KPMG

U.S. - LATAM Hot Button Issues (Part 2)

2023 U.S. Cross-Border Tax Conference

June 5–7, 2023

Prepare for Complexity

Notices

The following information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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Agenda

01 **BEPS 2.0 LATAM Complications**

02 **Selected Current Developments**
Direct and Indirect Tax

01

BEPS 2.0 LATAM Complications

Pillar 2 “Ordering Rules” for 15% Minimum Taxation

15% tax

Bottom-Up “Order of Operations”

0% tax

What is the tax?	Who is the taxpayer?
UTPR	**Other Constituent Entity in P2 Jurisdictions**
IIR	**Ultimate Parent Entity**
CFC	**Closest Shareholder with Applicable CFC Rules**
QDMTT	**Subsidiary / Constituent Entity**
Local taxation / covered tax	

Pillar 2 Developments within LATAM

BRAZIL

— No draft Pillar 2 legislation yet. Tax Reform is anticipated for the second semester of Congress. OECD has publicly requested that Pillar 2 be included in this reform package.

— Brazil is generally considered not a Pillar 2 target jurisdiction, do to its prevailing high income and withholding tax rates

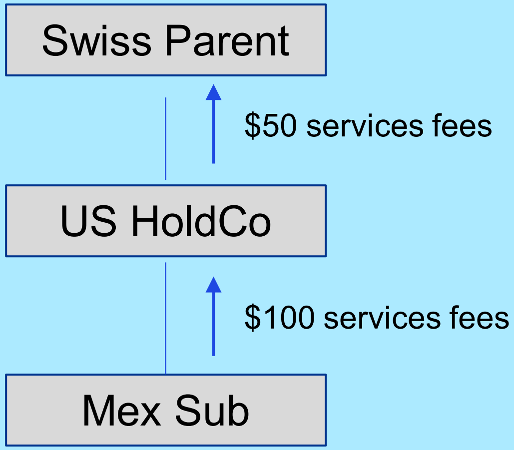
— BUT, a combination of direct and indirect tax incentives, e.g., for start-up manufacturing concerns, can create low-tax situations

Pillar 2 Developments within LATAM

MEXICO

1. **Do we expect modifications to deduction disallowance rules? Far beyond the Pillar 2 framework for UTPR.**

Example



Analysis: Deduction disallowance in Mexico?

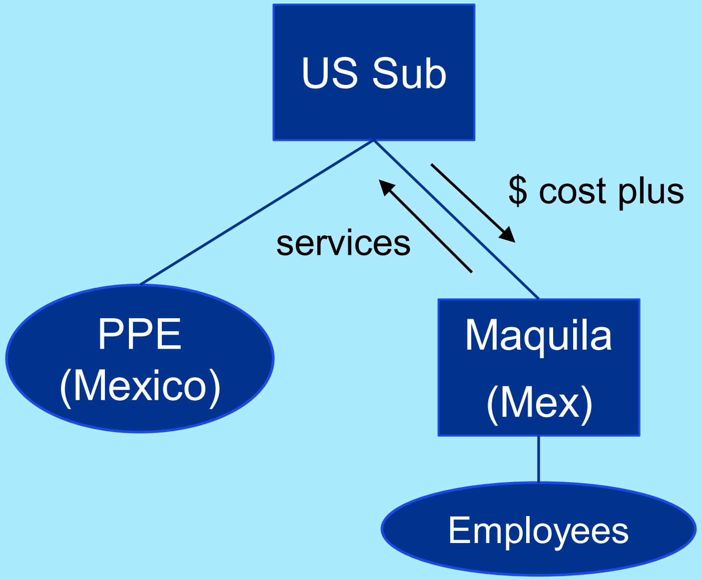
- ETR in the US at the federal level: less than 22.5%
  - State tax?
  - Substance?
- ETR in Switzerland
  - No way to rescue with substance?

2. **Would adoption of a "top up tax" version of UTPR be feasible in Mexico?**

3. **QDMTT?**

Pillar 2 Developments within LATAM (Cont.)

4. Application of Pillar 2 to maquilas?



1. Creation of stateless income?
2. To whom is the Mexican PPE attributed for purposes of the Substance-Based Income Exception?
3. Are the employees providing maquila services attributed to the Mexican entity or to the US principal?

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Pillar 2 developments within LATAM (Cont.)

Jurisdiction	Adoption?	Commentary
Argentina	✘	Too busy with macroeconomic and balance-of-payment problems for the government to be thinking about Pillar 2. Issue is being pushed off to the next legislative term (2024), but there have been administrative promises not to raise taxes.
Chile	✘	Nothing yet. Chile is in the process of drafting a new constitution, so unclear whether there is bandwidth to introduce Pillar 2 rules.
Colombia	✓	**15% minimum tax adopted in 2023**
Costa Rica	✘	No proposal has been put to Parliament yet and no official pronouncement. (Current focus is getting off the EU black list.) Informally, we understand that proposals would likely be limited to domestic top-up tax on a QDMTT basis.
Peru	✘	Still doing preliminary impact assessments, but given that Peru seeks OECD membership it is likely that at least some portion of the Pillar 2 framework will ultimately be implemented.

Pillar 2 Safe Harbors

- To qualify, the MNE group's results must satisfy at least one of the Safe Harbor tests in the tested jurisdiction. Under the transition rules (that applies, e.g., to CY2024-2026), the safe harbor tests are simplified and are met using data reported on a **"Qualified CbCR."**
  - **De Minimis Test**: Total revenue of less than €10 million and PBIT of less than €1 million;
  - **Simplified ETR Test**: The MNE group has an ETR of at least the Transition Rate specified for the year (15% for 2023 and 2024, 16% for 2025 and 17% for 2026). Simplified ETR is calculated for a tested jurisdiction by dividing current and deferred tax expense (eliminating non-covered taxes and uncertain tax positions), by PBIT; or
  - **Routine Profits Test**: The MNE group's PBIT is no more than the Substance-based Income Exclusion (SBIE) amount for entities resident in that jurisdiction.
- How are clients dealing with this? Are there practical issues we should be prepared to face?
- ***What is the risk that a tax authority will challenge status as a "qualified CbCR"? Who has the ultimate say on whether a qualified CbCR exists?***

LATAM Hurdles to Pillar 2 Implementation

- Inability to proceed from a political perspective
- Inability to proceed from a taxpayer rights perspective under, e.g., free trade zones rights, legal stability agreements, mining concession agreements, bilateral investment treaties
- If it is not possible for those jurisdictions to impose top up tax, is it at all possible to compensate the taxpayers in some other way (e.g., payroll tax deduction, rebates, or other incentives)?
- Do countries have the appropriate tax jurisdiction to impose UTPRs (esp. the “pure” top-up tax with no transactional involvement of a resident in that country)?

Any learnings from the flexibility taken in the EU Directive?

US Foreign Tax Credit Implications

- Query whether the IRS will give blanket credits for QDMTTs (under consideration)
- Better chance with respect to QMDTTs than with UTPRs
- Even with a blanket credit, QDMTTs seem unlikely to be creditable if the generally imposed CIT in that jurisdiction is not itself creditable

02

Selected Current Developments: Direct and Indirect Tax

BRAZIL

— **Indirect tax reform:** A tax reform focused on Indirect Taxes is anticipated later this year. The goal is to achieve simplification, especially across the 27 states and municipalities.

- Proposed elimination of federal level PIS, COFINS, and IPI, and state level ICMS and municipal level ISS
- Replacement of the old system with a national (or a national plus local) VAT regime
  - Charged on a uniform set of goods and services
  - Cities and states would be free to determine their own applicable rates
  - Transition is the hard part (much harder on the state/municipal side than on the federal side)…

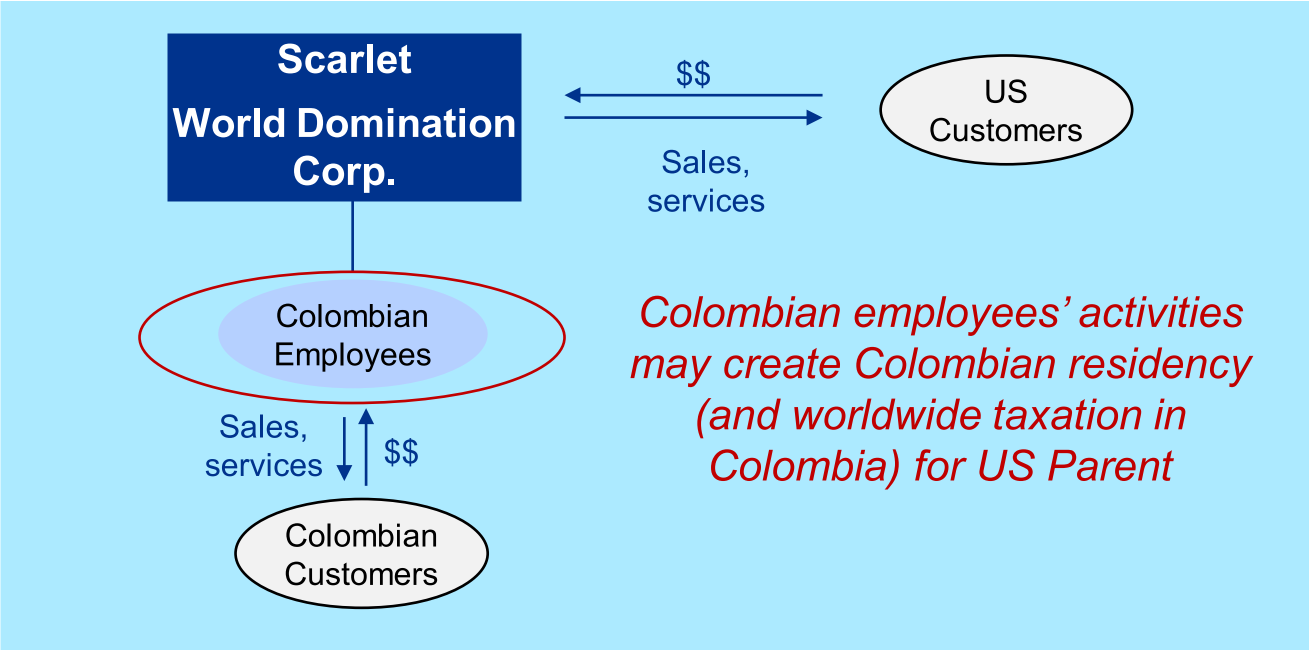
— **Direct tax reform (#2):** No draft yet. Possible proposed changes (maybe the following year) could include –

- Reduction of the CIT rate
- Introduction of WHT on dividends
- End of INE (interest on net equity)
- Pillar 2?

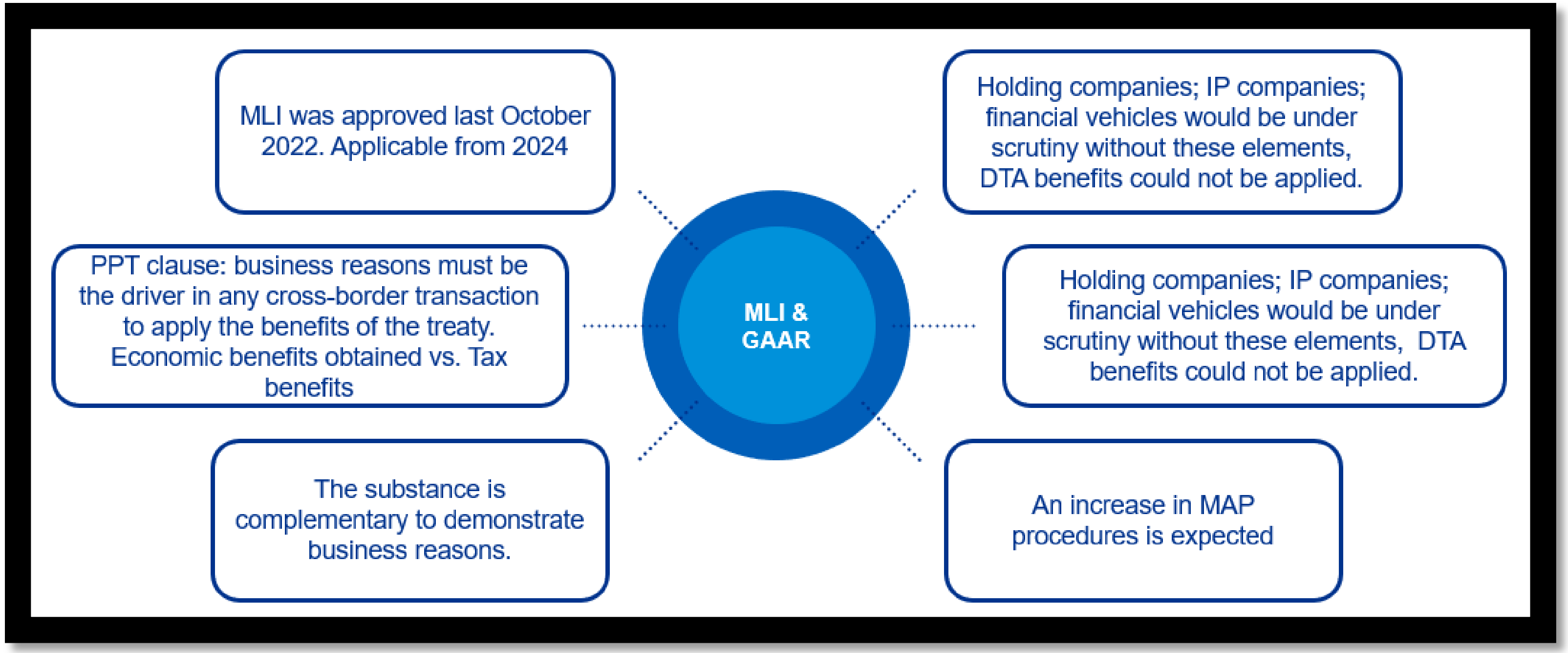
COLOMBIA -- Management & Control-Based Residency

Modifications to the residency (management & control) test

- No longer limited to an examination of key decision-making or highly ranked management activities; now applies based on management/administrative decisions of day-to-day business



MEXICO -- MLI entry into force and GAAR



The MLI does not modify the US-Mexico DTA, but consider preparing defense files…

- With an eye toward internal GAAR potentially applying
- Under the same principles as PPT, demonstrate business reasons for a transaction
- Document the economic benefit (must be greater than the tax benefit obtained)
- Keep workpapers on scenario planning -- operations with more steps that generate greater tax benefits will be compared to more direct alternatives that generate fewer benefits

PERU – Super-Sized R&D Deductions

Increased R&D expense deductions (enacted December, 2022)

— The new rules increase the deduction rates for Scientific Investigation, Technological Development and Technological Innovation expenses (R&D expenses) – currently allowed as 100% deductions.
  - **190% deduction** for qualifying expenses if the R&D is performed within Peru
  - **160% deduction** for qualifying expenses if the R&D is performed outside of Peru

— A few examples:

Scientific investigation

1. Non-routine computer activity that implies scientific or technical progress or that resolves technological uncertainties.
2. Research by doctoral students at universities.
3. Scientific or technical identification of the best program to reduce carbon footprints in packaging processes.

Technological development

1. Design changes that modify the functionality of a product.
2. Non-routine computer activity that involves the application of a tool (mobile or web app) that resolves uncertainties.
3. Use of a technological tool for inventory control and logistics and packaging processes (code printing systems, locator chips, etc).).

Technological innovation

1. Staff training if oriented towards a specific product or process innovation in the company.
2. Custom adaptation of an existing product or process to customer requirements that imply significantly different functional attributes.
3. Added value creation introducing a functional improvement in logistics and packaging processes.

PERU – Super-Sized R&D Deductions

— **Requirements for eligibility**

- Project qualification by CONCYTEC (Peruvian Regulatory Entity), including filing, documentation and details of proposed activities.
- Qualification of the entity that carries out the project (Direct Modality).
- Keep Independent Control Accounts (separately tracking costs as "R&D Expenses").
- Annual deduction limit of 500 Tax Units (PEN 2.3MM or USD 650K)

— **Applies for *costs incurred during the 2023 through 2025 calendar years*, with a possible extension through 2027 if a qualifying project ends after 2025**

Q&A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Thank you!

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