ties and poverty this implies.
In such a context, DTAs, which in the country have only started to extend
to income and property taxes in recent years, are part of the trend towards
the reduction of taxes on transnational capital (and the imbalance in revenue
distribution among States), and therefore towards the higher transnationaliza-
tion and exposure of the Colombian economy to foreign investment fl ows. It
is in this sense that they are closely related to the development of APPRIs and
investment chapters in FTAs.

4.3) The political economy of DTAs in Colombia

Until 2005, when a DTA was signed with Spain, the existence of these agree-
ments had been restricted to double taxation in the case of income of maritime
and air international transportation companies. At that time, treaties were in
force with four South American countries (Brazil, Argentina, Venezuela and
Chile), two European countries (Germany and Italy) and the United States.
The first comprehensive tax treaty was fi nally signed in 2005; it was glob-
ally applied on binational economic activities subject to income and property
taxes as defi ned by each State. The exception was the double taxation agree-
ment signed by the parties to the Andean Pact, which had, since 1971 (and
based on the source principle) strengthened economic relations with Ecuador,
Peru and Bolivia, and maintained a context of protectionist schemes and in-
dustrialization projects.
Currently, four comprehensive agreements remain in force with Spain, Chile,
Switzerland and Canada, and the Government (Uribe and Santos administra-
tions) has already made progress with new agreements with several European
and Asian countries. Given their specifi c character, these treaties are consis-
tent with the general progression of the neoliberal model in Colombia, which
in the early 21st century translated into new forms and processes of transna-
tionalization and denationalization.
Among other dimensions of its political and economic project, and under the
principle of investor confi dence, the Uribe administration promoted a redefi-
nition of the environment for foreign investment as a condition for vigorous
and sustained economic growth. This implied taking measures in the field of economic policy, institutional designs and the legal system, as well as in relation to security policy, along with the need to strengthen the political-military control of spaces and territories that were important for economic activity. In fact, and as shown in Figures 4.1 and 4.2, FDI has increased substantially in recent years, reaching historical levels; its annual evolution reveals, besides recent crises in the national and global economy—in the late 1990s and since 2008—, the trend towards reaching increasingly higher results: whereas in 1997 the total value of FDI accounted for 5.2% of GDP in Colombia, in 2005 it reached a historical high of 8.3%; in absolute (and current) terms this represents US$5.56 and US$10.25 billion, respectively.49 While between 1994 and 2002 investment represented, on average, 2.7% of GDP, from 2003 the average increased to 4.2%.

**Figure 4.1. FDI as a percentage of GDP (1994-2011)**

![Graph showing FDI as a percentage of GDP (1994-2011)]

*Source: Prepared by the author based on statistics from the Banco de la República [Bank of the Republic].*

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49 Of course, this behavior is mainly explained by the flows directed to the oil sector, which, in recent years, have come to represent more than half the total investment. This condition is a central element in the trend towards the strengthening of a primary commodity export economic model, based on mining, oil and raw materials for the agribusiness.

50 While in the 1990s the investment flow was largely explained by the privatization processes in progress, in the first decade of the 21st century the reason has been the dynamism of FDI, particularly in the energy and mining sectors.
In its first National Development Plan (PND, by its Spanish acronym), the Uribe administration emphasized its intention of strengthening and deepening strategic bilateral relationships, in order to promote investment in the private sector and further the development of public investment programs of the National Government and territorial entities (DNP, 2003, p. 95). In the second document, PND 2006-2010, we find an explicit reference to DTAs: in the context of the measures for the generation of an environment of legal stability for investment, it refers to the signing of agreements for the prevention of double taxation, together with agreements for the promotion of investments (DNP, 2007, p. 245). The Santos administration, on the other hand, in the context of the measures for the country’s integration into international markets, included the implementation of a strategic agenda for the negotiation of international investment agreements and DTAs, emphasizing their ability to generate favorable legal conditions; and although they were included in the same agenda as APPRIs, the Government highlighted the independent consideration and progress of DTA negotiations (DNP, 2011, pp. 514-515).

A breakdown of (non-oil) investment per country of origin reveals an alarming fact, which has been only sparsely discussed in the context of national public opinion and academia: a high percentage of the flows comes from tax havens.

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51 “FDI in Colombia” refers to direct investment by foreigners in Colombia; “FDI from Colombia” refers to direct investment by Colombia in other countries.

52 In the case of Colombian investment abroad, whereas in 2010 the value is mainly explained by investment in oil, mines and quarries, in 2011 the highest proportion derives from financial and corporate services.

53 The statistics presented by the Banco de la República [Bank of the Republic] classify only non-oil investment per country of origin.

54 Although formally some of these countries are no longer considered tax havens (in real or nominal terms), here we consider their past condition and the aspects by which they are still considered close to such definition.
The information contained in Figures 4.3 and 4.4 is an average of the annual value of investment in the seven years between 2005 and 2011. It can be seen that (out of the seven tax havens that appear in the first Figure) Anguilla, Panama and the Virgin Islands rank third, fourth and eighth in terms of investment volume. Thus, overall, FDI coming from tax havens accounts for 31% of total flows. Although this fact requires more in-depth research in order to make strong statements—which is beyond the purpose of this paper—, at first sight attention should be given to the possibility that these places might be settings for tax avoidance and evasion through the manipulation of transfer prices or the tax planning implemented by multinational corporations.

Figure 4.3. (Non-oil) FDI per country of origin (average 2005-2011)

Source: Prepared by the author based on statistics from the Banco de la República [Bank of the Republic].

Figure 4.4. (Non-oil) FDI from tax havens (average 2005-2011)

Source: Prepared by the author based on statistics from the Banco de la República [Bank of the Republic]
The sharp increase in investment and its structural significance within the country’s economic model is, then, the factor that explains the recent proliferation of DTAs. Although the agreements are far from being a condition for investment, there is no question about their importance as a component of the policies to promote foreign investment, together with APPRIs and FTAs, and as a step in the definition of optimum environments for bilateral investment and trade relationships.

As evidenced in the case of the four countries with which comprehensive agreements have been signed, i.e. Spain, Chile, Switzerland and Canada, the existence of one or both types of agreement (APPRi or FTA) has preceded the entry into force of DTAs. As a whole, the trend has rapidly and remarkably made investment more dynamic and massive: considering the limited data (since investment directed to the oil sector is not classified), in 2011 FDI flows coming from Spain (US$732 million), Chile (US$651 million), Canada (US$173 million) and Switzerland (US$107 million) reached the highest level since the beginning of the 21st century,55 the peak being particularly high compared to previous years in the case of Chile and Switzerland (Spain has maintained significant levels of investment throughout the analyzed period).

4.4) Specificities of DTAs in Colombia

Institutional and Legal Aspects of DTAs

Within the recent trend towards the execution of DTAs to support the significant growth of foreign investment flows, the Uribe administration opted for the basic structure of the OECD Model Tax Convention, although superficially UN Model guidelines have been included according to the particularities of domestic legislation. These agreements have been recognized as important tools to distribute the taxing power among signatory States, as well as instruments for international cooperation in the fight against tax evasion and fraud (DIAN, 2010).

The following are some characteristics of this Model that are relevant for the Colombian case, which have determined the position and specific measures included in the DTAs negotiated and executed so far, as well as related internal legal aspects.

55 Canada (without a DTA, since the first came into force only in 2012) also showed a historical level of investment for 2011, with US$174 million (0.32 trillion). Note that the maximum level was observed in 2000, when investment reached US$664 million.
In the first place, as legal acts executed by subjects of international law, that is, the States, tax treaties are guided by the general principles of international law. These are, among others, the principles of *pacta sunt servanda*, *negative effect*, *non aggravation*, *non discrimination* and *privacy*. The general rules for the interpretation of the treaties in the country are those defined by the Vienna Convention (Law No. 32 of 1985); however, the comments established by the OECD in that respect are taken as an *auxiliary criterion* for interpretation.

In order to enter into force, DTAs must follow a series of legal steps through the three branches of power, given their condition of international treaties. First, the President enters into the agreement, which is then presented to Congress and follows an internal procedure that is concluded with its approval. Next, the agreement goes back to the Executive, where it is enacted in the form of a law. Afterwards, the law goes through judicial review by the Court, and finally notice is served by diplomatic means, which marks the entry into force.

In general terms, the treaties make reference to income and property taxes; in the specific case of Colombia, this includes occasional gains and remittances, besides the industry and trade tax\(^{56}\) (Romero, 2005, p. 101). With reference to the latter, however, very few Colombian municipalities have defined collection procedures for activities conducted by foreign agents; therefore, those without a domicile in the country are not subject to the tax. Note that in Colombia, under the Constitution, territorial taxes can not be put at risk by a treaty.

Depending on the adopted profile, the rules for the distribution of the taxing power are defined according to the types of income. They are grouped as follows: some are exclusively taxed by the State of residence, others are taxed in a simultaneous-shared manner and others are taxed simultaneously and without limits by both States (residence and source).

The first group includes the income generated by the operation of vessels or aircraft in international maritime and air transportation, including income generated by activities like chartering or leasing of vessels and containers (among others), even if the transportation company (from the State of residence) has a permanent office in another State (source), since in this case the definition of a permanent establishment becomes irrelevant.

The second group contains income in the form of dividends, interest and royalties. In this case, taxation is shared, being limited for the source State (a maximum rate is imposed). Dividends are defined as income from shares of stock (except those related to credit) that entitle holders to a share in the profits of a company. For this income, domestic legislation establishes an *integrated system* that taxes profits and dividends at a general rate of 25%, considering the following situations: if the profits (of the company) have already been taxed, the corresponding dividends paid to stockholders are considered

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56 This is a municipal tax calculated on revenue, with rates that range between 0.3% and 1.1%, and it cannot be deducted from income tax.
neither income nor occasional gain; otherwise, the stockholders are taxed on the dividends they receive.\textsuperscript{57,58} Finally, the last group includes the income and capital gains from real property. Although the OECD Model does not define the concept explicitly (leaving it to be defined by domestic legislation), it makes reference to certain property that must be included: appurtenances to real property; cattle and equipment used in farming and forestry activities, and (among others) the right to receive payments for the exploitation of mine fields and other natural resources. In this case, both contracting States retain the right to levy taxes without limits, which in the case of Colombia implies a rate of 25%. Thus, this type of property would not present any problem in the negotiation of an agreement (Romero, 2005, p. 104).

As mentioned above, the definition of the concept of permanent establishment is crucial in the negotiation of the agreements. The dispute focuses specifically on the level of flexibility or restriction to define the conditions to qualify (or not) as a permanent establishment. However, the country’s tax legislation does not include a detailed definition and it is the Code of Commerce which defines a similar notion when it establishes that it is mandatory for foreign companies with \textit{permanent activities} in the country to register a branch in Colombia in order to operate within its territory. The concept of \textit{activities} includes the opening of business offices (a fixed place of business) and the function of contractor in the development of works and the provision of services. Although there is no explicit reference to the length of the \textit{permanence}, it is presumed to be six months, since that is the period required to acquire resident status (Romero, 2005, p. 105). Since the double taxation agreement of the Andean Pact does not include this either, the DTA signed with Spain (based, in this respect, on the UN model: six months) has become a benchmark on this issue.

Since the definition of the concept of permanent establishment implies a restriction of the source country’s right to levy taxes, this is a critical point: to the extent that another State imposes taxes at lower rates than Colombia, foreign companies will strive to prove that their presence is temporary or preparatory in order to avoid the payment of taxes. Therefore, the execution of DTAs, besides reinforcing the exchange of information, should be accompanied by a strengthening of the Colombian authority’s administrative and technical capabilities in the identification of permanent establishments, so that they are subject to relevant taxation.

\textsuperscript{57} This differs from the classical system, under which the corporation is taxed on its profits and the stockholders on the dividends they receive.

\textsuperscript{58} However, this situation implies a critical aspect to the extent that, when the tax that would be applied to the company is transferred to the stockholder, the rate limitation provisions established in the agreements (which provisions are traditionally agreed by Colombia, given its preference for the OECD Model) would seriously endanger global taxation (company and stockholder) in the country (DIAN, 2010, pp. 22-23).
DTAs in force and in preparation

Below are two matrixes: the first one shows the chronology of the DTAs that are currently in force in Colombia (from the latest to the first to enter into force); the second shows DTAs that are about to enter into force, whether they are in the negotiation stage (which concludes with the signing of the agreement) or in the subsequent process (the approval phases within each State). In each case the existence of APPRIs and investment chapters in FTAs related thereto is mentioned.

Table 4.1. DTAs in force in Colombia

<table>
<thead>
<tr>
<th>Country</th>
<th>Chronology⁵⁹</th>
<th>Taxes⁶⁰</th>
<th>Economic activities</th>
<th>Related agreements⁶¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Switzerland</td>
<td>AD: 2007/10/26; L: 1344 (09/07/31); J: C-460 (10/06/16); E: 2011/07/13</td>
<td>[Convention: to avoid DT]; Taxes on income and property.</td>
<td>Comprehensive</td>
<td>&gt;2010: FTA-EFTA (Switzerland and Liechtenstein) – Investment Chapter (V). &gt;2009: APPRI.</td>
</tr>
<tr>
<td>Chile</td>
<td>AD: 2007/04/19; L: 1261 (08/12/23); J: C-577 (09/08/29); E: 2009/12/22; EO: 586 (10/02/24)</td>
<td>[Convention: to avoid DT, to prevent tax evasion]; Taxes on income and property.</td>
<td>Comprehensive</td>
<td>&gt;2009: FTA – Investment Chapter (IX).</td>
</tr>
<tr>
<td>Panama</td>
<td>AD: 2007/04/13; L: 1265 (08/12/26); J: C-466 (09/07/15); E: 2009/11/23; EO: 430 (10/02/08)</td>
<td>[Convention: to avoid DT]; Taxes on business activities.</td>
<td>Operation of aircraft in international air transportation.</td>
<td>&gt;Under negotiation: FTA.</td>
</tr>
<tr>
<td></td>
<td>AD: 1970/03/19; L: 21 (72/12/30); E: 1978/02/01; EO: 866 (86/03/14)</td>
<td>[Convention: to avoid DT]; Taxes on income and capital.</td>
<td>Maritime and air navigation companies.</td>
<td></td>
</tr>
</tbody>
</table>

⁵⁹ AD: adoption; L: Law; J: Judgment; E: Effective date; EO: Executive Order.

⁶⁰ The information in this column reproduces, literally, the expressions contained in the text of the agreements. The information between parentheses refers to how the treaty is defined (convention or agreement) and its purposes.

⁶¹ The year refers to the year in which the agreements entered into force.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>05/03/31 1082 (06/07/31) C-383 (08/04/23) 2008/10/23 4299 (08/11/13)</td>
<td>Taxes on income and property.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>71/06/28 71 (93/08/30) 2006/08/17 935 (08/03/31)</td>
<td>Agreement: exemption from DT</td>
<td>Maritime and air navigation companies.</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>79/12/21 14 (81/01/19) 1987/10/09 119 (92/01/22)</td>
<td>Convention: to avoid DT</td>
<td>Maritime and air navigation.</td>
<td></td>
</tr>
<tr>
<td>Andean Community</td>
<td>Decision 578 (2004/05/04)</td>
<td>Convention: to avoid DT, to prevent tax evasion</td>
<td>Comprehensive</td>
<td>&gt;FTA &gt;2010: APPRI (Peru).</td>
</tr>
<tr>
<td>Venezuela</td>
<td>1975/11/22</td>
<td>Convention: to regulate taxation</td>
<td>Investment by the government and international transportation companies.</td>
<td>&gt;Signed: FTA</td>
</tr>
<tr>
<td>Germany</td>
<td>65/09/10 16 (70/12/15) 1971/06/14 85/06/14? 2584 (85/09/09)</td>
<td>Convention: to avoid DT</td>
<td>Maritime and air navigation companies.</td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>1987/10/16 4 (88/01/05) 1988/01/29</td>
<td>Exchange of Notes constituting an Agreement: exemption from DT</td>
<td>Vessel and aircraft operation.</td>
<td>&gt;2012: FTA – Investment Chapter (X).</td>
</tr>
<tr>
<td></td>
<td>61/08/01 124 (61/11/28) 1961/12/11</td>
<td>Exchange of Notes constituting an Agreement: exemption from DT</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Prepared by the author based on official websites and review of media articles.
Table 4.2. DTAs about to enter into force

<table>
<thead>
<tr>
<th>Country</th>
<th>Status</th>
<th>Related agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>Under negotiation</td>
<td>&gt;2012: FTA – Investment Chapter (X).</td>
</tr>
<tr>
<td>EUROPE</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>Under negotiation</td>
<td>-</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Under negotiation</td>
<td>&gt;Signed: APPRI.</td>
</tr>
<tr>
<td>France</td>
<td>Signed</td>
<td>&gt;Under negotiation: APPRI.</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Under negotiation</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>Under negotiation</td>
<td>-</td>
</tr>
<tr>
<td>Portugal</td>
<td>Signed</td>
<td>-</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Signed</td>
<td>-</td>
</tr>
<tr>
<td>ASIA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>Under negotiation</td>
<td>&gt;Under negotiation: FTA / &gt;2012: APPRI.</td>
</tr>
<tr>
<td>India</td>
<td>Signed</td>
<td>&gt;2012: APPRI.</td>
</tr>
<tr>
<td>Japan</td>
<td>Under negotiation</td>
<td>&gt;Under negotiation: FTA / &gt;Signed: APPRI.</td>
</tr>
<tr>
<td>South Korea</td>
<td>Signed</td>
<td>&gt;Signed: FTA / &gt;Signed: APPRI.</td>
</tr>
</tbody>
</table>

Source: Prepared by the author based on official websites and review of media articles.

The DTA with Spain

As mentioned above, the DTA with Spain was the first comprehensive agreement\(^{62}\) in the country. The process for its adoption (that is, the negotiation between both governments to define the text of the convention) was concluded on March 31, 2005 and the DTA entered into force on October 23, 2008.\(^{63}\) Based on the OECD Model, the treaty has become a benchmark for the country’s international tax policy; President Uribe himself described it as a “precedent to be replicated with other nations” (Romero, 2005, p. 81). However, this does not seem to be a good example to follow: the Agreement with Spain is said to cost the country almost one trillion pesos (around US$556 million) per year (Ángel C. Cabrera, Member of Congress for Bogotá, Party of the U),

\(^{62}\) In the case of Spain, the agreement contemplates the tax on the income of individuals, companies, the income of non-residents, property and local taxes on income and property; in the case of Colombia, it makes reference to tax on income and complementary taxes, and taxes on property (Article 2 of the Convention).

\(^{63}\) This date applies, in particular, for aspects such as the exchange of information and the system of withholdings at source (for instance), but not for the case of taxes on income and property, whose provisions became effective as from the first day of the following year (2009).
and the former Minister of Finance, Juan C. Echeverry, recognized the high costs it generated, as well as the need for a renegotiation to correct deficiencies (El Espectador, 2012).

This DTA represents the development of a new phase in the penetration of Spanish investment in Colombia, which has been historically important with a record high of US$1.27 billion (of non-oil investment) in 1997\(^64\), and a recovery since 2005 following the crisis in the late 1990s, reaching US$733 million in 2011. The number of Spanish companies in the country has risen to almost 300, including the recent intensification in the arrival of small and medium enterprises (El Espectador, 2012), which have focused on the sectors of services, energy production and information and communication technologies (El Tiempo, 2012).

Specifically, a big concession by Colombia in favor of Spain refers to the provisions on dividends transferred abroad: the tax rate was substantially reduced and brought down to 0% for cases in which the (Spanish) company that receives the repatriated dividends holds 20% or more of the total capital of the (Colombian) company that pays them, and to 5% for other cases (Article 10 of the Convention). Another critical aspect makes reference to the fact that the Agreement does not include mechanisms to avoid the annulment of tax benefits (this is typical in negotiations that follow the OECD Model). Despite the controversial policy that has been developed in the country in this respect, the absence of this issue in the treaty implies that the incentives designed for foreign investment are not enjoyed by private investors (that is, they do not become effective incentives for investment), but are rather absorbed by the State of residence\(^65\) (Romero, 2005, pp. 99-100). It remains to be seen whether the plan for the short or medium term is to dismantle the incentive scheme in order to justify this absence, but anyway the costs are significant and waiving is evident.

Regarding the exchange of information between tax authorities, a positive aspect of the treaty—quite common in negotiations between States—is the fact that banking confidentiality is expressly removed. Less positive is the issue of assistance in tax collection since, although it is included (as it was in the Andean Community treaty, Decision 578 of 2004), the development of instruments and procedures is not sufficient for its effective implementation (Romero, 2005). On the other hand, with reference to permanent establishment, the Agreement deviates from the OECD Model, since the period for recognition (of a work or a construction or installation project) is six months, as established in the UN Model.

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\(^{64}\) That was the year of the privatization of Empresa de Electricidad de Bogotá [Bogotá Electricity Company, EEB by its Spanish acronym], with a transaction of around US$2.17 billion.

\(^{65}\) To the extent that the tax benefits are not recognized, the discount applied (in Colombia) on the payment of income tax is not considered a part of the tax credit granted by the other State (Spain), which simply considers the difference between the rate effectively paid (in Colombia) and its own rate.
Amidst the deficiencies of the Agreement, and the waivers and concessions, it has been stated that we are facing the third Spanish business wave in Colombia, and the Spanish government has reiterated its interest in increasing the investment volume, even in the context of the deep crisis their economy is going through (El Espectador, 2012). The threat for the national interest is evident if the DTA with Spain becomes a benchmark to be imitated with other countries.

4.5) DTAs as an obstacle and an opportunity for development

When DTAs are signed between States with similar economies as to size and composition (and the way they relate to the global economy), their negotiation and effective existence does not represent an issue for the global distribution of the taxing power. However, when the differences are big, the execution of the agreements may be highly controversial, since it may give way to marked imbalances in the distribution of tax revenues between the States. This, of course, has perverse consequences for developing countries like Colombia, which, despite high (and structural) fiscal deficits and the weakness of public revenues and their regressive structure that limits the already fragile ability to finance (inclusive and equitable) social development, end up giving away (through consent and coercion) important resources under the pretext of the higher dynamism and better local economic performance that is generated by the growth in international capital flows.

To the extent that a country like Colombia, a net importer of capital (as clearly shown in Figure 4.2), has defined its preference for the OECD Model as the base structure for DTAs, significant potential fiscal resources are being sacrificed,66 allowing capital gains to be repatriated at low or zero rates. This contributes to the encroachment of an important component of the national taxable base (capital gains), which is countered by a higher burden on domestic consumption and the strengthening of a highly regressive national tax structure and a negative and degraded socioeconomic outlook. All of this is justified by invoking the argument of the need to strengthen a favorable environment for foreign investment, so that it may contribute to economic growth and development.

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66 Even before the execution of comprehensive DTAs, this sacrifice was observed in the agreements referring to international transportation companies, to the extent that they were based on the OECD Model, which supports the exclusive and full application of the residence principle for this case.
However, the characteristics that foreign investment has acquired in Colombia, particularly focused on the mining-energy sector, do not seem to give way to an offset of unilateral tax concessions and losses in tax revenues. It is an essentially capital-intensive rather than labor-intensive investment and, therefore, job creation (as well as technology transfer) processes are quite limited. Besides, the short reach of the links established with other sectors of the local economy helps create prospects for extractive and enclave dynamics, with an economic model that strengthens its primary commodity export character, highly dependent on the dynamics of demand and the prices defined in global commodity markets.

While the economy reached historical growth levels in the early 21st century (almost 7% in 2007), unemployment and income concentration rates are the highest in the last decades. Therefore, the design of the tax incentive regime to attract foreign investment into the country (including tax treaties) with the alleged benefits of higher growth and development is far from outweighing its huge and multidimensional (i.e. beyond the economic-monetary aspects) social costs.

However, despite the power asymmetries among types of States and regions of the world, and the conditions imposed by the socioeconomic model that prevails in the country, under a different perspective DTAs might be not only a means for building equitable and respectful economic relations with other countries but also a powerful instrument for international cooperation in the field of tax evasion prevention, through the effective exchange of information and reciprocal assistance in tax collection, against banking confidentiality and secrecy, and tax planning conducted by multinational companies.

Next, and as a conclusion for this section, comes a set of recommendations and lines of action that should guide the direction not only of the revision, evaluation and revaluation of existing DTAs and the development of future negotiations but also of the design of forms of advocacy by civil society organizations on public policies and political decisions related to tax issues and problems. Consideration is given to specific issues with reference to the treaties, as well as general matters of tax and fiscal policy, to the extent that the changes required in the approach to DTAs in the country are part of more general transformations that involve the economic model itself and the need to democratize it.

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67 While the mining sector accounts for almost 9% of GDP in Colombia, its share in the (direct) generation of employment is under 2%.

68 In Colombia, the unemployment rate has always remained above 10% (20% in 2000), at least during the past fifteen years. On the other hand, the Gini index, as an expression of the concentration of income, has been growing since the 1980s from levels just above 0.40 to almost 0.60 in the late 2000s.
About tax policy in general
1. Tax and fiscal policies in the country should become essential instruments for income and wealth redistribution and financing of development and social infrastructures, and not vehicles for higher levels of concentration, inequality, inequity and regressiveness.
2. It is vitally important that the tax and fiscal policy be analyzed, evaluated and designed from a gender perspective in order to differentiate their impact on men and women.
3. The Government should ensure conditions of transparency and access to national fiscal and tax information as a requirement for effective monitoring and evaluation by civil society and its organizational forms.

About international tax policy in particular
1. It is essential for Colombia to carefully and conscientiously define an international tax policy, considering the country’s condition as a net importer of capitals, the weakness of public finance and the current regressiveness of the tax structure. This implies academic and technical training processes for the institutions and teams in charge of the negotiation, in order to keep up with the preparation and significance assigned by other countries to this issue.
2. The inconvenience of uncritically accepting the OECD Model, as well as the contradictions it poses for the public interest of a developing country like Colombia should be acknowledged. OECD developments should be taken into account for the so-called best practices in the fields of transfer pricing, harmful fiscal competition, transparency, and the automatic exchange of information, but considering their insufficiencies, weaknesses and suitability for the Colombian case.
3. The paragraph above should lead to the recognition of the significance and convenience of the UN model. It is very important to (critically) undertake the task of drafting recommendations and standards on issues such as permanent establishment, the fight against capital flight, tax evasion and avoidance, international cooperation in fiscal areas and the strengthening of tax administrations in developing countries.
4. In the case of Colombia, given the technical and technological weaknesses of the tax administration, it is necessary to promote relevant changes and improvements in order to be prepared to ensure mutual cooperation in tax issues and problems.
5. Effective governmental technical devices should be established for the calculation of the fiscal cost, not only of the benefits on income tax, as is presently the case, but also of the investment and trade-related agreements and of DTAs.
About DTAs
1. It is necessary to promote and enforce domestic regulations (a law) with reference to the negotiation and execution of DTAs with other countries, defining principles and procedures, as well as a negotiation framework supported by the expertise of the teams in charge, to give this topic the formality and significance it deserves.
2. Colombia should have a statistical analysis and information system to determine the fiscal costs and consequences of existing and future tax treaties (and, in general, of all treaties and agreements on trade and investment), as a condition for their evaluation.
3. DTAs should be submitted to regular evaluations and revisions, in order to redefine inconvenient situations generated in their development, or to include temporary provisions to be applied whenever certain expected situations or adverse changes occur.
4. If the Government intends to consolidate the current tax benefit scheme, it should at least establish mechanisms to prevent their removal in the context of the agreements.

About the role of civil society
1. It is vitally important, in order to ensure the achievement of proposed transformations and changes, to promote the active participation of civil society and their organizations in educational processes on the issues and problems of taxation, tax policy and tax justice, among others, which lead to a full exercise of citizenship.
2. Civil society organizations play a central role in promoting the development of political and economic debate on international taxation in the country, and widely disseminating the topic among citizens, public opinion and at an institutional level.
3. Civil society organizations should devise national public policy advocacy projects in order to channel citizens’ pressure in favor of a progressive and fair national and international tax policy.

4.6) Conclusions

A clear illustration of the recent advancement of the neoliberal project in Colombia has been the significant momentum given to the execution of free trade agreements, agreements on reciprocal promotion and protection of investments and double taxation agreements. In relation to the latter, four
comprehensive agreements are in force with Spain, Chile, Switzerland and Canada, and the Government (Uribe and Santos administrations) has already made progress in the execution of new agreements with several European and Asian countries.

Given the purpose and the context for the development of Double Taxation Agreements (DTAs), such agreements pose a significant threat to sustaining financing for development and social infrastructures over time. And this is due, in many cases, to the inequitable distribution of revenues, the technical inability of the fiscal administration to ensure the effective enforcement of the agreed-upon provisions, and the possible association of DTAs with some grey areas related with capital accumulation, such as tax havens and aggressive tax avoidance efforts by multinational corporations. It is an alarming fact that one out of three dollars that flow into the country as foreign direct investment comes from tax havens.

The focus on productive efficiency and growth as a univocal road to further economic development has intended to downgrade and discredit the significance of public finance and national tax revenues for the financing of a sustainable and inclusive development model. Thus, they have justified the reduction of capital gains taxes as well as the transfer of the tax burden to domestic consumption. This has led to a more regressive fiscal policy in the region—a factor that increases inequalities and inequities.

To the extent that a country like Colombia, a net importer of capital has defined its preference for the OECD Model as the base structure for existing and future DTAs, significant potential fiscal resources are being sacrificed, allowing capital gains to be repatriated at low or zero rates. This contributes to the encroachment of an important component of the national taxable base, i.e. capital gains.

DTAs are part of a generalized trend towards the erosion of revenues from capital gains. As explained in this chapter, the revenue that the Central National Government does not collect as a result of the tax benefits on income tax (free economic zones excluded) amounts to the huge figure of US$19.4 billion for the period 2004-2010. Despite the tough social and economic times experienced by the country, policy design sacrifices very important tax resources, which are not offset by the increased economic growth that is claimed.

Under a different perspective, DTAs might be not only a means for building equitable and respectful economic relations with other countries but also a powerful instrument for international cooperation in the field of tax evasion prevention, through the effective exchange of information and reciprocal assistance in tax collection, against banking confidentiality and secrecy.

The country’s tax and fiscal policies should become essential instruments for income and wealth redistribution and financing for development and social infrastructures, and not vehicles for higher levels of concentration and exclusion that lead to more social conflict. However, the generation of changes and transformations requires the full exercise of citizenship in the area of national
oversight of issues and problems related to taxation, tax policy and tax justice. This implies ensuring the conditions of transparency and access to information, and participation in the preparation of public budgets, as a condition for the development of effective monitoring and evaluation by civil society and its organizational forms and for building truly fair and democratic tax systems.

It is vitally important that the tax and fiscal policy be analyzed, evaluated and designed from a gender perspective that differentiates their impact on men and women, turning them into tools to strengthen gender equality and to overcome the various inequalities caused, among others, by the tax and fiscal policy, with consequences that are not only monetary-economic but also multidimensional.

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Press Articles


Double Taxation Agreements in Ecuador

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Fausto García Balda

Coordination
Juan Carlos Campuzano

5.1) Introduction

In the field of taxation, globalization has led to some bad practices in taxpayers, such as offshoring of taxable bases to jurisdictions with low or no taxation; on the other hand, it has brought about double taxation for them, particularly in investments. Countries rely on two basic principles for tax allocation: the personalistic or residence principle and the territorial principle. Developing or capital-importing countries are more prone to applying the territorial principle, also known as the source or origin principle. *This criterion states that the country to be taxed is that where the source of production of income is located, that is to say, the country where the source’s funds are generated. It may be the place where goods are located or where taxpayers carry out their productive activity, completely irrespective of domicile, residence or nationality.* (Villegas, 2003: 615) On the other hand, developed or capital-exporting countries prefer the personalistic or residence principle in order to collect higher tax revenues.
There are several alternatives to address the double taxation issue: unilateral measures, bilateral measures and multilateral measures. Developing countries that apply unilateral measures use tax exemptions for multinational companies. Bilateral measures include Double Taxation Agreements (DTAs), whose aim is to distribute the taxing power among States based on the type of income.

The tax structure and an analysis of the ways to avoid double taxation in Ecuador are the heart of this research paper, which consists of five sections.

The first section summarizes the structures for taxing income, as well as the unilateral and bilateral measures adopted by Ecuador.

The second section reviews each of the signed DTAs together with their main provisions. In the following section, specific DTA cases are analyzed. Finally, we present our conclusions and recommendations.

5.2) Ecuador's tax structure and its relation to international trade, FDI and the general income taxing structure.

In the case of Ecuador, section 2 of the Internal Tax Regime Law (LRTI, by its Spanish acronym) states that income tax shall be levied on: “...1. Income from an Ecuadorian source obtained by way of gift or for valuable consideration arising from work, capital, or both sources, in the form of money, in-kind items or services; and 2. Income obtained abroad by individuals residing in the country or by national companies,..."

In Ecuador, therefore, the residence (or personalistic) principle is applied to individuals residing in the country and to national legal entities, and the source principle is applied to individuals and legal entities residing outside the country.

In Ecuador, the income tax rate for resident individuals is stated in section 36 of the LRTI and adjusted according to a table that is updated annually based on the Consumer Price Index for the Urban Area published by the National Institute of Statistics and Censuses (INEC, by its Spanish acronym)
as of November 30 each year. Non-resident individuals providing occasional services in Ecuador, under section 36 (b) are taxed at the same rate as companies. Under section 37 of the LRTI, the rate for companies was 25% until 2010; then it dropped 1% each year, to 24% in 2011, 23% in 2012, and 22% from 2013 onwards.

The definition of residence is stated in section 7 of the regulatory executive order for the implementation of the Internal Tax Regime Law: "Individuals shall be deemed to have their habitual domicile or place of residence in Ecuador whenever they have remained in the country for one hundred and eighty three (183) or more calendar days, whether consecutive or not, in the same fiscal year."

Until 2007 Ecuador used the tax credit (or the credit method) as a unilateral measure to avoid double taxation. This means that at the moment of calculating Income Tax, taxpayers may use any taxes on income paid abroad as tax credit.

Since the publication of the Amendment Law for Tax Fairness in 2008, the exemption method has been used as a unilateral measure, meaning that any income obtained abroad by individuals or companies residing in Ecuador will be excluded from the taxable base in Ecuador and will not be subject to taxation. The exemption method may not be applied to income from tax havens. In this case, income will be treated as residence-based income and the tax credit method will be applied.

Regarding bilateral and multilateral measures, Ecuador has signed a number of double taxation agreements (DTAs) with some countries, as stated in the following section.

The main objectives of signing DTAs include strengthening information exchange between countries and increasing investment in both of them. However, foreign direct investment (FDI) in Ecuador has behaved irregularly in the past ten years, showing a decrease from 2004 until 2007, rising again in 2008 and falling back in the following years.

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69 LRTI, section 49: Treatment of Income from Abroad.
Figure 5.1 Annual FDI in Ecuador, in US$, 2002-2011

Source: Prepared by the authors based on information provided by the Banco Central del Ecuador [Central Bank of Ecuador].

The top investing country in Ecuador for the past three years has been Canada, which invested as much as US$219.14 million in 2011. The second is China, followed by the United States and Spain. As shown below, Ecuador has only signed DTAs with Canada and Spain.

Figure 5.2. FDI in Ecuador, by country, in US$, 2002-2010

Source: Prepared by the authors based on information provided by the Banco Central del Ecuador [Central Bank of Ecuador].

Eighty-seven percent of the FDI coming from Canada in 2011 was used to develop mining and quarrying activities, whereas in the case of Spain 51% of the 2011 investments were used in manufacturing industries.
Ecuador has signed 14 DTAs so far. Between 2009 and 2011, the total amount transferred abroad by applying these agreements totaled US$1.18 billion. Without the DTAs, the country would have received an average of US$290 million in taxes (this implies a 25% and 24% rate on the US$1.18 billion). However, taxpayers declared and paid only US$67 million, meaning Ecuador sacrificed US$223 million from its fiscal coffers.

Table 5.1. Ecuador, payments sent abroad under DTAs, by country, in US$, 2009-2011

<table>
<thead>
<tr>
<th>Country</th>
<th>Payments sent abroad</th>
<th>Amount withheld</th>
<th>Withholding without DTA</th>
<th>IT lost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>188,137,693.79</td>
<td>7,222,382.19</td>
<td>46,110,336.65</td>
<td>38,887,954.46</td>
</tr>
<tr>
<td>Canada</td>
<td>159,024,301.99</td>
<td>4,166,306.55</td>
<td>38,964,318.27</td>
<td>34,798,011.72</td>
</tr>
<tr>
<td>Germany</td>
<td>128,651,247.21</td>
<td>6,050,365.77</td>
<td>31,392,368.51</td>
<td>25,342,002.74</td>
</tr>
<tr>
<td>Brazil</td>
<td>123,203,721.00</td>
<td>15,160,543.92</td>
<td>30,680,130.78</td>
<td>15,519,586.66</td>
</tr>
<tr>
<td>Mexico</td>
<td>122,820,405.75</td>
<td>11,601,325.86</td>
<td>30,114,328.42</td>
<td>18,513,002.56</td>
</tr>
<tr>
<td>Chile</td>
<td>105,100,983.85</td>
<td>4,143,827.81</td>
<td>25,756,776.26</td>
<td>21,612,948.45</td>
</tr>
<tr>
<td>Venezuela</td>
<td>103,519,182.42</td>
<td>235,063.44</td>
<td>25,469,702.34</td>
<td>25,234,638.90</td>
</tr>
<tr>
<td>Switzerland</td>
<td>83,024,655.95</td>
<td>7,471,481.85</td>
<td>20,222,956.19</td>
<td>12,751,474.34</td>
</tr>
<tr>
<td>France</td>
<td>56,594,984.25</td>
<td>3,975,338.34</td>
<td>13,931,462.43</td>
<td>9,956,124.09</td>
</tr>
<tr>
<td>Colombia</td>
<td>50,012,564.20</td>
<td>3,726,270.53</td>
<td>12,257,701.62</td>
<td>8,531,431.09</td>
</tr>
<tr>
<td>Other countries</td>
<td>64,053,187.17</td>
<td>3,061,260.14</td>
<td>15,720,411.10</td>
<td>12,119,150.96</td>
</tr>
<tr>
<td>Grand total</td>
<td>1,184,142,927.58</td>
<td>67,354,166.40</td>
<td>290,620,492.59</td>
<td>223,266,326.19</td>
</tr>
</tbody>
</table>

Source: Prepared by the authors based on information provided by Ecuador’s General Tax Bureau.

It is worth mentioning that out of the US$1.184 billion that left the country under DTAs, 55% paid taxes only in the country of residence of the income recipient, with Spain being the country with the highest amount of income that paid no taxes in Ecuador (the source country). However, percentage-wise, 99.05% of payments to Venezuela paid no taxes. This issue raises concern, because Ecuador has signed an agreement with the Andean Community of Nations and Venezuela is no longer a member of it.
Table 5.2. Ecuador, payments sent abroad with no withholding vs. total payments sent abroad, in US$, 2009-2011

<table>
<thead>
<tr>
<th>Country</th>
<th>Payments sent abroad (a)</th>
<th>Payments with no withholding</th>
<th>% (b / a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>188,137,693.79</td>
<td>118,492,751.15</td>
<td>62.98%</td>
</tr>
<tr>
<td>Canada</td>
<td>159,024,301.99</td>
<td>117,210,983.97</td>
<td>73.71%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>103,519,182.42</td>
<td>102,534,897.73</td>
<td>99.05%</td>
</tr>
<tr>
<td>Germany</td>
<td>128,651,247.21</td>
<td>87,661,640.68</td>
<td>68.14%</td>
</tr>
<tr>
<td>Chile</td>
<td>105,100,983.85</td>
<td>79,910,210.91</td>
<td>76.03%</td>
</tr>
<tr>
<td>Mexico</td>
<td>122,820,405.75</td>
<td>32,326,363.34</td>
<td>26.32%</td>
</tr>
<tr>
<td>Colombia</td>
<td>50,012,564.20</td>
<td>29,843,824.09</td>
<td>59.67%</td>
</tr>
<tr>
<td>France</td>
<td>56,594,984.25</td>
<td>28,037,110.04</td>
<td>49.54%</td>
</tr>
<tr>
<td>Peru</td>
<td>26,367,110.95</td>
<td>20,259,981.46</td>
<td>76.84%</td>
</tr>
<tr>
<td>Brazil</td>
<td>123,203,721.00</td>
<td>19,844,827.32</td>
<td>16.11%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>83,024,655.95</td>
<td>8,512,701.79</td>
<td>10.25%</td>
</tr>
<tr>
<td>Italy</td>
<td>22,919,318.50</td>
<td>5,086,716.26</td>
<td>22.19%</td>
</tr>
<tr>
<td>Bolivia</td>
<td>4,826,434.14</td>
<td>4,254,460.99</td>
<td>88.15%</td>
</tr>
<tr>
<td>Belgium</td>
<td>8,346,785.64</td>
<td>767,577.55</td>
<td>9.20%</td>
</tr>
<tr>
<td>Argentina</td>
<td>1,028,689.73</td>
<td>196,482.17</td>
<td>19.10%</td>
</tr>
<tr>
<td>Romania</td>
<td>564,848.21</td>
<td>-</td>
<td>0.00%</td>
</tr>
<tr>
<td>Grand total</td>
<td>1,184,142,927.58</td>
<td>654,940,529.45</td>
<td>55.31%</td>
</tr>
</tbody>
</table>

Source: Prepared by the authors based on information provided by Ecuador’s General Tax Bureau.

Regarding partially taxed money transfers under DTAs in Ecuador, transfers to Brazil paid the highest amount of taxes (US$15 million), which represent 22.51% of total withholdings on payments under DTAs, followed by transfers to Mexico and Switzerland, for US$11 million and US$7 million, representing 17.22% and 11.09%, respectively.
To conclude this brief general analysis, the sectors of the Ecuadorian economy that have made the largest payments abroad under DTAs are transportation, trade and manufacturing industries.

Table 5.3. Payments sent abroad by economic sector, in US$, 2009-2011

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Payments sent abroad</th>
<th>Amount Withheld</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transportation, storage and communications</td>
<td>382,576,192.55</td>
<td>28,223,210.75</td>
</tr>
<tr>
<td>Wholesale and retail trade; repairs of motor vehicles, motorcycles, personal items and household items</td>
<td>196,542,589.21</td>
<td>9,851,038.75</td>
</tr>
<tr>
<td>Manufacturing industries</td>
<td>176,847,725.32</td>
<td>14,359,745.11</td>
</tr>
<tr>
<td>Real estate, business and leasing activities</td>
<td>127,527,444.33</td>
<td>2,794,422.13</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>93,946,178.50</td>
<td>1,881,937.61</td>
</tr>
<tr>
<td>Financial brokerage</td>
<td>69,981,982.63</td>
<td>1,746,151.93</td>
</tr>
<tr>
<td>Construction</td>
<td>32,479,097.55</td>
<td>1,697,023.53</td>
</tr>
<tr>
<td>Fishing</td>
<td>23,440,185.63</td>
<td>270,757.48</td>
</tr>
<tr>
<td>Electricity, gas and water supply</td>
<td>22,632,311.87</td>
<td>1,839,422.67</td>
</tr>
<tr>
<td>Public administration and defense; mandatory social security programs</td>
<td>19,486,970.25</td>
<td>1,091,008.99</td>
</tr>
<tr>
<td>Agriculture, cattle farming, hunting and forestry</td>
<td>15,159,622.17</td>
<td>2,071,776.91</td>
</tr>
<tr>
<td>Other service-related community, social and individual activities</td>
<td>11,752,556.03</td>
<td>1,228,816.01</td>
</tr>
<tr>
<td>Others</td>
<td>11,770,031.54</td>
<td>298,834.53</td>
</tr>
<tr>
<td>Grand total</td>
<td>1,184,142,927.58</td>
<td>67,354,166.40</td>
</tr>
</tbody>
</table>

Source: Prepared by the authors based on information provided by Ecuador’s General Tax Bureau.
5.3) Institutional framework and description of DTAs

As stated earlier, Ecuador has implemented unilateral, bilateral and multilateral measures to avoid double taxation. That is the reason why it has signed 14 agreements and it is currently negotiating other DTAs with China, the United Arab Emirates, Portugal, South Korea and Iran (some of these agreements have already been concluded but are pending ratification by the National Assembly).

In 1975, as a member country of the Andean Community of Nations (ACN), Ecuador was a signatory to Decision 40, which is a multilateral agreement intended to avoid double taxation of income among its parties. The agreement became effective for Ecuador in 1981. In 2004, Decision 40 was amended and updated by Decision 578, in effect from 2005, to also include property taxes. This agreement adheres to the territorial principle and fixes payment of taxes in the country of origin or in the country where the source of production is located, such source being any "activity, right or good that produces or that may produce income."

Ecuador subscribed its first bilateral DTA with the Argentine Republic in 1981. This agreement only included the air transportation clause. Later on, Ecuador signed the rest of its DTAs using the Organization for Economic Cooperation and Development (OECD) model, in which the residence principle is chosen as a solution for the double taxation problem.

Figure 5.4. DTAs signed by Ecuador

Source: prepared by the authors based on information from Official Records.
Note: The years refer to the time when DTAs became effective or were ratified (in the case of Switzerland).

The following relevant aspects are worth noting:
- The DTA with Switzerland is the only one that does not include an information exchange clause.
- The DTA with Uruguay is the only one including a clause for assistance in tax collection.70

70 Assistance in tax collection implies mutual aid among DTAs contracting States to collect taxes due
Protocols (clarifications of certain sections of the agreement) have been signed with Belgium, Brazil, Canada, Chile, France, Germany, Mexico and Switzerland.

As stated earlier, Decision 578 of the ACN, which uses the UN Model, is based on the source principle. Therefore, it establishes the "tax jurisdiction" principle, that is to say, that income will be taxed in the country where the source of production of income is located, irrespective of the place of residence of individuals or legal entities.

The remaining DTAs using the OECD model focus on the “residence” principle, which means that taxes will be paid based on domicile, residence, regular place of stay or place of effective management, because OECD members are developed countries. A deciding factor for the country where items will be taxed is "permanent establishment" (PE), since the PE will pay taxes in the country where it is located depending on the profits it generates or the assets it owns.

DTAs address the distribution of taxing power among contracting States; therefore, their clauses specify whether income generated by different types of transactions (royalties, dividends, interest, etc.) will pay taxes unlimitedly at the place of residence (no withholding made in the source country) unlimitedly in the territory (withholding made in the source country) or limitedly in the territory (withholding made at lower rates in the source country).

The DTA signed with Argentina focuses only on the international air transportation clause, which stipulates that taxes will be levied on the following types of income in the State where the company is domiciled:

- Income obtained by air transportation companies engaged in international transportation, as well as income obtained from holdings in joint activities or "pools".
- Income from the sale of real and personal property directly involved in the normal course of business of international transportation companies.
- Income from the sale of aircraft used in international transportation.
- Remunerations obtained from employment aboard international transportation aircraft.

We shall now analyze the structure of each of the DTAs signed by Ecuador, except for the DTA signed with Argentina, which was summarized in the preceding paragraph. The following charts summarize the main clauses included in the DTAs signed with the countries mentioned in each column.
<table>
<thead>
<tr>
<th>ITEM</th>
<th>GERMANY</th>
<th>BRAZIL</th>
<th>ITALY</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Residence</strong></td>
<td>Whether it is subject to taxation based on domicile, residence, regular place of stay, place of management or management headquarters. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will reach an agreement, otherwise place of effective management.</td>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will reach an agreement, otherwise place of effective management.</td>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will reach an agreement, otherwise place of effective management.</td>
</tr>
<tr>
<td><strong>Permanent Establishment (PE)</strong></td>
<td>Fixed place of business a) An office or place of business administration or management; b) branches or agencies; c) a factory, plant or industrial workshop; d) mines, quarries or any other place for extraction of natural resources; e) construction or assembly works lasting for more than twelve months.</td>
<td>Fixed place of business a) place of management; b) a branch; c) an office; d) a factory; e) a workshop; f) a mine, quarry or any other place for extraction of natural resources; g) construction, installation or assembly works lasting for more than twelve months.</td>
<td>Fixed place of business a) place of management; b) branches; c) offices; d) factories; e) workshops; f) mines, quarries or any other place for extraction of natural resources; g) construction or assembly works lasting for more than twelve months.</td>
</tr>
<tr>
<td><strong>Real Estate Income</strong></td>
<td>Taxes paid unlimitedly where property is located. Vessels, boats and aircraft are not included.</td>
<td>Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included.</td>
<td>Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included.</td>
</tr>
<tr>
<td><strong>Business Profits</strong></td>
<td>Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE.</td>
<td>Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE.</td>
<td>Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE.</td>
</tr>
<tr>
<td><strong>Sea and Air Navigation</strong></td>
<td>Taxes are paid in the State where the place of effective management or administration is located.</td>
<td>Taxes are paid in the State where the place of effective management or administration is located. If aboard a vessel, taxes are paid where the base port is located or where the person exploiting the vessel resides.</td>
<td>Taxes are paid in the State where the place of effective management or administration is located. If aboard a vessel, taxes are paid where the base port is located or where the person operating the vessel resides.</td>
</tr>
</tbody>
</table>
### FRANCE

<table>
<thead>
<tr>
<th>Income Tax</th>
<th>Income and Property Tax</th>
<th>Income Tax</th>
<th>Income and Property Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will reach an agreement, otherwise place of effective management.</td>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will reach an agreement, otherwise place of effective management.</td>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will reach an agreement, otherwise place of effective management.</td>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will reach an agreement, otherwise place of effective management.</td>
</tr>
</tbody>
</table>

### SPAIN

<table>
<thead>
<tr>
<th>Fixed place of business</th>
<th>Place of business</th>
<th>Fixed point of business</th>
<th>Fixed place of business</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) place of management; b) a branch; c) an office; d) a factory; e) a workshop; f) a mine, oil or gas well, quarry or any other place for extraction of natural resources; g) construction or assembly works if their duration exceeds twelve months.</td>
<td>a) place of management of the activity; b) a branch, agency or office; c) a factory, plant, or industrial or assembly workshop; d) a mine, quarry or any other place for extraction of natural resources. It includes construction works or installation projects if their duration exceeds 12 months.</td>
<td>a) place of management; b) a branch; c) an office; d) a factory; e) a workshop; f) a mine, oil or gas well, quarry or any other place for extraction of natural resources. It includes construction workshops, construction works, when their duration exceeds twelve months, and service supply.</td>
<td>a) places of management; b) branches; c) offices; d) factories; e) workshops; f) mines, oil or gas wells, quarries or any other place for extraction of natural resources. It includes construction, installation or assembly works if their duration exceeds six months.</td>
</tr>
</tbody>
</table>

| Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included. | Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included. | Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included. | Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included. |

| Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE. | Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE. | Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE. | Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE. |

<p>| Taxes are paid in the State where the place of effective management or administration is located. If aboard a vessel, taxes are paid where the base port is located or where the person operating the vessel resides. | Taxes are paid in the State where the place of effective management or administration is located. If aboard a vessel, taxes are paid where the base port is located or where the person operating the vessel resides. | Taxes are paid in the State where the place of effective management or administration is located. If aboard a vessel, taxes are paid where the base port is located or where the person operating the vessel resides. | Taxes are paid in the State where the place of effective management or administration is located. If aboard a vessel, taxes are paid where the base port is located or where the person operating the vessel resides. |</p>
<table>
<thead>
<tr>
<th>ITEM</th>
<th>GERMANY</th>
<th>BRAZIL</th>
<th>ITALY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partner Companies</td>
<td>Adjustment if arm’s length principle is not complied with.</td>
<td>Adjustment if arm’s length principle is not complied with.</td>
<td>Adjustment if arm’s length principle is not complied with.</td>
</tr>
<tr>
<td>Dividends</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, internal legislation of paying State applies.</td>
</tr>
<tr>
<td>Interest</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10% or 15%, as the case may be. If there is PE, the section on Business Profits applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10%. If there is PE, the section on Business Profits applies.</td>
</tr>
<tr>
<td>Royalties</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15% or 25%, as the case may be. If there is PE, the section on Business Profits applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 5%. If there is PE, the section on Business Profits applies.</td>
</tr>
<tr>
<td>Capital Gains</td>
<td>Real property will pay taxes where it is located.</td>
<td>Real property will pay taxes under domestic legislation.</td>
<td>Real property will pay taxes where it is located.</td>
</tr>
<tr>
<td></td>
<td>PE personal property will pay taxes in the source State.</td>
<td>Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
<td>PE personal property will pay taxes in the source State.</td>
</tr>
<tr>
<td></td>
<td>Other non-specified property will pay taxes in recipient’s State of residence.</td>
<td></td>
<td>Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
</tr>
<tr>
<td>Income from Self-Employment</td>
<td>Income will be taxed in the individual’s State of residence, unless he/she has remained for more than 180 days in the same year at the State where income originated.</td>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE.</td>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE.</td>
</tr>
<tr>
<td>Income from Dependent Employment</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, the employer is not a resident in source State and remuneration is not paid by PE.</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, the employer is not a resident in source State and remuneration is not paid by PE.</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, the employer is not a resident in source State and remuneration is not paid by PE.</td>
</tr>
<tr>
<td>FRANCE</td>
<td>SPAIN</td>
<td>ROMANIA</td>
<td>SWITZERLAND</td>
</tr>
<tr>
<td>-----------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Adjustment if arm’s length principle is not complied with.</td>
<td>Adjustment if arm’s length principle is not complied with.</td>
<td>Adjustment if arm’s length principle is not complied with.</td>
<td>Adjustment if arm’s length principle is not complied with.</td>
</tr>
<tr>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
</tr>
<tr>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10% or 15%, as the case may be. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 5% or 10%, as the case may be. If there is PE, the section on Business Profits applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
</tr>
<tr>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
</tr>
<tr>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE, and the individual remains there for more than 183 days in the same year.</td>
<td>Income will be taxed in the individual’s State of residence, unless he/she has remained for more than 180 days in the same year at the State where income originated.</td>
<td>Income will be taxed in the individual’s State of residence, unless he/she has remained for more than 180 days in the same year at the State where income originated.</td>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE.</td>
</tr>
<tr>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, the employer is not a resident in source State and remuneration is not paid by PE.</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, the employer is not a resident in source State and remuneration is not paid by PE.</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, the employer is not a resident in source State and remuneration is not paid by PE.</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, the employer is not a resident in source State and remuneration is not paid by PE.</td>
</tr>
<tr>
<td>ITEM</td>
<td>GERMANY</td>
<td>BRAZIL</td>
<td>ITALY</td>
</tr>
<tr>
<td>------------------------------------</td>
<td>------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Artists and Sportspeople</td>
<td>Taxes will be paid in the State where artistic or sports activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
<td>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
<td>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
</tr>
<tr>
<td>Other Income</td>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence.</td>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence.</td>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence. If there is PE, taxes will be paid under Internal Legislation.</td>
</tr>
<tr>
<td>Property</td>
<td>Real property will pay taxes in the State where it is located.</td>
<td>N/A</td>
<td>Real property will pay taxes in the State where it is located.</td>
</tr>
<tr>
<td></td>
<td>Personal property in a PE will pay taxes in the State where it is located.</td>
<td></td>
<td>Personal property in a PE will pay taxes in the State where it is located.</td>
</tr>
<tr>
<td></td>
<td>Vessels or aircraft used in international transportation will be taxed in the State where the company’s place of effective management or administration is located.</td>
<td></td>
<td>Vessels or aircraft used in international transportation will be taxed in the State where the company’s place of effective management or administration is located.</td>
</tr>
<tr>
<td></td>
<td>All the remaining property items of a State’s resident will pay taxes in that State.</td>
<td></td>
<td>All the remaining property items of a State’s resident will pay taxes in that State.</td>
</tr>
<tr>
<td>Method to avoid double taxation</td>
<td>Exemption Method</td>
<td>Tax Credit Method</td>
<td>Tax Credit Method</td>
</tr>
<tr>
<td>FRANCE</td>
<td>SPAIN</td>
<td>ROMANIA</td>
<td>SWITZERLAND</td>
</tr>
<tr>
<td>--------</td>
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</tr>
<tr>
<td>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
<td>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
<td>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
<td>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
</tr>
<tr>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence. If there is PE, the section on Business Profits or Independent Professional Services applies, as appropriate.</td>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence. If there is PE, the section on Business Profits applies.</td>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence.</td>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence. If there is PE, the section on Business Profits or Independent Professional Services applies, as appropriate.</td>
</tr>
<tr>
<td>Real property will pay taxes in the State where it is located. Personal property in a PE will pay taxes in the State where it is located. Vessels or aircraft used in international transportation will be taxed in the State where the company’s place of effective management or administration is located. All the remaining property items of a State’s resident will pay taxes in that State.</td>
<td>Real property will pay taxes in the State where it is located. Personal property in a PE will pay taxes in the State where it is located. Vessels or aircraft used in international transportation will be taxed in the State where the company’s place of effective management or administration is located. All the remaining property items of a State’s resident will pay taxes in that State.</td>
<td>Real property will pay taxes in the State where it is located. Personal property in a PE will pay taxes in the State where it is located. Vessels or aircraft used in international transportation will be taxed in the State where the company’s place of effective management or administration is located. All the remaining property items of a State’s resident will pay taxes in that State.</td>
<td>Real property will pay taxes in the State where it is located. Personal property in a PE will pay taxes in the State where it is located. Vessels or aircraft used in international transportation will be taxed in the State where the company’s place of effective management or administration is located. All the remaining property items of a State’s resident will pay taxes in that State.</td>
</tr>
<tr>
<td>Tax Credit Method</td>
<td>Tax Credit Method</td>
<td>Tax Credit Method</td>
<td>Exemption Method</td>
</tr>
<tr>
<td>ITEM</td>
<td>CANADA</td>
<td>MEXICO</td>
<td>BELGIUM</td>
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<tr>
<td>------</td>
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</tr>
<tr>
<td><strong>Taxes</strong></td>
<td>Income Tax</td>
<td>Income Tax</td>
<td>Income and Property Tax</td>
</tr>
<tr>
<td><strong>Residence</strong></td>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will agree, otherwise tax exemption may not be applied.</td>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will agree, otherwise place of effective management.</td>
<td>Whether it is subject to taxation based on domicile, residence, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will agree, otherwise place of effective management.</td>
</tr>
<tr>
<td><strong>Permanent Establishment (PE)</strong></td>
<td>Fixed place of business (a) place of management; (b) a branch, (c) an office; (d) a factory, plant, or industrial or assembly workshop; (e) a mine, oil or gas well, quarry or any other place related to the exploration or exploitation of natural resources. It includes (a) construction works or construction or installation projects and supervision activities related thereto, but only if they last for more than six months.</td>
<td>Fixed place of business a) place of management; b) a branch; c) an office; d) a factory; e) a workshop; f) a mine, oil or gas well, quarry or any other place for extraction of natural resources. It includes works, construction or installation or assembly projects, or inspection activities related thereto, but only if they last for more than six months.</td>
<td>Fixed place of business a) places of management; b) branches; c) offices; d) factories; e) workshops; f) mines, oil or gas wells, quarries or any other place for extraction of natural resources. Construction, installation or assembly works are considered permanent establishments only if their duration exceeds 12 months.</td>
</tr>
<tr>
<td><strong>Real Estate Income</strong></td>
<td>Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included.</td>
<td>Taxes paid unlimitedly where property is located. It includes: agriculture and forestry income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included.</td>
<td>Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included.</td>
</tr>
<tr>
<td><strong>Business Profits</strong></td>
<td>Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE.</td>
<td>Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE.</td>
<td>Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE.</td>
</tr>
<tr>
<td><strong>Sea and Air Navigation</strong></td>
<td>Taxes are paid in State of residence.</td>
<td>Taxes are paid in the State where the place of effective management or administration is located. If aboard a vessel, taxes are paid where the base port is located or where the person operating the vessel resides.</td>
<td>Taxes are paid in the State where the place of effective management or administration is located. If aboard a vessel, taxes are paid where the base port is located or where the person operating the vessel resides.</td>
</tr>
<tr>
<td><strong>CHILE</strong></td>
<td><strong>URUGUAY</strong></td>
<td><strong>ACN</strong></td>
<td></td>
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<tr>
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<td></td>
</tr>
<tr>
<td>Income and Property Tax</td>
<td>Income and Property Tax</td>
<td>Income and Property Tax</td>
<td></td>
</tr>
<tr>
<td>Whether it is subject to taxation based on domicile, residence, place of incorporation, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will agree, otherwise tax exemption may not be applied.</td>
<td>Whether it is subject to taxation based on domicile, residence, place of incorporation, place of management. Tie-breaker rule: permanent dwelling place, center of vital interests, habitual residence, national, otherwise States will agree, otherwise tax exemption may not be applied.</td>
<td>It defines Tax Jurisdiction: irrespective of nationality or residence, income will be taxed where the &quot;source of production&quot; of such income is located, such source being any activity, right or good that generates income.</td>
<td></td>
</tr>
<tr>
<td>Fixed place of business (a) places of management; (b) branches; (c) offices; (d) factories; (e) workshops; (f) mines, oil or gas wells, quarries or any other place related to the exploration or exploitation of natural resources. It also includes: construction, installation or assembly works or projects, and supervision activities related thereto, but only if they last for more than six months.</td>
<td>Fixed place of business (a) places of management; (b) branches; (c) offices; (d) factories; (e) workshops; (f) mines, oil or gas wells, quarries or any other place related to the exploration or exploitation of natural resources. It also includes construction, installation or assembly works or projects, and supervision activities related thereto, but only if they last for more than six months.</td>
<td>It establishes that a company conducts activities in a territory if it maintains: a) an office; b) a factory, plant or workshop; c) a construction site; d) a place where natural resources are extracted or exploited; e) a sales agency or office; f) a procurement agency or office; g) a warehouse, storehouse; h) an office to help with the company’s business; i) an agent or representative.</td>
<td></td>
</tr>
<tr>
<td>Taxes paid unlimitedly where property is located. It includes: agriculture income, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included.</td>
<td>Taxes paid unlimitedly where property is located. It includes: income from agriculture, mining and oil, income from exploiting or from the right to exploit mineral deposits, sources and other natural resources. Vessels, boats and aircraft are not included.</td>
<td>Income is taxed in the State where property is located.</td>
<td></td>
</tr>
<tr>
<td>Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE.</td>
<td>Taxes paid unlimitedly in country of residence. If there is PE, taxes are paid at source based on profits attributable to PE.</td>
<td>Taxes are paid in the Member Country where income was earned.</td>
<td></td>
</tr>
<tr>
<td>Taxes are paid in State of residence.</td>
<td>Taxes are paid in State of residence.</td>
<td>Ships, aircraft, buses and other transport vehicles are taxable only by the Member Country where the owner is domiciled.</td>
<td></td>
</tr>
<tr>
<td>ITEM</td>
<td>CANADA</td>
<td>MEXICO</td>
<td>BELGIUM</td>
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<tr>
<td>------</td>
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</tr>
<tr>
<td>Partner Companies</td>
<td>Adjustment if arm’s length principle is not complied with. Appropriate adjustment.</td>
<td>Adjustment if arm’s length principle is not complied with.</td>
<td>Adjustment if arm’s length principle is not complied with.</td>
</tr>
<tr>
<td>Dividends</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 5%, if controlling directly or indirectly at least 25% of a company that pays dividends. In other cases, tax will be paid at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 5%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
</tr>
<tr>
<td>Interest</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10% or 15%, as the case may be. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
</tr>
<tr>
<td>Royalties</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10% or 15%, as the case may be. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
</tr>
<tr>
<td>Capital Gains</td>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
</tr>
<tr>
<td>Income from Self-Employment</td>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE, and the individual remains there for more than 183 days in the same year.</td>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE, and the individual remains there for more than 183 days in the same year.</td>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE.</td>
</tr>
<tr>
<td>Income from Dependent Employment</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, employer is not a resident, and remuneration is not paid by PE.</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, employer is not a resident, and remuneration is not paid by PE.</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, employer is not a resident, and remuneration is not paid by PE.</td>
</tr>
<tr>
<td>CHILE</td>
<td>URUGUAY</td>
<td>ACN</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Adjustment if arm's length principle is not complied with. Appropriate adjustment.</td>
<td>Adjustment if arm's length principle is not complied with. Appropriate adjustment.</td>
<td>Adjustment if arm's length principle is not complied with. Appropriate adjustment.</td>
<td></td>
</tr>
<tr>
<td>Taxes will be paid limitedly in the source State at a rate of up to 5%, if controlling directly or indirectly at least 25% of a company that pays dividends. In other cases, tax will be paid at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10%, if controlling directly or indirectly at least 25% of a company that pays dividends. In other cases, tax will be paid at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Dividends and equity investments will only be taxed by the Member Country where the company distributing them is domiciled.</td>
<td></td>
</tr>
<tr>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 15%. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Interest and other financial yields are taxable only by the Member Country in whose territory payment thereof is entered and recorded.</td>
<td></td>
</tr>
<tr>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10% or 15%, as the case may be. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Taxes will be paid limitedly in the source State at a rate of up to 10% or 15%, as the case may be. If there is PE, the section on Business Profits or Independent Professional Services applies.</td>
<td>Royalties from intangible assets are taxable only by the Member Country where the intangible asset is used or where a person has a right to use it.</td>
<td></td>
</tr>
<tr>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
<td>Real property will pay taxes where it is located. PE personal property will pay taxes in the source State. Sales of other non-specified property will pay taxes in recipient’s State of residence.</td>
<td>Capital gains will only pay taxes in the Member Country where assets are located at the time of their sale, except for sales of securities and shares of stock, which will be taxed in the State where they were issued.</td>
<td></td>
</tr>
<tr>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE, and the individual remains there for more than 183 days in the same year.</td>
<td>Income will be taxed in the individual’s State of residence, unless such income is attributable to a fixed base or PE, and the individual remains there for more than 183 days in the same year.</td>
<td>Remunerations, fees, salaries, wages, profits and similar forms of compensation received as retribution for services provided by employees, professionals, technicians or for personal services in general, including consulting services, are taxable only in the territory where such services were provided.</td>
<td></td>
</tr>
<tr>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, employer is not a resident, and remuneration is not paid by PE.</td>
<td>Taxes will be paid at source except when: stay does not exceed 183 days, employer is not a resident, and remuneration is not paid by PE.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ITEM</td>
<td>CANADA</td>
<td>MEXICO</td>
<td>BELGIUM</td>
</tr>
<tr>
<td>--------------------------</td>
<td>------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Artists and Sportspeople</strong></td>
<td><strong>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</strong></td>
<td><strong>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</strong></td>
<td><strong>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</strong></td>
</tr>
<tr>
<td><strong>Other Income</strong></td>
<td><strong>Income not specified in the Agreement will pay taxes in the recipient’s State of residence.</strong></td>
<td><strong>Income not specified in the Agreement will pay taxes in the recipient’s State of residence. If there is PE, the section on Business Profits or Independent Professional Services applies, as appropriate.</strong></td>
<td><strong>Income not specified in the Agreement will pay taxes in the recipient’s State of residence. If there is PE, the section on Business Profits or Independent Professional Services applies, as appropriate.</strong></td>
</tr>
<tr>
<td><strong>Property</strong></td>
<td><strong>N/A</strong></td>
<td><strong>N/A</strong></td>
<td><strong>Real property will pay taxes in the State where it is located. Personal property in a PE will pay taxes in the State where it is located. Vessels or aircraft used in international transportation will be taxed in the State where the company's place of effective management or administration is located. All the remaining property items of a State's resident will pay taxes in that State.</strong></td>
</tr>
<tr>
<td><strong>Method to avoid double taxation</strong></td>
<td><strong>Tax Credit Method</strong></td>
<td><strong>Tax Credit Method</strong></td>
<td><strong>Exemption Method</strong></td>
</tr>
<tr>
<td><strong>Other Clauses</strong></td>
<td><strong>Non-discrimination Clause</strong></td>
<td><strong>Non-discrimination Clause</strong></td>
<td><strong>Non-discrimination Clause</strong></td>
</tr>
<tr>
<td>CHILE</td>
<td>URUGUAY</td>
<td>ACN</td>
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</tr>
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<td>----------------------------------------------------------------------</td>
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<td>----------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
<td>Taxes will be paid in the State where artistic or sport activities are conducted, irrespective of whether income is attributable to the artist or sportsperson or to a third party.</td>
<td>Income is taxable only in the Member Country where the activities took place.</td>
<td></td>
</tr>
<tr>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence.</td>
<td>Income not specified in the Agreement will pay taxes in the recipient’s State of residence.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real property will pay taxes in the State where it is located. Personal property in a PE will pay taxes in the State where it is located. Vessels or aircraft used in international transportation will be taxed in the State where the company's place of effective management or administration is located. All the remaining property items of a State's resident will pay taxes in that State.</td>
<td>Real property will pay taxes in the State where it is located. Personal property in a PE will pay taxes in the State where it is located. Vessels or aircraft used in international transportation will be taxed in the State where the company's place of effective management or administration is located. All the remaining property items of a State's resident will pay taxes in that State.</td>
<td>Real property will pay taxes in the territory where it is located.</td>
<td></td>
</tr>
<tr>
<td>Tax Credit Method</td>
<td>Exemption Method</td>
<td>Exemption Method</td>
<td></td>
</tr>
</tbody>
</table>
5.4) Analysis of practical cases

To analyze practical cases in Ecuador, it is essential to explain the rules governing the calculation of Income Tax.

As background information, the Production Code published in 2010 introduced important amendments to the income tax, including a 1% annual reduction of the rate until it reached 22%.

The tax burden in Ecuador is made up of a 15% payment for employee profit sharing. Then, income tax is calculated based on the difference between the taxable base and the employee profit sharing amount. Until 2010, the income tax rate was 25%, but it was reduced by 1% every year, until stabilizing at 22% in 2013.

The following table explains the tax burden an Ecuadorian taxpayer would have if he/she behaved ethically and fully complied with tax regulations:

**Table 5.4. Income tax evolution under the Production Code, in US$**

<table>
<thead>
<tr>
<th>Income Tax Rate</th>
<th>25%</th>
<th>24%</th>
<th>23%</th>
<th>22%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal Year</td>
<td>2010</td>
<td>2011</td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td>Accounting Profit</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>(-) 15% Employee Profit Sharing</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>(=) Profit After Employee Profit Sharing</td>
<td>85</td>
<td>85</td>
<td>85</td>
<td>85</td>
</tr>
<tr>
<td>(+) Non Tax-Deductible Expenses</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(=) Taxable Base</td>
<td>85</td>
<td>85</td>
<td>85</td>
<td>85</td>
</tr>
<tr>
<td>(-) Income Tax</td>
<td>21.25</td>
<td>20.40</td>
<td>19.55</td>
<td>18.70</td>
</tr>
<tr>
<td>(=) Profit After Taxes</td>
<td>63.75</td>
<td>64.60</td>
<td>65.45</td>
<td>66.30</td>
</tr>
<tr>
<td>Tax Burden</td>
<td>36.25%</td>
<td>35.40%</td>
<td>34.55%</td>
<td>33.70%</td>
</tr>
</tbody>
</table>

*Source: Prepared by the authors.*

To simplify the calculation, Table 5.4 considered an accounting profit of US$100, so that when there is a profit, this type of taxpayer would pay 15% in employee profit sharing plus the appropriate income tax rate (depending on the fiscal year). This means a taxpayer with *tax culture* would have a tax...
burden (33% to 36%) which is commensurate with the average income tax rates paid in South America.

Table 5.5 shows the example of a taxpayer attempting to avoid71 tax payment (in the Ecuadorian case, he is actually seeking to reduce the tax burden). The taxpayer generates no accounting profit and therefore does not pay 15% in employee profit sharing to his workers. This taxpayer considers the US$100 value as non-deductible expenses and calculates the tax based on this new taxable base. As we can see, the tax burden drops significantly as compared to Table 5.4.

Table 5.5. Income tax evolution using fiscal planning, in US$

<table>
<thead>
<tr>
<th>Income Tax</th>
<th>25%</th>
<th>24%</th>
<th>23%</th>
<th>22%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal Year</td>
<td>2010</td>
<td>2011</td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td>Accounting Profit</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(-) 15% Employee Profit Sharing</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(=) Profit After Employee Profit Sharing</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(+) Non Tax-Deductible Expenses</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>(=) Taxable Base</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>(-) Income Tax</td>
<td>25</td>
<td>24</td>
<td>23</td>
<td>22</td>
</tr>
<tr>
<td>(=) Profit After Taxes</td>
<td>75</td>
<td>76</td>
<td>77</td>
<td>78</td>
</tr>
<tr>
<td>Tax Burden</td>
<td>25%</td>
<td>24%</td>
<td>23%</td>
<td>22%</td>
</tr>
</tbody>
</table>

Source: Prepared by the authors.

In the absence of adequate control, these bad practices lead to unfair competition among taxpayers, because tax burdens imply expenses for companies, which will have an impact on the dividends received by shareholders. This introduction to tax calculation will help identify the transactions made among companies operating under a DTA and prevent tax fraud, since Ecuadorian law considers that expenses incurred under a DTA are deductible. One of the goals of the agreements is to prevent fiscal fraud. For example, the

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71 Tax avoidance means using legal loopholes in tax regulations to pay less taxes.
agreements do not seek to have a taxpayer fail to pay taxes, but rather to prevent him from paying taxes twice for the same transaction in different states. Countries may control tax fraud by using the information exchange clause in cooperation with other countries, in order to stop taxpayers from obtaining advantages by applying DTAs.

As mentioned above, DTAs offer three different ways of taxing, based on the type of transaction:

- Unlimitedly in the Territory.
- Unlimitedly in the Place of Residence.
- Limitedly in the Territory.

Out of these kinds of withholdings, tax administrations should pay closer attention to transactions that pay taxes unlimitedly in the place of residence and limitedly in the territory, because the source country will not tax such transactions.

This type of transaction is known as income offshoring, which is nothing but transferring taxable bases to other countries. That is why the regulatory bodies need to analyze these strategies used by large companies, so that the correct application of each agreement and the nature of the transaction can be studied.

Other types of income, that is to say, those that are taxed unlimitedly in the territory, should not be analyzed, because the source country levies the whole tax and there are no advantages for taxpayers in this kind of transaction.

Table 5.6. Payments sent abroad vs. withholdings at source, in US$

<table>
<thead>
<tr>
<th>Years</th>
<th>Total Payments Sent Abroad</th>
<th>No Withholding</th>
<th>Taxed Base</th>
<th>Total Withheld</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>275,486,262.88</td>
<td>133,956,266.19</td>
<td>141,529,996.69</td>
<td>18,936,729.16</td>
</tr>
<tr>
<td>2010</td>
<td>367,132,733.73</td>
<td>183,746,058.61</td>
<td>183,386,675.12</td>
<td>23,405,076.16</td>
</tr>
<tr>
<td>2011</td>
<td>541,523,930.97</td>
<td>337,238,204.65</td>
<td>204,285,726.32</td>
<td>25,012,361.08</td>
</tr>
<tr>
<td>Total</td>
<td>1,184,142,927.58</td>
<td>654,940,529.45</td>
<td>529,202,398.13</td>
<td>67,354,166.40</td>
</tr>
</tbody>
</table>

Source: Prepared by the authors based on the information provided by Ecuador’s General
Chapter 5

Tax Bureau.
An analysis of the type of transaction made by taxpayers in Ecuador would show that in relation to total payments sent abroad (this may be considered as capital flight), there has been an increase in the use of detrimental tax planning. From 2009 to 2011, payments under DTAs that were not taxed in Ecuador rose from 50% to more than 60% of total payments sent abroad under DTAs. This implies that transactions need to be monitored, as stated in previous paragraphs.

Figure 5.5. Payments sent abroad vs. withholdings at source, in US$

This figure shows that the actual tax burden on total payments sent abroad is extremely low. According to Ecuadorian law, payments sent abroad under DTAs are deductible for calculation of employee’s profit sharing (at a 15% rate) and income tax (at a 24% rate in the 2011 fiscal year). However, the tax burden on payments sent abroad under DTAs has been only about 5.69%. But what would have happened if this expense had not been recorded on the taxpayer’s accounting? In that case, that tax burden would have been 35.40%. Nevertheless, the amount actually collected by the fiscal coffers is almost one sixth of this figure.

With this difference, which we could call savings, taxpayers have more capital flow to offer some price reductions and harm competitors that do not make transactions under DTA provisions. This could lead to two situations: one, a taxpayer that does bear the 35.4% burden may leave the market as a result of unfair competition, or, two, the taxpayer that does not apply these practices will start doing so, thereby paying less money to the State and to the workers.
That is why Tax Administrations (TAs) should amend laws: to prevent taxpayers from avoiding taxes. Similarly, TAs should create some risk by introducing intensive and large-scale controls, so that taxpayers make payments correctly.

This type of control helps the economy because capital flight results in money market imbalances, leading the Ecuadorian economy to experience a reduction in foreign currency availability, since workers receive less under the employee profit sharing system. We should consider that this is the money that is directly introduced into the economy and prompts higher consumption, production, employment and indirect taxes associated to consumption.

The following figure shows the behavior of payments sent abroad and tax withheld, based on the DTAs signed by Ecuador.

**Figure 5.6. Payments sent abroad by country vs. withholdings at source, in US$**

![Payments sent abroad by country vs. withholdings at source, in US$](image)

*Source: Prepared by the authors based on information provided by Ecuador’s General Tax Bureau.*

The figure shows that the country to which the largest amount of capital has fled (from Ecuador by application of DTAs) is not necessarily the country with the highest withholdings. Spain and Canada, for example, are positioned as the first and second country, respectively, receiving flows from companies with registered offices in Ecuador. However, the country with the highest withholdings is Brazil.

The following figure shows what was said in the previous paragraph, confirming that Brazil and Mexico are the countries with the highest withholdings made in the territory under DTAs, but they are not necessarily the countries receiving more payments.
By analyzing practical cases it is possible to see that TAs should strictly control the definition of permanent establishments and business profits. This concern arises because taxpayers willing to pay less taxes will want to state they have no permanent establishments in a certain country and, based on that, under the section on business profits, they will not pay taxes in the source country, but rather in the country of residence. The issue here is not only that taxes may not be paid at all, but that, as we have noted, if these items are treated as deductible expenses, employee profit sharing will not be paid either. The TA analyzes DTAs together with the comments to the 2010 OECD Model Tax Convention, which states the following: "...to define the term ‘profits’, it should nevertheless be understood that the term when used in this Article and elsewhere in the Convention has a broad meaning including all income derived in carrying on an enterprise.” That is why the TA verifies whether the transaction falls within the definition of business profits or not.

An analysis of one of the most emblematic cases considered by the TA with respect to transactions by companies in the telecommunications sector showed that the countries with which transactions are made include Spain, Brazil and Mexico, which from 2009 to 2011 transferred 155,762,287.05, and only approximately 23,500,000 remained in Ecuador. As noted above, the most common transactions with Spain involve business profits, for an amount of 17,903,730.06. As for Brazil, the highest number of transactions is related to fees or royalties for an amount of 91,327,955.49, with a 10% withholding in the territory. Finally, transactions with Mexico are more related to interest, for an amount of 20,056,530,017.

*Source: Prepared by the authors based on information provided by Ecuador’s General Tax Bureau.*
On the other hand, an analysis of some relevant aspects of international double taxation agreements signed by the Republic of Ecuador suggests the following:

- The Agreement with Switzerland is the only one that does not include an information exchange clause.
- The Agreement with Uruguay includes a clause for assistance in tax collection.
- Protocols (clarifications of certain sections in the agreement) have been signed with Belgium, Brazil, Canada, Chile, France, Germany, Mexico and Switzerland.
- The Agreement signed with Argentina only included the air transportation clause (1982).
- In 2011, payments were sent abroad under DTAs for several billion dollars. Only US$29 million were paid in income tax.

Ecuador’s TA has had different experiences regarding the information exchange clause contained in DTAs. The Ecuadorian government has requested information from the following countries:

- Canada (for wheat purchase transactions)
- Belgium (for banana sale transactions)
- Italy (for banana sale transactions)
- Spain (for banana sale transactions)

Similarly, following the reciprocity principle, Ecuador has responded to certain countries that requested information under the information exchange clause:

- Spain (transactions made by individuals such as professionals, artists, freelance professionals, etc.).
- Chile (fuel purchase transactions in the aviation sector)
- Mexico (purchase transactions in the fishing sector)

The following is a brief summary of the main sectors where double taxation agreements have been used and the countries with which they are mostly applied:

- Companies in the fishing sector
  - Application of the agreement with Spain
- Companies in the aviation sector
  - Application of the agreement with Chile
- Requests for information on individuals
  - Decision 578 issued by the ACN
  - Application of the agreement with Italy
5.5) Conclusions

I. DTAs are bilateral or multilateral mechanisms used by States for the purpose of preventing a taxpayer from paying taxes on the same income in two or more States. In the short term, signing DTAs is good for developing countries, because they are a way to lure developed countries into investing in developing countries while preventing them from paying taxes on their profits in two territories. However, taxpayers use DTAs to pay less taxes in source countries, so that they may re-export their profits.

II. With the aim of attracting FDI, Ecuador's TA issued a Production Code that provided for a 1% reduction in the income tax rate until it reached a 22% rate in 2013 (to remain constant thereafter). In addition, it granted income tax exemptions for a five-year period for new investments, as long as those investments were made out of Guayaquil and Quito, Ecuador's largest cities. This idea met the requirement of the development plan for smaller cities, creating a win-win situation for both the investor and the city where the investment was made.

III. In an average three-year period, the total amount of money sent abroad totaled US$1.18 billion, though taxes were paid only on 5.69% of that amount for a total of US$67 million. If the DTAs had not been signed, withholdings would have reached approximately US$290 million. This shows that from a fiscal standpoint Ecuador lost US$223 million in tax revenues, which could have been used in education, health, security, public works, etc.

IV. With the aim of reducing tax evasion and avoidance, Ecuador's Tax Administration has put forward amendments to tax laws and regulations. One of the main amendments is the foreign currency outflow tax, which is aimed at striking a balance in the money market of a dollarized economy, as well as at keeping away financial speculators or hot money investors, so that if they want to take their monies abroad they would now have to pay for doing so. This tax was created in 2009 at a 0.5% rate. In 2010 it was raised to 1%; in 2011 it rose to 2% and since 2012 it has remained at 5%. It was conceived as a way to stop the entry of speculative capitals, since investors would have to consider this cost at the time of repatriating funds to the headquarters in their countries of residence.
V. In addition, Ecuador’s TA has adopted the policy of negotiating DTAs with potential country investors, but it is also renegotiating agreements with countries that have already signed agreements, in order to distribute income more equitably.

VI. FDIs are an economic policy instrument to improve business competitiveness both in more industrialized countries and in developing countries.

VII. In the first stage, the investing company looks for markets or resources (natural or created) abroad. Then, the company makes investments on a sequential basis, and some time later it restructures its FDIs abroad to obtain higher profits based on the efficiency of its processes. The content of DTAs deals mainly with the distribution of the taxing power among States based on income type.

VIII. Another fundamental conclusion is that the main aim of DTAs is to avoid international double taxation, though they also seek to prevent fraud and tax evasion. Therefore, signing these agreements helps strengthen legal certainty for taxpayers and promote economic and business relations. By signing these international legal instruments it is also possible to exchange information among countries and ensure an equitable distribution of tax revenues between source states and states of residence.
5.6) Recommendations

I. One of the main recommendations is to revise the agreements as the economy becomes more dynamic, so that income distribution is more equitable in light of each country’s current situation.

II. It would be advisable that the Tax Administration intensively monitor the use of DTAs, especially in transactions with Venezuela.

III. Additionally, the exemptions granted by internal tax regulations should be revised, in order to reduce legal loopholes that pave the way for tax avoidance and to avoid tax sparing and matching credits.

IV. The tax legislation of the countries with which DTAs have been signed should be constantly reviewed, in order to avoid the creation of disadvantages for Ecuador by means of internal amendments introduced by those countries.

V. Developing countries should analyze the countries with which capital flows are increasing and the actual tax burdens of transactions when sending payments to headquarters.

VI. It is also advisable that developing countries get involved in forums where DTA-related issues are addressed, in order to make them known and contribute ideas for a better distribution of the tax burden.

VII. Each country should analyze existing DTA models and adapt them to its own reality, so that it can have a clear idea of what it is seeking in terms of taxing power at the time of negotiating.

VIII. Legislators of each jurisdiction should be educated, because they are the ones who ultimately approve these legal documents.

Bibliography


Double Taxation Agreements in Nicaragua

Adolfo José Acevedo Vogl
Brenda Marvelly Alfaro Ortiz

Summary

A growing internationalization of economic relationships is taking place in contemporary society. A significant number of transactions among economic agents are taking the form of cross-border transactions. Very often, they involve income flows that are the return on investments made by non-residents in a country’s territory—usually called source country—and which are sent to the country of residence of such agents.

Since each of the States involved in these transactions applies its own tax law when exercising its taxing power—which is a concrete example of the exercise of their Sovereignty—, it is possible to levy taxes on the income involved in these transactions twice: in the source country and in the country of residence of the economic agent.

Double Taxation Agreements are international legal instruments, usually signed by two States—although there may be a
greater number of contracting countries—which modify the enforcement of
domestic law in relation to non-resident agents, in order to determine which
of the Contracting States has the exclusive power to levy taxes on certain
income types, and which one has the power to levy taxes on other types of
income on a limited basis, thereby having to share the power to tax such in-
come with the other Contracting State.
The first section of this document presents an analysis of the role of Double
Taxation Agreements in economic and international legal relationships based
on the analysis of the specific restrictions established by such agreements
always to the detriment of the taxing power of the same type of State. Ad-
ditionally, it intends to show the destination of the resource transfers that
DTAs promote—always for the benefit of the same type of State.
The second section, taking the above mentioned as reference, analyzes the
latest amendments in Nicaraguan tax legislation in relation to the taxation
regime for non-residents, and tries to determine the extent to which these
changes may or may not facilitate or encourage the incorporation of the
country into the double taxation agreement network, or whether they evi-
dence any interest to move in this direction.

6.1) Introduction

International taxation has historically rested on two basic principles. The first
one is single taxation, which states that the revenue or income resulting from
a cross-border transaction should be taxed only once, neither more nor less
than once (which also means it just cannot be free from taxation).
The second principle is the principle of benefit: according to this principle,
the first right to tax income belongs to the source country, that is to say, to
the country where the income is earned, because the company that generated
the income benefited from the protection and from the public goods and
services provided by the source country’s Government.
Based on these principles, the League of Nations established, in 1923, the so-
called “first bite at the apple” rule72 according to which the source country (the

State from whose territory the income is sourced) has the primary right to levy taxes on the income originated within its territory, including the income of persons not domiciled or not residing in the country.

On the other hand, if the jurisdictional principle of residence is applied, the *country of residence* (the State where the taxpayer resides or is domiciled) is required to avoid double taxation by granting an exemption or credit for the tax already paid by its residents to the source country.

Therefore, the country of residence usually recognizes the primacy of the source country’s right to tax the income generated or earned in its territory, and it also recognizes the credits derived from the taxes paid in the source State (credit method) or exempts the income earned in the source country from paying taxes (exemption method).

In this case, both the source country and the taxpayer’s country of residence levy taxes in accordance with their domestic law, exercising their taxing power, but the country of residence recognizes that the taxes paid in the source country are to be discounted, by applying these methods, from the amounts the taxpayer should pay for the foreign source income.

This way of avoiding double taxation, which is carried out unilaterally, has been combined with the signing of International Double Taxation Agreements (DTAs).

Double Taxation Agreements—hereinafter called DTAs—are bilateral agreements that are applied preferably to the provisions of domestic law, thus modifying the non-resident general regime, either by determining non-taxation cases based on the sharing of taxing power between the Contracting States, or by reducing the tax rates applicable to certain income. The essential mechanism of the agreements is to grant each Contracting State the right to levy taxes on certain types of income or property, either by giving preference to one State over the other or by excluding one of them.

Despite the fact that these agreements are nominally aimed at “avoiding double taxation and preventing tax evasion,” they are actually not necessary to avoid double taxation, even though they could be useful in extreme situations, for example, when discussing the source of income. In fact, almost all countries unilaterally avoid double taxation, because the country of residence is obliged to grant an exemption on foreign source income or a credit for the tax paid in the source country.

The real function of these agreements is to divert tax revenues from source countries to countries of residence. With these agreements, the power of the source State to levy taxes on the income of non-residents earned in its territory is limited through different mechanisms.
In the case of active, business or economic income, the possibility of taxing income earned by non-resident companies or individuals from their economic activity in the source country is restricted to cases in which there is a permanent establishment, which is defined in a very restrictive way. In the case of passive income derived from return on investments in movable property assets (dividends, interest and capital gains), immovable property assets (leases and capital gains), or intangible assets (royalties and other payments for the use of intellectual property rights), the limitation of the right to levy taxes on non–residents’ income earned in the territory of the source country is effected by:

a. granting the country of residence the exclusive right to tax certain types of income generated or earned in the source country, or
b. establishing the obligation to share taxation of a third type of income with the State of residence and limiting the tax that the source country may impose on such income.

According to generally accepted rules, the source country has the primary right to levy taxes on income derived from sources related to its territory. In the absence of a DTA, source countries may tax, pursuant to their own legislation, both active and passive income connected to their territories, regardless of the nationality, domicile or residence of the recipients. On the contrary, by signing DTAs, governments, on the one hand, are prevented from taxing certain income types, fully waiving the right to levy taxes in favor of the country of residence, and, on the other hand, they are forced to share the right to tax other types of income with limitations on the tax they can levy on such income.

Furthermore, in the absence of DTAs, source countries are not bound by the requirement to have a permanent establishment in order to levy taxes on income from economic activities or by any restrictive definition regarding the type of income that is originated or has its source in the country (it is the country itself that autonomously defines the circumstances under which income is deemed to have its source in the country). Thus, upon signing DTAs, it is the source country that faces a total or partial loss of tax revenues from income that it is fully entitled to tax under customary international law, and therefore, this implies a loss of revenues in favor of the State of residence that would not occur if these agreements did not exist.
6.2) Nicaragua: a renewed interest to move forward in the signing of Double Taxation Agreements?

Until recently, Nicaragua applied a territorial income tax system and showed no interest or willingness to levy taxes on the income from economic activities of non-residents in the country or to properly levy taxes on income transfers abroad made by non-residents, so how important is it for Nicaragua to sign a DTA?

In this case, when one of the two countries does not apply residence or residence criteria, but only levies taxes on income derived from transactions related to its own territory, as is the case in Nicaragua, it does not have problems with double taxation of residents generating or earning income abroad, because, a priori, it has waived its right to fully levy taxes in favor of the source country.

This explains why the country does not have a natural interest in entering into this type of agreement. Furthermore, if it did negotiate a DTA, it would be in a weaker position, since it has, a priori, waived the right to tax its residents.

At the same time, the countries of residence of most investors were not interested in entering into DTAs with Nicaragua, because the country has a vast and generous tax incentive and privilege system that eliminates or strongly limits taxation on economic sectors in which foreign investment is important. Income from this type of investment is thus free from any burden or subject to minimum tax.

There is no accurate estimate of tax revenue loss resulting from exemptions and special treatments granted to foreign companies, because they are generally offered to specific sectors of the economy that favor both national and foreign companies.

Nevertheless, these sectors—free economic zones, mining, hotels, agribusiness consortia—are characterized by the predominance of the largest and most profitable companies in the country, many of which are often foreign-owned companies.

The official estimate of tax revenue loss resulting from these exemptions, tax breaks and special treatments showed that for 2010 this loss amounted to US$333.3 million, which was equivalent to 79% of that year’s income tax revenues.

The importance of this revenue loss becomes obvious if we take into account...
that per capita social investment in the country is extremely low and that the fiscal sacrifice arising from this exemption system is highly costly for the country in light of the lean positive results that it produces.

**Figure 6.1. Per capita public social spending for 2008, in constant 2000 US$**

![Bar chart showing per capita public social spending for 2008, in constant 2000 US$](chart)

*Source: Prepared by the authors based on information provided by ECLAC.*

At the same time, in more general terms, the income of non-residents has been given a highly favorable treatment. Most non-resident income was not taxed and if it exceptionally was, the rates applied were low. This treatment discriminated against national taxpayers and companies by creating tax haven conditions for certain income and income-generating activities conducted by non-residents.
Table 6.1. Non-resident tax withholdings up to December 2009

<table>
<thead>
<tr>
<th>Activity</th>
<th>Effective Withholding Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment of salaries, wages and other forms of compensation</td>
<td>Individual 20%</td>
</tr>
<tr>
<td></td>
<td>Legal Entity 10.5%</td>
</tr>
<tr>
<td>Royalties and other payments for Intellectual Property Rights</td>
<td>21%</td>
</tr>
<tr>
<td>Leasing of movies, radio and TV shows</td>
<td>9%</td>
</tr>
<tr>
<td>Transportation</td>
<td></td>
</tr>
<tr>
<td>Sea</td>
<td>3%</td>
</tr>
<tr>
<td>Land</td>
<td>3%</td>
</tr>
<tr>
<td>Air</td>
<td>1.5%</td>
</tr>
<tr>
<td>International Communications</td>
<td>1.5%</td>
</tr>
<tr>
<td>Insurance premiums and bonds</td>
<td>0.6%-3%</td>
</tr>
<tr>
<td>Public performances</td>
<td>Individual 15%</td>
</tr>
<tr>
<td></td>
<td>Legal Entity 10%</td>
</tr>
<tr>
<td>Income from immovable property</td>
<td>With buildings 21%</td>
</tr>
<tr>
<td></td>
<td>Without buildings 24%</td>
</tr>
<tr>
<td>Interest from loans granted by non-financial institutions</td>
<td>22.5%</td>
</tr>
</tbody>
</table>

It should be noted that no withholding was made on dividends or profits distributed to non-residents, on interest and returns resulting from loans granted by financial institutions or from investment in financial instruments, or on income from business activities conducted by non-residents in most of sectors and branches of the economy. This tax scheme was highly favorable for foreign investment income: between 2008 and 2011, the amount of non-residents’ investment income sent abroad totaled US$1.07 billion—excluding the amounts transferred through mechanisms such as transfer pricing and illegal flows. If a 25% withholding rate had been applied, US$269.5 million would have been collected, which is a considerable amount for a country like Nicaragua.
On October 15, 2009, the Executive sent a Tax Harmonization Bill [Iniciativa de Ley de Concertación Tributaria] to the National Assembly, which imposed a specific income tax (IT) on non-residents’ income. This income was defined as follows: “The IT governed by the regulations of this Chapter is levied on the income resulting from economic activities, from employment, from capital and from capital gains and losses, pursuant to the definitions and regulations set forth in previous chapters; that is obtained from Nicaraguan sources by individuals, legal entities and other entities not residing in Nicaraguan territory but conducting activities within it, with or without a permanent establishment.”

It established that this tax would be levied on non-resident individuals and legal persons earning incomes in the country’s territory with or without permanent establishment.

“The following are the IT taxpayers governed by the provisions of this Chapter: individuals, legal entities, and other entities without legal personality not residing in the Nicaraguan territory that earn income generated in said territory, with or without a permanent establishment” (Tax Harmonization Bill, December 2009, Chapter V, Non-Residents’ Income Tax)

Taxpayers earning income from economic activities by means of a permanent establishment located in Nicaraguan territory would be taxed on the total amount of the income attributable to that permanent establishment. In this case, the same provisions governing the taxation of residents’ economic activities would apply, and the same 25% rate would be applied on net income, after making all allowed deductions from gross income.

Those obtaining income without a permanent establishment would be taxed...
separately for each totally or partially accrued amount of the income being
taxed, without it being possible to offset them against each other. The tax
to be paid by non-residents not earning income by means of a permanent
establishment would result from applying a 25% rate to the taxable base repre-
sented by a percentage of the gross income that would be set forth by regu-
lations according to income type. The effective withholding rate according to
income source or type is not known, since the regulations of this Law were
never issued.
Under this Bill, the country would determine when an income is to be deemed
sourced in Nicaragua, and therefore, taxed. Thus, pursuant to this Bill, the
income derived from the following economic activities would be deemed
sourced in Nicaragua:

- The export of goods and services produced, manufactured, processed
  or marketed from Nicaragua, including their mere transfer abroad by
  means of agencies, branches, representatives, purchasing agents and
  other intermediaries of non-resident individuals or entities.
- Transportation services of people or goods to or from Nicaragua, re-
gardless of the place or form in which the fare or freight are issued or
  paid.
- Communications of any kind and by any means among people in Ni-
caragua and abroad, regardless of the place of incorporation, residence
  or domicile of those providing the services.
- Services used in the Nicaraguan territory which are provided from
  abroad, even if the one providing the service has not been physically
  present in Nicaragua, to any individual or company, trust, entity or
  community residing in the country, as well as to permanent establish-
  ments of non-resident individuals or entities, including those related to
  providing advice in technical, financial, administrative, and manage-
  ment or similar matters.
- The sale, assignment or, in general, any way of disposing, transferring
  or acquiring shares under any legal means, in which the percentage or
  the way of managing, owning or holding shares in legal entities, eco-
  nomic units or permanent establishments is changed.
- Public shows and performances presented in Nicaragua by artists and
  sportsperson and any other activity related thereto, even when the in-
  come is earned by a person other than the show organizer, artist or
  sportsperson or when it derives indirectly from such events.
- Acquisitions for no consideration, subsidies, grants and other forms of
  financial support paid by public or private entities to resident taxpayers.

It should be noted that some of these provisions are contrary to what DTA
models set forth. For example, the OECD model provides that profits from
the operation of ships or aircraft in international traffic are taxable only in the
country where the place of effective management is located.
Also, the Bill established that, in all cases, income earned from international traffic between Nicaragua and foreign countries would be considered Nicaraguan sourced income taxable by the Nicaraguan Government, regardless of the place or form in which the fare or freight are issued or paid.

As regards passive income from non-residents’ capital, this Bill set forth that the following income would be considered Nicaraguan sourced, pursuant to the “reinforced territoriality” criterion:

- Dividends, profits, earnings and other types of income derived from holdings in companies, trusts, entities or communities residing in the country or from holdings in the earnings of permanent establishments of non-resident entities.
- Interest, returns, commissions and the like arising from deposits, money loans, securities, bonds or other securities and financial instruments, regardless of the denomination given by the parties, as well as any other type of income derived from the transfer of own capital to third parties or paid by companies, trusts, entities or communities residing in the country or by non-residents’ permanent establishments located in the country.
- Royalties paid for the use of intellectual property rights by natural or legal persons, trusts, entities or communities residing in Nicaraguan territory or by non-residents’ permanent establishments located or used in the country.
- Income derived from immovable property located in the territory of the Republic.
- Capital gains and losses derived from shares, bonds or securities issued by natural or legal persons, trusts, resident entities or communities, as well as from other movable property other than securities or bonds, or from rights complied with or exercised in Nicaraguan territory.
- Capital gains and losses derived from rights, shares or holdings in resident or non-resident entities whose assets are directly or indirectly made up of immovable property located in Nicaraguan territory.
- Capital gains and losses derived from the transfer of rights, shares or holdings in resident or non-resident entities which grant their holders the right to enjoy immovable property located in Nicaraguan territory.
- Capital gains and losses derived from the transfer of immovable property located in Nicaraguan territory, as well as from transfers received for no consideration.

Notwithstanding the aforesaid, it is worth reviewing the official argument that explained the increase in withholding rate for non-residents:

“The international tax technique favors the application of high rates on income sent abroad, not only to meet collection goals, but also, and mainly, to promote the
signing of agreements to avoid double taxation among the Governments of resident and non-resident taxpayers operating with goods and services” (Government of Nicaragua, Rationale for the Tax Harmonization Bill, October 15, 2009). A possible interpretation of this argument is that, perhaps, they were “raising the bar” of the bill provisions in relation to the taxes levied on the income and profits of non-residents, firstly “to promote the signing of double taxation agreements,” and secondly, to be in a better position to negotiate these agreements. In any case, the Bill was never discussed by the National Assembly; instead, it was set aside because of the pressure exercised by business groups, and an amendment of existing legislation was approved after being negotiated, behind the scenes, among officials of the economic cabinet and representatives of the country’s business groups.

As regards the non-residents’ income, this amendment introduced a final withholding rate of 10% on Nicaraguan sourced interest and dividends paid to residents and non-residents (in the past only the interest of loans granted by non-financial institutions was subject to withholding at a 22.5% rate).

**Table 6.2. Withholdings made to non-residents as of January 2010**

<table>
<thead>
<tr>
<th>Activity</th>
<th>Effective Withholding Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment of salaries, wages and other forms of compensation</td>
<td>Individual 20%</td>
</tr>
<tr>
<td></td>
<td>Legal entity 10.5%</td>
</tr>
<tr>
<td>Royalties and other payments for Intellectual Property Rights</td>
<td>21%</td>
</tr>
<tr>
<td>Leasing of movies, radio and TV shows</td>
<td>9%</td>
</tr>
<tr>
<td>Transportation</td>
<td></td>
</tr>
<tr>
<td>Sea</td>
<td>3%</td>
</tr>
<tr>
<td>Land</td>
<td>3%</td>
</tr>
<tr>
<td>Air</td>
<td>1.5%</td>
</tr>
<tr>
<td>International Communications</td>
<td>1.5%</td>
</tr>
<tr>
<td>Insurance premiums and bonds</td>
<td>0.6%-3%</td>
</tr>
<tr>
<td>Public performances</td>
<td>Individual 15%</td>
</tr>
<tr>
<td></td>
<td>Legal entity 10%</td>
</tr>
<tr>
<td>Income from immovable property</td>
<td>With buildings 21%</td>
</tr>
<tr>
<td></td>
<td>Without buildings 24%</td>
</tr>
<tr>
<td>Dividends</td>
<td>10%</td>
</tr>
<tr>
<td>Interest</td>
<td>10%</td>
</tr>
</tbody>
</table>
Afterwards, throughout 2011, during negotiations with the IMF, this organization repeatedly expressed the need to revise the comprehensive tax exemption and tax break system to improve the State’s fiscal situation. The Government said that they would analyze options to amend the tax system.

In 2012, the authorities announced that they would engage in a new process to reach an agreement with the country’s business groups in order to amend the tax system. To begin with, they established that the tax exemption and tax break system favoring the sectors dominated by the largest and most profitable companies would remain untouched.73

Likewise, the Economy Minister announced that the preferential treatment accorded to capital income in relation to salary income would be maintained, and that the Income Tax (IT) rate on economic activities would be reduced.

The alleged purpose was to encourage investment as a way to promote growth, create employment, reduce poverty and improve the country’s competitiveness. The alleged objective was “to free economic forces to stimulate the productive capacity and to create employment, thus improving competitiveness” (Government of Nicaragua, Tax Harmonization Proposal, Managua, July 2012).

Likewise, it was established that one reason for the amendment was that “the need to enter into agreements with financial institutions such as the IMF, a vital factor to attract investment, motivates the introduction of fiscal corrections, including the revision of taxes” (Government of Nicaragua, Tax Harmonization Proposal, Managua, July 2012).

It was also announced that withholdings made to non-residents would be “revised,” but no further explanations were given in this regard. However, since it was announced that negotiations with business groups would be based on the Tax Harmonization Bill of December 2009, some positive result was expected, that is to say, some progress in relation to existing legislation.

The result of almost five months of negotiations was a new “Tax Harmonization Bill” sent to the National Assembly on November 22, 2012 and passed without further formalities or discussion a week later. This Law introduces different income taxes on business income, salary income, capital income, and capital gains and losses. The chapters referring to each of them establish the withholdings to be made to non-residents.

73 In an interview with TV Station 8, the Economy Minister said that “another issue that has to do with the objective of the Economic Policy is the incentive for sectors and different economic agents in the form of exemptions and tax breaks. And the first thing we would like to ratify in this regard … is that exemptions will remain untouched; exemptions are untouchable. That’s why we make clear that we are not discussing the possibility of removing them, because in many cases, more incentives are needed.”
Regarding income from non-residents’ economic activities, the concept of “reinforced territoriality” set forth in the October 2009 Bill is repeated, and it is stated that “income accrued or earned in the national territory, with or without permanent establishment” will be deemed to be Nicaraguan sourced. Such income is classified as follows:

- The export of goods produced, manufactured, processed or marketed in Nicaraguan territory, as well as the export of services even when they are provided in or from foreign countries and take effect in Nicaragua.
- Transportation services of people or goods from Nicaragua to foreign countries, regardless of the place or form in which the fare or freight are issued or paid.
- Communications of any kind and by any means among people in Nicaragua and abroad, regardless of the place of incorporation, residence or domicile of those delivering the services.
- Services used in the Nicaraguan territory but provided from abroad, even if the one providing the service has not been physically present in the Nicaraguan territory.
- Brokerage services concerning Nicaraguan sourced bonds, securities and other financial instruments, even if this brokerage takes place outside Nicaraguan territory.
- Public and private shows and performances and any other activity related thereto presented in Nicaraguan territory by residents or non-residents.
- Acquisitions for no consideration, subsidies, grants, cancellations and any other form of donation paid by public or private entities when they are received by resident taxpayers.
- The net profit originated by exchange differentials of assets and liabilities in foreign currency or with value maintenance.

The definition of taxpayer of the tax on income from economic activities repeats that taxpayers are “all non-resident individuals or entities operating with or without a permanent establishment” who produce or earn income from economic activities on a regular or occasional basis (Section 31).

This contrasts with the requirement set forth by the OECD Model Tax Convention (2008) and the UN Model Double Taxation Convention (2001), which provide that permanent establishment is a requirement for the source country to tax non-residents’ business activities in its territory. However, once again, it is worth recalling the Rationale for the October 2009 Bill, which established an interest in “promoting the signing of double taxation agreements.”
It is noteworthy, though, that, in the initial definitions of the Law, only two definitions are considered, one of them being that of permanent establishment, which is a virtual copy of the definition found in the UN Model Convention.

### Table 6.3. Definitions of permanent establishment in different models

<table>
<thead>
<tr>
<th>Definition of permanent establishment in the new Law</th>
<th>Definition of permanent establishment in the UN model</th>
</tr>
</thead>
</table>
| Permanent establishment is defined as:  
1. The place where the economic activity of a non-resident taxpayer is wholly or partly carried on, including:  
   a. The place of management;  
   b. branches;  
   c. offices or representative;  
   d. factories;  
   e. workshops; and  
   f. mines, oil or gas wells, a quarries or any other place of extraction of natural resources.  
2. It also includes:  
   a. A building site, a construction or installation project, or supervisory activities in connection therewith, but only if the duration of such site, project or supervision activity lasts more than six months; and  
   b. Business consultancy services, provided that they last more than six months within a yearly period.  
3. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status—acts on behalf of a non-resident taxpayer, that enterprise shall be deemed to have a permanent establishment in Nicaragua in respect of any activities which that person undertakes for the enterprise if such a person:  
   a. Has in Nicaragua an authority to habitually sign contracts or perform acts in the name of the enterprise; or  
   b. Has no such authority, but habitually maintains in Nicaragua a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise. | 1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.  
2. The term "permanent establishment" includes especially:  
   a. A place of management;  
   b. a branch;  
   c. an office;  
   d. a factory;  
   e. a workshop, and  
   f. a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.  
3. A building site, a construction or installation project, but only if such site, project or supervisory activity lasts more than six months; and  
4. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 6 applies—is acting in a Contracting State on behalf of an enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, if such a person:  
   a. Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 herein; or  
   b. Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise. |

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74 The comparative table of permanent establishment in the UN model and in the new Law was prepared by Adolfo Acevedo Vogl.
It is interesting that this definition should be deemed so important, and that, in fact, it should be one of only two definitions of terms, in a Law which does not limit taxation on non-residents’ business income to income obtained by means of a permanent establishment.

<table>
<thead>
<tr>
<th>Limits or restrictions on the taxing power of source countries set forth in DTAs(^{75}):</th>
</tr>
</thead>
<tbody>
<tr>
<td>A permanent establishment is deemed to be a necessary condition to levy taxes on the income earned in a territory by non-resident companies. The business profits obtained in the source country are taxable only in the Contracting State of which the company is deemed to be a resident, unless such company carries on activities in the other State (Source Country) through a permanent establishment. (OECD and UN Models, article 7)</td>
</tr>
<tr>
<td>The theory of the source, mainly supported by the signatory countries of the Andean Pact, excludes the theory of domicile or residence, and establishes that the country where the wealth is originated or where goods are located, or source country, is the only one with taxing power, regardless of the existence of a permanent establishment. The countries that favor the domicile or residence criterion, generally developed countries, support the permanent establishment principle.</td>
</tr>
<tr>
<td>The concept of permanent establishment was supposedly created as a midpoint between both positions. The scope of this concept seems to depend on the breadth of the definition of permanent establishment. If it is too broad, the establishment tends to coincide with the source. If it is too narrow, the actual taxing power of source countries is weakened and the taxing power of the countries of domicile or residence is strengthened.</td>
</tr>
<tr>
<td>The concept of permanent establishment that is mostly applied in international treaties is the one set forth by the OECD Model Convention, which has been followed by the UN Model Convention (with minor changes) and by most countries that have signed these agreements.</td>
</tr>
<tr>
<td>Article 5 of the OECD Model Convention refers to the permanent establishment and defines it as “a fixed place of business through which the business of an enterprise is wholly or partly carried on.” Paragraph 2 provides that “the term permanent establishment includes especially: a) a place of management; b) a branch; c) an office; d) a factory; e) a workshop; f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.”</td>
</tr>
<tr>
<td>This provision is quite narrow in its scope: in the OECD and US models, the threshold of the definition of permanent establishment is set at a high level, which shows an interest in limiting, as far as possible, taxation at source of capital exporting companies from developed countries.</td>
</tr>
<tr>
<td>In the OECD and US models, a building site or installation project must remain in the country for more than twelve months to be taxed, but in the UN model only six months are required. The articles of the OECD and US models also include a large list of exceptions(^{76}) and a specific prohibition against the provision (included in the UN model) according to which taxes are levied on income when there is a permanent establishment, even if they are not attributable to the permanent establishment. The OEDC model provides that income is taxable only when it is attributable to such permanent establishment.</td>
</tr>
</tbody>
</table>

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75 Table: Prepared by Adolfo Acevedo Vogl.

76 Article 5, paragraph 4 of the OECD Model excludes from the concept of permanent establishment: a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise; b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery; c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise; e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
As far as passive income is concerned, the agreements set forth income categories that are not taxable in the source State; as a general rule, income is only taxable in the taxpayer’s State of residence. The source State has to waive the right to levy taxes on such income or property. This is valid, for example, for:

- Royalties and other payments for intellectual property rights (OECD Model Convention, article 12), capital gains derived from the alienation of shares and other securities (article 13), and capital represented by shares and securities (article 22).
- Gains derived from the operation of ships and aircraft in international traffic or from boats engaged in inland waterways transport, gains from the alienation of such ships, boats or aircraft are taxable only in the State in which the effective management of the enterprise is located (articles 8, 13 and 22).
- Business profits and the income derived from the provision of independent personal services not attributable to a permanent establishment or to a fixed base in the source State are taxable only in the country of residence (article 7 and 14).

The following income categories are taxable limitedly in the source State:

- Dividends: if the holding in respect of which dividends are paid is not effectively linked to a permanent establishment or to a fixed base situated in the source State, such State has to limit its tax to 5 per cent of the gross amount of the dividends, when the effective beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends, and to 15 per cent of the gross amount in other cases (article 10);
- Interest: as in the case of dividends, the source State has to limit its tax to 10 per cent of the gross amount of the interest, in the case of interest not exceeding the normal market amount (article 11).

It is also worth mentioning that, as far as tax havens are concerned, it is established that “jurisdictions having an international double taxation agreement in force with Nicaragua with an exchange information clause” will not be deemed to be tax havens.

The following table shows the structure of effective rates applied as final withholdings on non-residents’ income:
Table 6.4. Effective withholdings made to non-residents as of January 2013

<table>
<thead>
<tr>
<th>Activity</th>
<th>Effective withholding rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Withholding on the payment of salary income to non-residents.</td>
<td>20%</td>
</tr>
<tr>
<td>2. Withholdings on income from economic activities:</td>
<td></td>
</tr>
<tr>
<td>Reinsurance</td>
<td>1.5%</td>
</tr>
<tr>
<td>Sea and air transportation</td>
<td>3%</td>
</tr>
<tr>
<td>International telephone communications</td>
<td>3%</td>
</tr>
<tr>
<td>Insurance premiums and bonds of any kind</td>
<td>3%</td>
</tr>
<tr>
<td>Other economic activities</td>
<td></td>
</tr>
<tr>
<td>3. Withholdings on income from movable capital (dividends, interest and financial income)</td>
<td>15%</td>
</tr>
<tr>
<td>Payment of dividends and interest</td>
<td></td>
</tr>
<tr>
<td>4. Withholdings on income from immovable property (leases and rents)</td>
<td>5%</td>
</tr>
<tr>
<td>Payment of leases and rents</td>
<td>7%</td>
</tr>
<tr>
<td>5. Withholdings on income from intangible capital (royalties and other payments for the use of intellectual property rights)</td>
<td>10%</td>
</tr>
<tr>
<td>Payment of royalties and other payments</td>
<td></td>
</tr>
</tbody>
</table>

It should be noted that, in the case of payment of dividends to non-residents, which seem to be the main form of return on foreign investment in Nicaragua, the effective withholding rate on gross income set forth by the OECD Model Convention is exactly the same (5%) as the one established for cases in which the beneficial owner is a company directly holding 25% of the shares of the company paying the dividends. Such rate is also much lower than the 15% established in the OECD Model for all other cases.

In the case of payment of interest, the effective 5% withholding rate is also scarcely half the rate established as a ceiling by the OECD Model Convention.

It is important to remember that the rate established up to that moment for dividends and interest paid to residents and non-residents was 10% on gross
income. In the Bill sent to and passed by the Assembly, the effective withholding rate on dividends and interest paid to residents was also reduced from 10% to 5%, just as in the case of non-residents; therefore, there seems to be a trend towards minimizing taxes on capital returns and capital gains.

Applying such a low withholding rate in Nicaragua implies that the remaining 95% of the gross amount of dividends or interest will be taxed in the beneficial owner’s country of residence (after crediting or exempting the 5% paid in Nicaragua), so that the purpose of DTAs in this field is already partly achieved, thanks to decisions made by the country itself.

In addition, the draft Bill (dated November 19) which was still being negotiated with business groups, provided for levying taxes on the dividends, interest, capital gains, royalties, and leases earned by Nicaraguan residents abroad under the “reinforced territoriality” criterion—which was certainly a step forward in the application of the residence principle. Specifically, the following was set forth:

“The following types of income earned or accrued by residents outside the national territory shall also be deemed to be capital income and capital gains and losses:

1. Profits, surpluses and other earnings paid in respect of holdings in companies, trusts, entities or communities not residing in the country;
2. Interest, returns, commissions and the like arising from deposits, money loans, securities, bonds or other securities or financial instruments, regardless of the denomination given by the parties, as well as other types of income derived from the assignment of own capital to third parties, paid by individuals or entities not residing in the country;
3. Intangible rights paid or credited by individuals or companies, trusts, entities or communities residing outside the Nicaraguan territory;
4. Income from immovable property located outside the Nicaraguan territory.”

Therefore, this draft bill provided for unilateral mechanisms to avoid double taxation, according to international customary practice:

**Correction of double taxation:** Should the income of a resident taxpayer include capital gains or income earned and taxed abroad, the smallest of the following amounts shall be deducted from the tax to be paid: a) the effective amount paid by the taxpayer abroad for taxes on such capital gains or income which are identical or analogous to this tax; or b) the result of applying a ten percent (10%)
rate on the portion of the taxable base which has been taxed abroad” (Draft Tax Harmonization Bill, November 19, 2009)

However, this November 19 draft was amended after negotiations, and in the final version sent to the National Assembly on November 22 it was set forth that passive capital income—dividends, interest, leases, capital gains and royalties—earned by residents outside the national territory, would be considered Nicaraguan sourced—and taxed in the country— “as long as they are derived from Nicaraguan sourced assets and capital.”

This means that residents in Nicaragua may be taxed only for capital income earned abroad only when the assets (shares, financial instruments, immovable property, etc.) or capital (movable, immovable or intangible) in which they invest are of “Nicaraguan origin.” This eliminates the progress made towards the residence-based system. The purpose of moving towards a residence-based system is to levy taxes on the earnings of residents who have invested in foreign assets, regardless of whether the invested capital has originated in Nicaragua or in a tax haven.

Pursuant to this new provision, if Nicaraguan residents invest in shares or financial instruments of non-Nicaraguan origin and/or the capital comes from an account in Grand Cayman, the returns on their investment will no longer be considered Nicaraguan sourced income and will be exempt from taxes in Nicaragua. This would make the provision on the implementation of unilateral measures to avoid double taxation virtually inapplicable, and this might have been the reason why it was deleted from the final version of the Bill sent to the National Assembly.

On the other hand, the November 19 draft set final IT withholding rates on capital income and capital gains and losses at 10% for non-residents operating with a permanent establishment, and at 15% for non-residents operating without a permanent establishment. As it has been observed, after the negotiations with business groups, nominal and effective withholding rates for the most important sources of income of non-residents were reduced. It is also worth wondering why no changes were introduced in this new Law in respect of tax exemptions granted to non-resident companies whose source countries apply the residence principle. As it is known, the residence-based system implies that taxes being paid in Nicaragua will be credited or deducted from the taxes to be paid in the country where headquarters are located or where the shareholders earning dividends reside. If they do not pay IT in Nicaragua, the only consequence is a transfer of taxes from Nicaraguan fiscal coffers to those of the country of residence of the shareholders or headquarters.
Perhaps the interest of those who negotiated this new Law when they agreed to keep this tax privileges for foreign investment untouched was to have clauses included in DTAs to acknowledge the tax incentives granted by the country to foreign investors in the form of exemptions and tax breaks, so that the country of residence would not offset them by taxing the income that was exempted in Nicaragua.

Nicaragua seems to have made significant progress towards addressing the negotiation of DTAs with investors’ countries of origin. The aspects of Nicaraguan law that do not conform to provisions can be considered items to be negotiated—otherwise, investors’ countries could find that national law already grants everything that could be achieved by means of a DTA—and they would become invalid upon signing the agreement.

Indeed, if necessary, it would not be at all difficult to amend Nicaraguan legislation afterwards—as it has occurred on many occasions with the agreements negotiated with the IMF—in order to fully adapt it to DTA provisions, based on the grounds that it is in the best interest of the country to do so—as it was argued whenever the agreements with the IMF required a change in the country’s legal system.
6.3) Conclusions and Recommendations:

I. Signing a DTA is not necessary to avoid international double taxation, since the design of the residence-based system allows for a unilateral mechanism to prevent a certain type of income from being taxed both in the source country and the country of residence: such mechanism involves granting credits for taxes paid in the source country (credit method) or excluding the income earned in the source country from the taxable income (exemption method).

II. However, signing DTAs is not only redundant: DTAs turn into a mechanism through which resources may be transferred from developing to developed countries. As it has been explained, its main function is to limit the power of developing countries to tax income from foreign investment.

III. In all cases, it is the source countries—that is to say, developing countries—that lose all or part of their revenues from taxes on income that they are fully entitled to tax under international customary law, and therefore, this represents a revenue loss in favor of the State of residence which would not occur if these agreements did not exist.

IV. Antonio Hugo Figueroa, who initially led the UN Committee of Experts on International Cooperation in Tax Matters and was later forced to leave his position under undue pressures, has written that: “The above-mentioned models (the UN model to a lesser extent) are ‘instruments aimed at solving the so-called double taxation problem’ of companies residing in capital exporting countries, by means of tax reductions in the developing country (source country) on the most important income in any bilateral economic relationship or, in some cases, by granting the country of residence of the beneficiaries the exclusive power to tax income derived from activities carried on in the developing country, including, most importantly, the provision of services and the construction and installation of all kinds of plants. According to the technique outlined in the models, the developed country, where the beneficiary of the income resides, does not make any fiscal sacrifice, it does not give up anything; it simply enshrines in the agreements ‘to avoid the so-called double taxation’ the same credit for the tax paid in the Developing Country that is already established in its domestic legislation. ‘This produces, as we have noted, an increase in its revenues as compared to the bilateral situation existing before the entry into force of the agreement.’
V. Therefore, signing these agreements is not only unnecessary but also counterproductive for countries like ours, which are in deep need of increasing their tax collection levels in order to be in a position to fund the provision of essential public goods to raise living standards and foster development. It is worth adding that, in the specific case of Nicaragua, the problem is not that the signing of these agreements will represent a revenue loss as compared to current revenue levels.

VI. In terms of the effective rate to be applied to foreign investment income, no withholding has been made so far, even though pursuant to Nicaraguan legislation, the fact that beneficiary companies are exempted from the payment of Income tax does not exempt them from withholdings on dividends and profits distributed to shareholders. Before the December 2009 Tax Reform, they would have been subject to the progressive scale applied to individuals, the maximum marginal rate of which was 30%.

VII. After the December 2009 Tax Reform, which excluded passive capital income (dividends and interest) from that progressive scale (which was then applied basically to employees and freelance workers), dividends and financial income were subject to a final withholding rate of 10%. However, for some reason, that withholding rate was never applied to foreign investment income. Therefore, technically speaking, reducing the effective withholding rate on dividends and financial income to 5% would not imply a real revenue loss. However, in our opinion, the results of a reform should be evaluated from the perspective of the country’s need to have a tax system based on the principles of generality, horizontal equity, and vertical equity (progressiveness); not only for basic equity reasons, but also because it is the only way in which the country may have the necessary resources to invest in education, health, social protection and basic infrastructure required to make the most of the current demographic transition phase and to reach the population aging phase in better conditions.

VIII. Along these lines, Nicaragua still faces the challenge of dismantling the costly system of exemptions, tax breaks and special treatments that benefit the economy sectors dominated by the largest and most profitable companies in the country (free economic zones, large hotels, mining companies, and large agribusiness consortia).

The system of “investment incentives” not only results in huge revenue losses as compared to the revenues that would be otherwise collected,
but also fails to guarantee capital flows in high value-added investments. Instead, it has been useful for attracting investment aimed at mining exploitation, taking advantage of cheap labor or acquiring already existing companies.

IX. At best, the attraction of investments in high value-added activities with important positive externalities seems to require specific characteristics such as workforce education and the availability of suitable infrastructure, but developing these aspects requires investment that cannot be made if tax collection is limited by mass and generalized incentives.

X. As regards passive income from capital investments, all the income sources of resident taxpayers, regardless of their source and country of origin, should be added up and the same progressive scale should be applied to all of them, thus eliminating any form of privileged treatment of capital income, and establishing a unilateral mechanism to avoid double taxation when this income is generated abroad. Under the international taxation technique, it would be correct to apply a higher withholding rate on non-residents’ income.

XI. Signing DTAs would mean that, even if such exemption and tax break system were eliminated or reduced to a minimum with the purpose of eventually taxing the income of the sectors enjoying these benefits—in which subsidiaries of transnational companies are of great importance—and even if global taxation on income and the residence-based system were established, these agreements would severely limit the Nicaraguan Government’s power to tax non-residents’ income, pursuant to its tax sovereignty and international customary law.

XII. In this sense, the DTA problem is similar to the one posed by Free Trade Agreements: they tie the hands of countries and prevent them from implementing the policies they need for equitable development. It is no longer a matter of domestic legislation, which may be amended at any time, but of a network of international agreements that limit the country’s scope of action. Hence, in our opinion, these agreements are not only redundant, but also highly counterproductive.

XIII. The recent tax reforms, exclusively negotiated with the representatives of large business groups, seem to show some willingness to make quick progress towards signing DTAs. Nevertheless, in light of the country’s need to dramatically increase tax burdens and turn the tax system into
a progressive system so as to be able to fund the necessary investments to achieve an equitable development, we recommend rethinking the chosen path and engaging in a more detailed discussion, through a highly participatory process, to decide whether this path is in the best interest of the country. This would imply submitting the long-term implications of making progress in the signing of DTAs to a more rigorous analysis and national debate, and steadily moving towards a global and residence-based tax system that includes a unilateral mechanism to avoid double taxation.

Some possible lines of action for promoting debate and discussion on these issues could be the following:

<table>
<thead>
<tr>
<th>Actors</th>
<th>Lines of Action</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Congressmen</strong></td>
<td>• Round table on the Tax Harmonization Act in force as of January 2013, focusing on the effective withholding rate applied to non-residents, and the implications of entering into a DTA.</td>
</tr>
</tbody>
</table>
| **Civil Society** | • Dissemination of the results of the Study on Double Taxation Agreements Study in the Tax Justice Workshops that are being delivered in 12 departments by 50 young people all over the country.  
• Presentation of the Study on DTAs to different civil society organizations, including women’s networks, teachers’ trade unions, youth platforms, national universities, and departmental networks, etc. |
| **Government** | • Arrangement of a meeting with officers of the General Tax Bureau, the Ministry of Economy Public Credit to present the Study on Double Taxation. |
| **Regional Alliances** | • International Forum on DTA implications with the participation of representatives from Latin America and the Caribbean who have worked on this issue, in order to jointly put together an agenda for regional advocacy. |

*Managua, April 8, 2013*
Bibliography:


Figueroa, Antonio Hugo (2012): ¿Tratados tributarios para evitar la doble imposición internacional o para trasferir recursos de países en desarrollo a países desarrollados? [“Tax treaties to avoid international double taxation or to transfer resources from developing countries to developed countries?”], in Voces Magazine, in Fénix No. 14, May 2012.


Double Taxation Agreements in Uruguay

Jorge Marchini

Uruguay is located in the South East of the continent, between the two largest countries in South America (Argentina to the West and Brazil to the North West); it has a long coastline on the Atlantic Ocean and the big estuary of the River Plate and the Uruguay and Paraná Rivers.

With an area of 176,215 km² and a population of 3,286,311 inhabitants, Uruguay is mostly a flat plain with some low hills which offers basic suitable temperature and humidity conditions for extensive cattle farming, forestry and agriculture. These activities also account for the country’s main exports.

Since farming activities are mostly extensive, 93.7% of the population lives in urban areas (1,319,000 in the capital city, Montevideo) with a high standard of living (education, health, access to basic services). The country’s most developed activities are services (government, finance, tourism) and some transformation industries (food, textiles, construction materials, auto parts, among others).

77 National Institute of Statistics of Uruguay (INE, by its Spanish acronym) - see http://www.ine.gub.uy/
Uruguay has a reputation for social and legal stability, even though it has
gone through significant changes and crises along its history, just like other
countries in Latin America.

Compared to the region, Uruguay has always stood out for the competitive
factor of being an open economy that promotes and protects foreign invest-
ment. The country has maintained a liberalizing and deregulating policy for
decades and under various administrations based on a promotion framework
characterized by liberal measures, protection of investment and the devel-
opment of free economic zones with ample freedom for the development of
activities. All this is combined with the elimination of restrictive controls to
financial and capital movements, the preservation of bank secrecy and abso-
lute freedom to negotiate foreign currency, which has turned the country into
an important financial hub in the region.

Uruguay is a member of the Common Market of the South (MERCOSUR,
by its Spanish acronym), created in 1995 by Argentina, Brazil, Paraguay and
Uruguay. Its purpose was to create a customs union through the elimination
of tariffs among member states and a gradual reduction of barriers in order to
enable the free movement of goods, services and people. The differential open
market policy has historically been justified as necessary in order to compen-
sate Uruguay for the impossibility to compete on an equal footing with its
large neighboring countries. This is part of a much more general debate in
core and periphery countries on the role and conditions for development in
smaller economies versus bigger economies, and the problem of the so-called
“asymmetries.”

Welfare and stability conditions, added to financial liberalization, earned the
country the name of the “Switzerland of the Americas” in the 20th century.
Although this name has created a praiseworthy image of the country, it has
also aroused debates on and criticism of the role of Uruguay as a shelter for
non-registered capitals and tax evasion, since the country is considered an
offshore financial center.

78  See http://elsolonline.com/noticias/view/130645/uruguay-denuncia-asimetrías-en-el-cumplimien-
to-de-normas-del-mercosur (in Spanish)

79  As we will see later, until late 2011 the OECD included Uruguay in a “grey list” of countries
prepared by its Global Forum on Transparency and Exchange of Information for Tax Purposes. Now,
although it has overcome this status, the country is still under observation – see http://www.elpais.com.
uy/111216/pecono-612935/economia/ocde-saco-de-lista-gris-a-uruguay-pero-resta-cumplir-otros-pasos/
(in Spanish)
7.1) Liberal treatment of capital and investment

The promotion and protection of investments has been a consistent policy of the Uruguayan Government, based not only on the equal treatment of national and foreign investors but also, in particular, on ample freedom to operate in the financial market and the absence of authorization requirements for transactions in foreign currency or the inflow/outflow of capital.

The financial deregulation and liberalization strategy of Uruguay has meant that many limiting controls are non-existent and that the country has become an offshore financial center, particularly for capitals from Argentina and, to a lesser extent, from Brazil, with international banks and operators praising the favorable legal, tax and financial conditions as compared to other countries in the region.

Uruguay is a member of international organizations that promote the security of investments, such as the Multilateral Investment Guarantee Agency (MIGA) and the International Center for Settlement of Investment Disputes (ICSID), which belongs to the World Bank Group. Furthermore, it has entered into treaties for the reciprocal promotion and protection of investments with Armenia, Australia, Belgium-Luxembourg, Bolivia, Canada, Czech Republic, Chile, China, El Salvador, France, Germany, Hungary, Israel, Malaysia, Mexico, the Netherlands, Panama, Poland, Portugal, Romania, Spain, Sweden, Switzerland, United Kingdom, the United States, and Venezuela.

Besides non-discriminating between local and foreign investors in terms of access to incentives for the promotion of investment offered by the Government, there are no limitations on the share of foreign capitals in domestic companies. The tax system in Uruguay is also neutral with respect to foreign investment. No prior authorizations or registrations are required to invest, except for environmentally-related permits. There is a single exception to foreign holdings, which is related to the operation of radio and TV stations, since their directors must be Uruguayan citizens.

One of the most outstanding aspects of the liberal treatment of foreign investments/capitals (with tax consequences) in Uruguay is the fact that it is easy to create corporations (the most frequently used type of company), limited liability companies (SRL, by its Spanish acronym) or other types of companies that may be set up by local or foreign individuals and legal entities. This is criticized particularly by those who remark on the possibility of concealing money laundering or other non-registered operations and therefore, tax evaders from other countries.
From a financial system standpoint, Uruguay has a public banking system\(^{80}\) (Banco de la República [Bank of the Republic] and Banco Hipotecario [Mortgage Bank]) and a very important private brokerage sector (accounting for more than half the financial assets deposited in the country\(^{81}\)) made up of commercial banks and brokerage cooperatives. These institutions may take savings, open accounts, grant loans, and provide other services to customers (guarantees, sureties, investment products, foreign trade transactions, etc.) just like other financial institutions all over the world.

In any case, from a tax evasion perspective, the following offshore service providers have special significance:

- financial firms [casas financieras], which carry out all manner of financial transactions except for those reserved to banks and cooperatives (for instance, opening checking accounts), but are authorized to receive resources both from residents and non-residents, and
- Offshore Banking Institutions [Instituciones Financieras Externas], which are institutions that provide financial services exclusively to non-residents under a specific regulatory framework, and are fully exempted from any kind of tax.

Finally, the significance of free economic zones should be mentioned. They were initially set up for the production and trading of real goods and services,\(^{82}\) but later they were authorized to carry out financial transactions for “non residents”.\(^{83}\) Currently, there are free economic zones in the cities of Canelones, Colonia, Colonia Suiza, Florida, Fray Bentos, Libertad, Montevideo, Nueva Helvecia, Nueva Palmira, Punta Pereira, Río Negro and Rivera.

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80 The financial system is controlled by the Banco Central de Uruguay [Central Bank of Uruguay] (BCU, by its Spanish acronym), which has a large number of functions.
82 Law No. 15,921.
7.2) The Uruguayan tax system

The Uruguayan tax system includes indirect and direct taxes. Indirect taxes are the main source of revenue. The main taxes are: Value Added Tax (VAT), which accounts for over 50% of revenues,\textsuperscript{84} Income Tax on Economic Activities (IRAE, by its Spanish acronym), which has a lower share in total fiscal revenues and also promotes investment, and Property Tax (PT).

Value Added Tax (VAT) is a tax levied on the domestic circulation of goods and services, imports and the addition of value arising from building on land. The basic VAT rate is 22% and there is a minimum rate of 10% applicable to staple commodities and medicines, as well as a series of goods and services that are exempted from the tax.

Income is taxed by the Income Tax on Economic Activities (IRAE, by its Spanish acronym), the Income Tax on Individuals (IRPF, by its Spanish acronym) or the Income Tax on Non-Residents (IRNR, by its Spanish acronym), as the case may be.

IRAE is an annual tax levied at a rate of 25% on net income originating exclusively in Uruguayan sources and derived from economic activities of whatever nature. Income from Uruguayan sources is that obtained from Uruguay-based activities or assets, or from rights economically exploited in Uruguay. Income derived from agriculture is also subject to IRAE; though in certain cases taxpayers may opt to pay either this tax or the Tax on the Sale of Agricultural Goods (IMEBA, by its Spanish acronym), which is specifically applied to the sale of agricultural products.

Income Tax on Individuals is a personal and direct tax levied on income from Uruguayan sources obtained by resident individuals. For the purposes of this tax, residents are individuals who stay in the country for more than 183 days per calendar year or who have the center of their vital or economic interests in Uruguay. The tax is applied under a dual system that distinguishes income derived from capital as a factor of production (taxed at proportional rates that range between 3% and 12%) and income derived from labor as a factor of production (taxed at progressive rates that range between 0% and 25%).

\textsuperscript{84} See statistics at http://www.dgi.gub.uy
Income Tax on Non-Residents is an annual tax applied on income from Uruguayan sources obtained by non-resident individuals and companies. The tax is applied at proportional rates that range between 3% and 12% depending on the type of income.

Property Tax is levied on the assets in the country (after deduction of certain debts) at the end of the fiscal year, at a rate of 2.8% for banks and financial institutions and 1.5% for other legal entities. Individuals pay Property Tax at progressive rates that range between 0.7% and 2.5% with a tax-free allowance of around US$110,000 and twice that amount for family groups. Property Tax settled by industrial and commercial companies, including financial entities, can be compensated by up to 1% with the Income Tax on Economic Activities paid in the same fiscal year (except in the case of non-resident companies or resident companies with bearer shares of stock or with shares of stock held by another company).

With reference to the topic under discussion, it should be emphasized that, given the advantages offered by Uruguay as an open financial center, brokerage firms that carry out only offshore operations are exempted from Income Tax on Economic Activities and Property Tax, and corporations that carry out goods trading activities are subject to a preferential tax scheme, under which they pay IRAE at a rate of 25% on 3% of the difference between the sale price and the cost price.

Finally, operations conducted in free economic zones enjoy broad tax exemptions, and they are not subject to domestic or foreign trade taxes.

The liberalization and openness policies maintained in recent decades, even with different political parties in power, has enabled Uruguay to strictly comply with its international obligations, as opposed to other countries in the region (particularly Argentina, which defaulted on its debt and dismantled its banking system in 2001).

The concept “we are different” has been emphasized as a core argument for Uruguay to position itself favorably in international markets and develop a reputation as a regional financial center, with a long tradition of freedom for capital movement and investment security.

Uruguay offers full freedom in the movement of capitals, foreign currency and gold to and from the country and a free convertibility exchange system for local currency. The maintenance of an open financial system, the liberalization

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85 A statement from the then President of Uruguay, Jorge Batlle, in the context of the deep crisis in Argentina in the early 21st century is still remembered: “The Argentines are a bunch of thieves, from start to finish”. Clarín newspaper, June 4, 2002, Buenos Aires, Argentina. Available at http://edant.clarin.com/diario/2002/06/04/p-01201.htm
of international financial transactions and a legally established bank secrecy policy have turned Uruguay into the leading financial hub in the region. Around 76% of deposits in the financial system are in US dollars and 22% of them belong to non-residents.\footnote{86 “Guía para el Inversor” [Investor’s Guide]-Uruguay XXI- Montevideo, Uruguay, 2012.}

Furthermore, Uruguay maintains an orthodox macroeconomic policy that combines a fiscal policy based on the attainment of primary surpluses consistent with the sustainability of its public debt and a monetary policy primarily intended to maintain price stability (inflation targeting).\footnote{87 IMF (2011).} Discipline in public accounts is also shown by the existence of a law that sets a maximum annual variation level in public indebtedness.\footnote{88 Law No. 17,947.}

### 7.3) Uruguay and the growing significance of FDI

FDI flows in Uruguay have been increasing considerably over the last few years. Foreign investment has been at its high since 2008, with an average inflow of more than US$2 billion a year. In 2011, the FDI stocks totaled US$14.859 billion, leaving Uruguay with one of the highest FDI stock to GDP ratios in the region.

**Figure 7.1. FDI in Uruguay, in million US$ and as a percentage of GDP, 2001-2012.**

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{fdi_uruguay.png}
\caption{FDI in Uruguay, in million US$ and as a percentage of GDP, 2001-2012.}
\end{figure}

*Source: Uruguay XXI based on BCU.*
Uruguay has one of the highest FDI to GDP ratios. Particularly in 2011, the FDI reached US$14.85 billion, accounting for 32% of GDP. This ratio is higher than that of Argentina (21.3%), Brazil (27.1%) and Colombia (20.3%), but lower than that of Chile (63.6%).

It should be noted, though, that the main production projects undertaken in the last few years in the field of industrialization of forestry production in connection with cellulose pulp, mining and other prospective export-related projects may enjoy the advantages of being considered extra-territorial for tax purposes by being granted the status of “free economic zones”.

This results in general and broad exemptions from Income Tax on Industry and Commerce (IRIC, by its Spanish acronym) and Property Tax. In the case of IRIC, the exemption does not apply to dividends and profits paid or credited to foreigners when they are taxed in their country of origin and tax credit is granted for the tax they paid in Uruguay. Attention has also been brought to “free economic zones” following reports of maneuvers in connection with foreign trade operations in Argentina, which allegedly used the advantages of liberalization to evade taxes through ghost companies.

7.4) Uruguay and Double Taxation Agreements (DTAs)

Particularly in recent years, Uruguay has entered into double taxation agreements (DTAs) that have been justified as a way to facilitate “the expansion of companies both in developing and developed countries and to promote investment in the country where they establish their operations.”

89 The investment made by the Finnish group Botnia (now UPM) was of approximately US$1.2 billion and this was included in the FDI figures for 2005-2006. The investment made by the company Montes del Plata (a joint venture of the companies Arauco from Chile and Stora Enso from Finland) is estimated at around US$1.9 billion for the facilities and US$700 million for the land. The plant will be operational in 1Q 2013. This investment will be included in FDI figures for 2011, 2012 and 2013.

90 Iron extraction by Minera Aratiri.

91 A deepwater port, a regasification plant, and a potential third pulp mill.

92 “El ABC de las Zonas Francas en Uruguay” [Free Economic Zones in Uruguay], Uruguay XXI, Montevideo, Uruguay. See also Law No. 15,921 on Free Economic Zones and its regulatory decrees.


94 See the official website of the Office of the President of Uruguay http://presidencia.gub.
The treaty signed with Germany, for instance, is derived from the “German model” inspired in the OECD model. The main aspect of this treaty is the reduction of tax withheld, as applicable, on payments or credits made to the other signatory country for royalties, technical assistance, interest and dividends. Under certain conditions in Uruguay, all these items, except interest, are subject to a withholding tax in the case of payments or credits sent abroad.

Under the DTAs, the rates are reduced as follows:
- Dividends, royalties and interest: up to 15%.
- Payments for technical assistance: up to 10%.

The concept of permanent establishment has been introduced in order to accept taxes by the country where the establishment is located. The treaty signed with Hungary contains provisions similar to those in the treaty signed with Germany.

Furthermore, Uruguay has information exchange agreements that adopt the standards proposed by the OECD.

Uruguay has been accumulating international tax treaties not only for the purpose of establishing mechanisms to avoid international double taxation, but also to respond to international pressure for the country’s being described as not very collaborative and for its inclusion in the “grey area,” after failing to pass “phase 1.” That is, until 2011, its domestic legislation did not provide for transparency and the international exchange of tax information, according to the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes.

Furthermore, Uruguay relaxed its bank secrecy policy. The rule established that if a foreign State with which Uruguay had signed a tax information exchange treaty requested tax information from the General Tax Bureau (DGI, by its Spanish acronym), that country could file a petition with a judge to lift bank secrecy, although initially this was applicable to information of fiscal years starting as from January 1, 2011 only. Parliament also approved the creation of a bearer security registry.

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In October 2012, the Assembly of the OECD Global Forum held in Cape Town reassessed the situation of Uruguay and approved its removal from the “grey list” of non-cooperative countries that had not implemented the internationally agreed standards. Thus, the country was moved to the “white list” and started Phase II, which includes an analysis in 2014 of the implementation of the regulatory system evaluated in Phase I.

The report that led to the Global Forum’s approval included, in particular, the reiteration of the claim that had already been expressed in the previous 2011 critical report: Uruguay had to make available the information of Argentinian and Brazilian savers who had accounts in the country and who were then protected by bank secrecy.

The report stated that “Uruguay should make sure that all relevant banking information is accessible for the exchange of information, regardless of the time period, to ensure the full enforcement of its information exchange agreements.” It even mentioned that retroactivity to early 2011 was “limited”. Furthermore, it stated that “Uruguay should rapidly expand its network of Exchange of Information (EOI) Agreements and prioritize the conclusion of agreements with Argentina and Brazil.”

“The 2011 report had already indicated that Uruguay’s EOI Agreements were not adequate. In particular, Uruguay had been notified that its two main partners (Brazil and Argentina) had unsuccessfully tried to engage in negotiations with it, which indicated a lack of commitment on the part of Uruguay.”

In recent decades, Uruguay has been considered as a tax haven, particularly in relation to other countries in South America. Broad deregulation of fiscal exemption and bank secrecy policies to attract investment implied that, as opposed to other countries in Latin America under study, it did not deem necessary to make progress with DTAs in the 1990s, when these agreements were most popular as part of the neoliberal strategies adopted in the region.

The recent introduction of DTAs by Uruguay was the consequence of several factors: on the one hand, the changes introduced in the Uruguayan tax system in 2007, which resulted in an immediate prohibition on the creation of new offshore companies in the form of financial investment corporations (SAFI, by their Spanish acronym) (and in the adaptation of those that had already been operating since 2010 to new criteria and requirements for more transparency

99 See report at http://eoi-tax.org/jurisdictions/UY#p1
100 Tax Transparency Report 2011.
in their composition). Another factor was the introduction of the obligation for individuals to pay income tax, since before that they were not subject to this tax.\textsuperscript{101} This was compounded by the growing international pressure, through the OECD, for Uruguay to adopt the tax standards mentioned above.

Therefore, it is important to note that the perspective for the introduction of DTAs in Uruguay has been very different from that of other countries in Latin America. The process has not been part of a broader political and social debate and/or a fundamental strategic deviation from previous conditions. DTAs were essentially an answer to the need to adapt to new international tax conditions and demands while trying to maintain the same country profile, with conditions that favored rather than restricted investment and capital movements.

In the process of overcoming its status of country under observation, Uruguay made quick progress in the signing of new agreements. To date, the country has signed 13 DTAs and 12 information exchange agreements. The change was acknowledged in 2011 by OECD Secretary-General Ángel Gurría: “I congratulate the government for swiftly acting to adopt the recommendations of the Global Forum (on Transparency and Exchange of Information for Tax Purposes) and implement global standards.”\textsuperscript{102}

### Table 7.1. Uruguay, DTAs in force as of April 2013

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>SIGNATURE</th>
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Source: OECD - Exchange of Tax Information Portal (http://eoi-tax.org)


\textsuperscript{102} Available at: http://www.oecd.org/newsroom/taxuruguaystaxtransparencyimprovingsaysoeccdgurria.htm
Table 7.2. Agreements for the exchange of tax information as of April 2013

<table>
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<tr>
<td>Sweden</td>
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<td>Yes</td>
</tr>
</tbody>
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Source: OECD - Exchange of Tax Information Portal (http://eoi-tax.org)

7.5) Conclusions

I. Even with administrations of different background and ideological positions, Uruguay has maintained an ongoing strategy based on openness, liberalization and regulatory stability and economic reliability. Over the years, the liberalizing and deregulating philosophy of Uruguay found expression in the establishment of a liberal framework for the promotion and protection of investment, the development of free economic zones with ample freedom for business activities, the elimination of restrictive controls on capital and financial movements, and the maintenance of bank secrecy and total freedom to make transactions in foreign currency, thus becoming an important regional financial center. The openness policy has been historically justified as necessary to compensate Uruguay for the impossibility to compete on an equal footing with its large neighboring countries.
II. Recent progress made in connection with DTAs is praised by the government and leading economic sectors essentially as a way to attract more foreign investment rather than to fight tax evasion and avoidance. As the Office of the President of Uruguay stated, DTAs “facilitate the expansion of companies both in developing and developed countries and promote investment in the country where they set up their operations.”

III. The most significant problems concerning tax evasion and avoidance are closely linked to Argentina. Uruguay is still a convenient destination for unregistered Argentine capitals and foreign trade transactions, as individuals and companies can benefit from tax differentials and the underbilling of exports and the overbilling of imports. In recent years, this trend has increased with the introduction in Argentina of tighter foreign exchange controls on foreign trade operations (see chapter on Argentina). Reports already exist of wrongdoings using apocryphal invoices made out by large agricultural exporters who take advantage of the Uruguayan free economic zones.

IV. In 2012, Argentina and Uruguay reached an initial understanding for signing a tax information exchange agreement (an instrument that in Argentina is now considered more effective and straightforward for detecting extraterritorial tax evasion). This agreement, effective as of February 2013, has some specific characteristics. Even when it has certain limitations (it will not be retroactive, it will be limited to criminal cases, it cannot be used for fishing expeditions), it may become a significant benchmark for individuals and organizations that report evasion or illicit maneuvers.

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103 Communication of the Office of the President of Uruguay, November 29, 2012.
104 “Trabas argentinas buscan mitigar la fuga de capitales” [“Argentine Obstacles to Mitigate Capital Flight”]. El País newspaper of Uruguay (in Spanish).
7.6) Proposals

I. There seems to be no social movement in Uruguay that has included the revision of DTAs on its agenda. The challenge is to show their significance and the negative impact they may have both on tax revenues and on Uruguay’s increased dependence on foreign economic and trade cycles, with no matching increase in productive investment and job creation.

II. For now, it is possible to observe the growing significance, in the Uruguayan balance of payments, of income payments abroad in relation to capital accounts of Uruguay, but it is essential to further investigate the effects of DTAs. This may well be related to the advantages offered by free economic zones, not only for their lack of “fiscal accrual” but also for the priority status accorded to large public works projects (roads, electricity and communication networks, ports, etc.) without correlative compensation through taxing. This should be addressed in a serious and effective manner, taking into account that the belief still prevails in Uruguay that a liberal approach to investment and finance is the only way to attract significant productive investments.

III. It is necessary to link the demand for transparency and tax justice in Uruguay with other regional social movements, connecting this issue to the fair claim for the “asymmetries” of a small country vis-à-vis its larger neighbors (Argentina and Brazil), and to the analysis of the conditions and effects of mega investments in the extractive sector that are currently multiplying in Latin America (and to which governments grant huge advantages). Uruguay should have opportunities for sustainable development and employment in priority complementation with Latin America.

IV. Social movements should pay special attention, develop critical capability and put forward alternatives to prevalent positions in the Uruguayan political scene that favor more openness and liberalization in the country through free trade agreements with core countries, even if this reverses the priority given to regional integration processes (MERCOSUR and ALADI, by their Spanish acronyms), which are now strongly criticized and blamed for the problems and restrictions in the country. An effort should be made to prevent the defense of national interests from being misunderstood and disarticulated and turned into dangerous circumstantial chauvinism, particularly serious in recent years in relation to Argentina.
Bibliography:


Sources:

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Banco Central de Uruguay [Central Bank of Uruguay] (BCU, by its Spanish acronym)

Office of the President of Uruguay.


Exchange of Tax Information (OECD).
Double Taxation Agreements in Venezuela

Jorge Marchini

8.1) Introduction

The Bolivarian Republic of Venezuela is located on the North Atlantic coast of South America, with an area of 916,445 km² and an estimated population of 29,105,362 inhabitants (2009). It is considered a country with vast natural resources, biodiversity with a varied geography including the Andean mountains to the west, the Amazon basin and jungle to the south, the extensive plains and the Caribbean coast at the center and the Orinoco River delta to the east.

Up until the first decades in the 20th century, the Venezuelan economy was mainly focused on agricultural (coffee, cocoa, sugar, tobacco) and cattle farming products and exports, but as from the 1920s the oil business started to be more prevalent as huge, easy to exploit hydrocarbon reserves were found, bringing significant economic changes (gradual abandonment of farming activities) and social changes (urban population growth to the detriment of the rural population).

By 1928 Venezuela was the second world
oil producer and the top exporter, and it maintained this leadership position until the early 1970s. In the 1930s, the oil sector concentrated, as it does at present, more than 90% of the national exports, and this gave rise to a permanent economic debate on the contractual, labor and tax conditions for oil companies.

Social and political mobilization after a long dictatorship period (administrations of Juan Vicente Gómez from 1908 to 1935, Eleazar López Contreras from 1935 to 1941, and Isaías Medina Angarita from 1941 to 1945) led to the emergence of a brief civil government headed by Rómulo Gallegos between 1947 and 1948. This administration imposed, under the critical influence of its Mining and Hydrocarbon Minister Juan Pablo Pérez Alfonso (who later on became one of the creators of OPEC, Organization of Petroleum Exporting Countries), the contractual and tax formula known worldwide as “fifty-fifty” (50-50), whereby oil surplus was distributed in equal parts between the Venezuelan government and private oil companies operating in the country.

Under the subsequent military dictatorship of Marcos Pérez Jiménez (1951-1958), the economy grew building on the contractual conditions established by the civil government and high world oil demand. Investments were brought to somehow modernize the infrastructure, though their concentrated benefits remained with the elite surrounding the political power at the expense of limiting political participation and social inclusion.

The fall of Pérez Jiménez by a military insurrection in 1958 led to the establishment of democracy and the signing of the so-called "Punto Fijo Agreement," which implied the hegemonic presence of two parties in political life during four decades: the Social Democratic party Acción Democrática [Democratic Action] (AD, by its Spanish acronym) and the Social Christian party Comité de Organización Política Electoral Independiente [Committee of Independent Electoral Political Organization] (COPEI, by its Spanish acronym).

The 1960s saw the emergence of rebel and social movements which, even though they failed to succeed, placed oil nationalization and criticism to corruption in ruling sectors at the core of their claims.

The election of Carlos Andrés Pérez from AD as president in 1973 coincided with the international oil crisis and with a marked international price increase, and thus enjoyed a period of economic splendor as a result of large public income. This also allowed for oil nationalization in 1976 and the creation of the powerful state-owned oil company PDVSA.

In contrast, the fall of oil prices by the early 1980s directly influenced subsequent, recurrent crises. Governmental failure, a dramatic drop in the living conditions of a vast majority of the population and an increase in poverty and exclusion resulted in a popular uprising in 1989 known as "Caracazo" and in the emergence of a rebel military leader: Hugo Chávez.

After being in prison until 1994 for having headed an insurrection against the implementation of economic adjustments, Chávez was amnestied and then
democratically elected President of the Nation in 1998. His main campaign argument was based on his criticism of the Punto Fijo political party system and on a nationalistic discourse (called "Bolivarian Revolution") that enabled him to remain in power from then on based on popular support recurrently ratified in elections.106

Based on a rise in prices, an increasing role of the state-owned oil company PDVSA and a renegotiation of the contractual terms with the private oil sector, the Chávez administration managed to have increasing public resources channeled into actions/programs for greater redistribution of income, such as advancing the agrarian reform, nationalizing basic economic sectors (telecommunications, finance, electricity, cement, steel) and supporting an active policy to foster political and economic integration with other countries in Latin America.

But in spite of the aspirations of the Chávez administration, Venezuela continues to have a non-diversified economic base and a State whose income is heavily dependent on the behavior of oil prices and oil exports, despite the introduction of some partial and limited tax amendments.107

8.2) Economy, investments and public resources

In economic and social terms, Venezuela has experienced a dramatic change in the past 14 years. It has significantly progressed in terms of equality—Venezuela has the fairest income distribution in Latin America, according to the Gini index, which in 2011 dropped to 0.39.108 Brazil’s index, for example, was 0.52—a historic figure in its own records. However, Venezuela’s evolution has been difficult and it has not been possible to change one of the central goals set up-front: to modify and diversify the country’s productive and economic base, which is mainly based on tapping the most significant natural resource in the world market: oil.

106 President elect Hugo Chávez died on March 5, 2013. As he had been in office for a new term for less than a year, elections were held within three months after his death, as stated in the Venezuelan Constitution. Thus, on April 14, 2013, with 50.7% of the votes, the candidate for the ruling party, the Partido Socialista Único de Venezuela (United Socialist Party of Venezuela), Nicolás Maduro, was elected President.

107 The government introduced some taxes on non-priority and luxury items with the aim of shifting the tax burden from the poorer sectors to the richer ones and helping control inflation. In 2005, a 0.5% rate was introduced for financial transactions (it was repealed in 2006) and Value Added Tax (VAT) was reduced from 14% to 9% for basic products. However, VAT was increased to 12% in 2009 to compensate for lower oil income as a result of a drop in prices following the international crisis.

108 Information obtained from ECLAC online Statistics Division. See http://websic.cepal.org/sisgen/ConsultaIntegradaFlashProc.asp# (in Spanish)
Hugo Chávez took office as president in a country with an economy in recession and high inflation, with an unfavorable international context, marked by Russia’s situation following the Asian crisis and a fall in hydrocarbon prices. This weakness continued for a few years, together with very strong and constant political opposition (including a failed coup in 2002 and a long-lasting oil strike in 2002-2003).

However, after the first complex years in power, conditions started to improve noticeably, pushing the Venezuelan economy to a fast recovery. In fact, the country’s GDP went up by 17% in 2004. The key was a substantial increase in public income from 2003, not only due to a rise in oil prices but also as a result of the increasing role given to the national state-owned company PDVSA and to Venezuela’s active policy to reactivate the role of OPEC. Tax revenue from oil income rose from US$23 billion in the 1992-1999 period to US$383 billion in the 1999-2012 period. Out of this amount, US$251 billion were related to legislative and contractual changes to favor the public sector. Venezuela’s exports of oil and oil by-products increased significantly, totaling US$90 billion in 2011, whereas a decade before they had barely exceeded US$25 billion.

The expansion of foreign currency inflow and the appropriation of oil income by the Government (main source of public resources) made it possible to finance a sustained increase in public spending, which went from 29% to 42% of the GDP in 2012.

At the beginning of Hugo Chávez’s term in office, half of the population lived in extreme poverty, while income distribution was very unequal: the income ratio between the first and last decile was 25. Poverty dropped from 49% in the first semester of 1998 to 27.4% of Venezuelan households in 2011. The percentage of households in extreme poverty in the same period dropped from 21% to 7.3%.109 These achievements are associated with a very high increase in public social spending, particularly with the implementation of “missions” in education, health and housing.

In the area of health, between 1998 and 2011 infant malnutrition dropped from 5.3% to 2.9%, infant mortality went down from 23.4% to 16% (last data obtained in 2010) and life expectancy at birth, which initially was 72 years, grew to more than 74. In the field of education, school enrolment exploded from 2000 to 2011, going up from 46.4% to 71.4% at pre-school level, from 90.7% to 93.2% at primary school level and from 53.6% to 73.3% at high school level. Finally, while in the year 2000, 895,000 Venezuelan students attended university, in 2011 this figure rose to 2.3 million, meaning enrolment tripled.110


110 Data based on official statistics provided by Venezuela’s National Institute of Statistics (http://
Despite a significant increase in its exports, and while the economic and social conditions of the population improved as a result of broad government outreach and public resources, in the past years the country has suffered pressures due to high levels of capital flight, tax evasion and persistent inflation.\textsuperscript{111} FDI and the income derived from it clearly reflect the negative tendency and even active opposition to the Venezuelan political and economic process.


<table>
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Source: Banco Central de Venezuela [Central Bank of Venezuela]

Beginning in 2003, the Government decided to combat the relative scarcity of US dollars by implementing exchange controls, which in turn resulted in the creation of a parallel foreign exchange market, increasingly detached from the official market, with a significant gap between the official and the parallel exchange rate.\textsuperscript{112} Despite the controls, tax evasion and non-registered capital flight have continued, leading to a greater problem that needs to be addressed.

\textsuperscript{111} Retail inflation was 27.6% in 2011 and 20.1% in 2012.

\textsuperscript{112} Zuñiga (2013).
8.3) Taxes in Venezuela

The Venezuelan tax system is founded on the National Constitution adopted in 1999 and amended in 2009, which includes essential tax principles:

1. **Equity Principle**: Tax burdens should consider a fair distribution of the burden in a progressive fashion, based on each individual’s capacity.
2. **Legality Principle**: Each tax should be created and governed by a law.
3. **Generalization Principle**: Taxes should be applied in a general manner.

In addition, an aspect of particular importance when analyzing DTAs in Venezuela is that legislative amendments to the Income Tax Law introduced the principle of "residence" and amended the tax regime in force since 1942 under the first Income Tax Law, which had been based on the "source or territory" principle to levy taxes on the income of residents as well as on generated income, taking into account that Venezuela is a capital-importing country with vast natural resources.

The Income Tax Law states that income obtained in the country by residents or non-residents, as well as income obtained by residents at any origin (local or foreign) will be taxed.

Individuals or legal entities that are not residents or are not domiciled in Venezuela will be subject to the tax set forth in this Law, provided the source or cause of their income is or occurs within the country (even when they do not have a permanent establishment or fixed base in the Bolivarian Republic of Venezuela).

Individuals or legal entities domiciled or residing abroad with a permanent establishment or fixed base in the country will pay taxes only for income with a national or foreign source attributable to such permanent establishment or fixed base.

Section 2 of the Income Tax Law clearly states that "any individual or legal entity domiciled or residing in Venezuela, as well as individuals or legal entities domiciled or residing abroad with a permanent establishment or a fixed base in the country shall be entitled to credit, against the tax they shall be required to pay, any income tax paid abroad as a result of foreign source income subject to tax in Venezuela."

The legal method to establish income tax is based on total income less costs and deductions permitted by Law, which are normal or necessary for taxpayers to obtain their profit.

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The Law incorporates the "tax unit" concept, which is a numerical value changed each year depending on the previous year inflation. This unit serves as a reference to calculate tax liabilities. For the 2012 fiscal year and part of the 2013 fiscal year, it was fixed at 90 bolivars.\textsuperscript{115} Rates are adjusted progressively based on tax revenues using the following ratios in relation to "tax units".

- Up to 2,000: 15%
- From 2,000 to 3,000: 22%
- More than 3,000: 34%

Those who qualify as “residents” receive specific treatment: progressive rates are fixed from a minimum of 6% (1,000 "tax units") to a maximum of 34%. The Law defines non-resident individuals as individuals who have not been in the country for more than 183 days in the previous calendar year. Non-residents must pay taxes at a 34% rate.

The Venezuelan legislation also includes taxes on capital gains and dividends.\textsuperscript{116}

8.4) Venezuela and DTAs

In 1973, Venezuela signed the "Cartagena Agreement," also known as the "Andean Pact" and therefore adopted Decision 40, which had been approved in 1971, as a multilateral agreement to avoid double taxation on income and capital, to be applied among member countries.\textsuperscript{117} Decision 40 contains a model for the negotiation of double taxation agreements between a member country of the Andean group and another country outside the region. The main characteristic in both model agreements is the adoption of the territorial criterion whereby the taxing power is distributed following the taxation criterion of the source country (13). Decision 40 was not applied by Venezuela.

It was only in the early 1990s that Venezuela started to sign agreements to avoid double taxation in relation to income tax. Until that period, Venezuela had only signed DTAs in the sea and air transportation fields with countries.

\textsuperscript{115} Decision No. SNAT/2012/0005 published in Official Gazette No. 39866.

\textsuperscript{116} This may be reviewed more extensively on the website of Venezuela’s tax administration and authority Servicio Nacional Integrado de Administración Aduanera y Tributaria [National Integrated Service for Customs and Tax Administration] (SENIAT, by its Spanish acronym) http://www.seniat.gob.ve/portal/page/portal/PORTAL_SENIAT

\textsuperscript{117} Originally Bolivia, Colombia, Chile, Ecuador and Peru.
where sea and air transportation companies flying or sailing to Venezuela were domiciled or where their place of management was located (Argentina, Belgium, Brazil, Canada, Chile, France, Germany, Great Britain and Northern Ireland, Italy, the Netherlands, Portugal, Spain, Switzerland, Trinidad and Tobago, and the United States of America.).

The territorial nature of income tax in Venezuela, the country’s condition as an investment recipient and the relatively few investments made by Venezuelan companies abroad may well have been the reasons for the lack of interest of Venezuelan authorities in signing double taxation agreements. However, in the 1990s, with a neoliberal wave of openness and liberalization, the Venezuelan governments that preceded Chávez made a significant effort in this regard and signed DTAs with the following countries:

1. Italy (Extraordinary Official Gazette (O.G.) No. 4,580 dated May 21, 1993)
2. France (Extraordinary O.G. No. 4,635 dated September 28, 1993)
4. Germany (O.G. No. 36,266 dated August 11, 1997)
5. Portugal (Extraordinary O.G. No. 5,180 dated November 4, 1997)
6. Czech Republic (Extraordinary O.G. No. 5,180 dated November 4, 1997)
7. Trinidad and Tobago (Extraordinary O.G. No. 5,180 dated November 4, 1997)
8. The Netherlands (Extraordinary O.G. No. 5,180 dated November 4, 1997)
9. Switzerland (Extraordinary O.G. No. 5,192 dated December 18, 1997; Extraordinary O.G. No. 5,265 dated October 1, 1998)
11. Mexico (Extraordinary O.G. No. 5,273 dated November 6, 1998)
12. Sweden (Extraordinary O.G. No. 5,274 dated November 12, 1998)

Remarkably, this trend was not reversed throughout the years of President Hugo Chávez’s government.118

With the exception of Barbados and Trinidad and Tobago (members of the Commonwealth of Nations) and Indonesia, all the countries with which Venezuela has signed DTAs are OECD members, and so all the Agreements

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118 During Hugo Chávez's tenure: 2000, USA (although it was negotiated and signed by the previous government of Rafael Caldera, but ratified by Parliament during Chávez’s government); 2001, Barbados and Indonesia; 2002, Denmark; 2005, China, Canada and Spain; 2006, Cuba; 2007, Kuwait; 2008, Austria, Korea, Qatar and Iran; 2009, Malaysia; 2010, Belarus, Russia and Vietnam; 2011, Brazil; 2012, United Arab Emirates. See detailed information based on data provided by the Inter-American Center of Tax Administrations: http://www.ciat.org/index.php/corgs/productos-y-servicios/ciatdata/tratados.html
followed the OECD Model Convention, except in the case of the DTA signed with the United States of America, which followed the United States model. Venezuela has not been consistent when choosing methods to avoid international juridical double taxation in the agreements it has signed. In some cases, it has adopted the full exemption method, and in others, limited taxation with a progressiveness clause was chosen. This may be so because most DTAs were negotiated, signed and became effective when Venezuela levied taxes on its residents according to the source criterion, and therefore the adopted method to avoid international juridical double taxation was mainly the exemption method. In some cases, as we will see, Venezuela also considered the possibility of using the limited taxation and progressive exemption method if it changed its territorial taxation system for the residence-based system.

The dangerous application of the exemption method
In the Agreements signed with Italy, Germany, the Netherlands, Belgium and Sweden, Venezuela adopted the full exemption method as the single method to avoid applying international double taxation to its residents. These agreements state that when a Venezuelan resident’s income is taxable in another country under DTA provisions, such income will be exempted from Venezuelan income tax.

The DTA signed with France also adopted the full exemption method whereby income taxable in France and collected by a Venezuelan resident was exempted from the Venezuelan tax. However, this agreement admitted an exception concerning dividends collected by a Venezuelan resident and taxed in France, in which case the limited taxation method was applied by allowing the deduction of tax paid in France but limited to the portion of Venezuelan tax paid on such dividends.

Agreements based on the limited taxation method
The DTAs that use the limited taxation method are those signed with the United Kingdom of Great Britain and Northern Ireland, Mexico, Indonesia, Barbados and Denmark (in the text of the Agreement itself), and those signed with Portugal, the Czech Republic, Trinidad and Tobago, Switzerland and Norway (in the respective Protocols).

To avoid international juridical double taxation, Venezuela adopted the limited taxation method by establishing that if a Venezuelan resident is required to pay taxes in Venezuela for income earned globally, the Venezuelan resident may deduct any tax paid abroad from the Venezuelan tax. This amount may not exceed the portion of Venezuelan tax calculated before the exemption was allowed.
In all of these agreements, the country reserved the right to consider income exempt from tax in Venezuela and obtained by a Venezuelan resident when calculating the tax due on the remaining income (progressive clause). It is worth noting that all of these agreements originally considered the exemption method to avoid international juridical double taxation. However, they stated that in case Venezuela changed its territorial taxation system by the residence-based taxation system (this happened as from January 2001), the applicable method to avoid international double taxation would be the limited taxation method.

**The Agreement with the United States**

The DTA signed with the United States establishes that Venezuela will allow its residents to eliminate double taxation of income that may be subject to taxation in the United States. This elimination will be implemented under the provisions and subject to the limitations stated in the laws of Venezuela and it may involve an exemption of such income from Venezuelan tax or, alternatively, a tax credit against the Venezuelan income tax (Section 24 of the Agreement).

Since Venezuela adopted the limited taxation method to avoid international double taxation, and in compliance with the terms agreed on with the United States, this is the method applied to income obtained in the United States. The agreement with the United States is particularly significant due to the economic importance it has had in Venezuela, despite tense bilateral relations during Chavez’s government, both as a result of American opposition to nationalizing economic sectors and of Chavez’s anti-market position, controls on capital movements (including foreign exchange and export controls), and his recurrent statements against the interference of the United States in the region; and also, naturally, as a result of the statements in favor of “21st century Socialism.”

The continuity of relations between the United States and Venezuela has been remarkable, considering that the United States has continued to be Venezuela’s main business partner, concentrating more than half of its exports (mostly oil exports), and that Venezuela has continued to be the third market for U.S. exports in Latin America (after Mexico and Brazil). Thus, North American investments and private businesses in Venezuela’s oil sector continue to be persistently significant.119

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## Table 8.3. Venezuela, DTAs in force as of April 2013.

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<td>The Netherlands</td>
<td>5180 (Extraordinary)</td>
<td>1997</td>
<td>Full exemption method</td>
</tr>
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<td>1997</td>
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</tr>
<tr>
<td>Qatar</td>
<td>38796</td>
<td>2007</td>
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<td>Russia</td>
<td>5822 (Extraordinary)</td>
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<td></td>
</tr>
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<td>37913</td>
<td>2004</td>
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<td>5192 (Extraordinary)</td>
<td>1997</td>
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<td>39685</td>
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<td>5427 (Extraordinary)</td>
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<td></td>
</tr>
<tr>
<td>Vietnam</td>
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Source: Prepared by the author based on the Sistema Nacional Integrado de Administración Aduanera y Tributaria [National Integrated Service for Customs and Tax Administration].
8.5) Conclusions

I. Many years after their introduction, DTAs have not met the initial goal of "attracting investment," which justified their implementation when liberal and pro-market governments were in office. Opinions are still divided based on the highly polarized positions regarding the conditions developed and the results attained throughout the Chávez administration.

II. In contrast to the developments in other countries of the region with an anti-neoliberal bias, which have adopted a critical position regarding double taxation agreements (Argentina, Bolivia and Ecuador), Venezuela has not only refrained from rectifying, amending or withdrawing from agreements, but, on the contrary, it has signed new ones to reach a total of 32 agreements in effect in 2012.

III. Despite the persistent criticism of the "anti-investor" bias in the Venezuelan legislation and the very high level of evasion prevailing in the country, no structural changes to the tax system or to the foreign investment regime in Venezuela have been proposed.

IV. There are no official statistics/estimates of the meaning and costs associated with DTAs. However, according to studies by independent social organizations such as the Red Venezolana Contra la Deuda [Venezuelan Network Against Debt], the estimated cost for Venezuela for accrued and uncollected taxes under DTAs is US$17.87 billion a year. The enormous relative significance of this figure may be observed when considering that the estimated Venezuelan National Budget for the year 2013 is US$92.2 billion, out of which US$70 billion are "ordinary income" and US$22.2 billion are "financing sources."

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120 Corrales, Javier (2012).

121 Zarraga Villaroel and Arelys Zulay (2003) explain that evasion may be due to "the lack of trust in the government as a result of the inadequate implementation of economic measures and the recession we are currently experiencing as well as to legal uncertainty resulting from constant changes in the game rules related to tax matters."

122 Recently, Venezuela’s Planning and Finance Minister Jorge Giordani advocated a tax amendment after calculating that the current level of internal tax payment is very low and it does not exceed 12% of the revenue the Government should collect. He also said that "evasion, export overbilling, the use of foreign currency and speculation" are issues that should be discussed.


123 Britto García (2009).

8.6) Proposals

I. So far, there has been no significant debate in Venezuela on the potential benefits and setbacks of DTAs. This may have been softened by the fact that in the past few years the country has experienced an expansion period of significant public economic activism, supported and funded by high oil prices and by the fact that public opinion and political debate have recurrently shifted their attention to other priority issues.

II. Changes in the local and international political and economic arena and new social and/or investment demands may raise the need to focus the attention on the Venezuelan tax system in the future. Given the significance of DTAs from a taxation perspective, analyzing and debating their conditions and prospects may become very important.

III. Social and political movements in Venezuela do not seem to include this issue on their agendas, as they are mainly focused on analyzing the potential creation of public resources through oil income.\textsuperscript{125} It will be essential to include a debate on DTAs in the context of proposals to give priority to strengthening Venezuela's interests.

IV. In the past few years Venezuela has been at the forefront in acknowledging the importance of regional integration and furthering initiatives associated with it. The issue of DTAs should not only be addressed at the national level but also linked to common positions in relation to problems and challenges shared by Latin American countries, such as the possibility of building a common proposal for a model agreement on financial and tax information and transparency to replace current DTAs, which have been used for tax evasion and/or avoidance as well as for draining national resources.

\textsuperscript{125} http://www.iberoamerica.net/venezuela/prensa-generalista/noticirodigital.com/20121121/noticia.html?id=sn01S66 (in Spanish)
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Inter-American Center of Tax Administrations (CIAT, by its Spanish acronym)
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*Red Latinoamericana sobre Deuda, Desarrollo y Derechos* [Latin American Network on Debt, Development and Rights] (LATINDADD, by its Spanish acronym) is made up of institutions, teams and campaigns from Latin American countries that strive to solve the problems resulting from the systemic crisis, in an attempt to create the necessary conditions for an economy at the service of the people that is respectful of economic, social and cultural rights. Latindadd actions include awareness campaigns, training, public policy monitoring, critical analyses, creation of alternative proposals, lobbying and mobilizations with the civil society and its social movements. At present, 17 institutions and organizations from 11 countries (Argentina, Bolivia, Brazil, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Nicaragua, Peru and Uruguay) are working together to facilitate the exchange of information within the network, engage in joint advocacy, collaborate with the global citizens movement and contribute to regional integration and democratic change in North-South relations.
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Fundación SES [SES Foundation] is an Argentine social organization focused on the promotion and development of strategies in the area of youth rights for the inclusion of adolescents and young people with fewer opportunities. The name SES stands for the organization’s three foundational values: Sustainability, for its commitment to future generations; Education, understood as the driver of development; and Solidarity, a basic element of social integration. Website: http://www.fundses.org.ar

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Corporación de Investigación y Acción Social y Económica - CIASE

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Coordinadora Civil - Nicaragua
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brings together regional and sectoral networks, trade unions, social move-
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International Debt Observatory
The IDO is a forum created to exchange knowledge and to analyze and do re-
search on the problem of the debt. Its aim is to provide individuals and organi-
zations involved in the study of the debt mechanism with accurate analyses of
most of the debt-related dimensions as well as with a unique statistical database.
Website: http://www.oid-ido.org.

Research on Double Taxation Agreements in Ecuador
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This movement was created back in May 1999 and approved by Ministerial Agreement No. 8781 on July 18, 2007. It is an ample and pluralistic social movement which, in partnership with national and international social organizations, carries out actions to raise awareness among the people of Ecuador on issues such as inequity and injustice in economic and financial relations, and to urge national and international decision-makers to look for fair solutions that respect State sovereignty.
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