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Bill on International Tax Transparency and Prevention of Money Laundering

The Bill is intended to state certain rules in order to comply with the agreed international standards on international tax transparency and prevention of money laundering and financing of terrorism

Last July 11th, the Government sent to the Parliament a Bill in order to comply with the agreed international standards on international tax transparency and prevention of money laundering and financing of terrorism (hereinafter "the Bill").

The Bill responds to the international commitments assumed by Uruguay in order to adopt the guidelines and directives issued in those matters by the Organization for Economic Cooperation and Development (OECD) and the Financial Action Task Force (FATF).

The Bill is structured in four chapters regulating the following aspects:

(i) automatic report to the Tax Authority of balances and income from financial source,

(ii) identification of the beneficial owner and the owners of nominative shares,

(iii) rules to be applied to entities which are resident in countries or jurisdictions of low or null taxation, or who are benefited from a special regime of low or null taxation, and

(iv) adjustments to the transfer pricing regime.

In this *InfoTax* we will briefly analyze the referred chapters.

I. Automatic report to the Tax Authority of balances and income from financial source.

I.1. Background and purpose of the rules.

The Bill states the obligation in head of the financial entities that are resident in Uruguay and also the branches of non-resident financial entities that are located in Uruguay, to report to the Tax Authority (DGI), on an annual basis, all the information related to balances and income of the identified accounts held by individuals, legal entities and others entities which configure tax residency: (i) in other country or jurisdiction (ii) in Uruguay.

The projected rules has, as explained in the preliminary recitals, two key purposes: (i) compliance with the commitments assumed by Uruguay on the agreed international standards on transparency and exchange of Information, and (ii) provide certain Information to the Tax Authority in order to allow an efficient management of the domestic tax system (this explains the circumstance that certain projected solutions exceed of the international requirements).

I.2. Information to be reported.

The Information to be reported makes reference to balances and income, at the end of the civil year, of the accounts subject to report.

The information that exceeds such data is excluded from the reporting obligation, and its access must be granted following the proceedings stated in Uruguayan Law for said purposes (i.e. prior authorization of the accountholder or judgment imposing the disclosure).

I.3. <u>Entities obliged to report. Excluded entities.</u>

The following financial entities are obliged to report:

(i) those who develop financial intermediation,

(ii) those who develop custodial activities or investments on behalf of third parties, even when there are not subject to the supervision of the Uruguayan Central Bank (BCU). In addition, those who are administered by other financial entities obliged to report,

(iii) insurance entities, in relation to certain insurance agreements, and life annuity agreements.

The Government is authorized to exclude from the reporting obligation certain financial entities considering its purpose and low tax risk.

I.4. <u>Reportable and excluded accounts</u>.

The obliged financial entities must report information related to the identified accounts held by individual, legal entities and other entities that: (i) configure their tax residency in other country or jurisdiction or (ii) be Uruguayan resident.

With respect to the referred obligation, there are considered as financial accounts: debt instruments, participation in the capital stock of a trust, investment fund and any other entity who render custodial or investment activities on behalf of third parties, and also the balances corresponding to any beneficial owner.

The accounts held within branches of resident entities located abroad are excluded.

Furthermore, the Government is authorized to exclude from the reporting obligation certain accounts that present low tax risk considering its condition and value, and also to establish deadlines taking into account the place of residence of the accountholder and the balances.

In this respect, it is important to highlight that while the standards taken as reference *(Common Reporting Standard, 2014)* provides for a threshold under USD 250.000 (two hundred fifty thousand dollars) in order to exclude certain accounts to the reporting obligations, it is public knowledge that the threshold to be determined by the Government could be significantly lower.

I.5. <u>Identification of the beneficial owner</u>.

In case of accounts whose accountholders are entities that present high risk of tax evasion the obliged financial entities must report who is the beneficial owner, following the criterion to be determined by the Government.

I.6. <u>Due diligence proceedings for the identification of the tax residency</u>.

The obliged financial entities must report the tax residency of the accountholder or the tax residency of the beneficial owner, if corresponds.

In order to comply with such obligation the referred entities must follow the due diligence proceedings to be determined by the Government. It is expected that, as it occurred in the legislation of different jurisdictions, the regulation of the referred proceeding largely follow the guidelines contained in the *Common Reporting Standard*, including the different types of accounts and proceedings associated to them.

I.7. <u>Requirement for opening new accounts or issuance of debt instruments</u>.

It is stated the prohibition, as of the entry into force of the Act, for opening new accounts or issue debt instruments without comply, among others, with the obligation to declare to the financial entity the tax residency of the individuals, legal entities or other entities and the beneficial owner, if corresponds.

I.8. <u>Control and penalties</u>.

The DGI will be in charge of controlling the compliance with the obligations and also impose the penalties in case of non-compliance.

The penalties could increase up to around USD 215.000 (two hundred fifteen thousand dollars).

I.9. <u>Inapplicability of banking secrecy and other secrecy rules.</u>

In one of the most controversial aspects of the Bill, it is stated the inapplicability of banking Secrecy and any other secrecy rule before the DGI.

I.10. <u>Entry into force</u>.

The referred rules will come into force next January 1st, 2017.

II. Identification of the beneficial owner and shareholders with nominative shares.

II.1. <u>Background and purpose of the rules</u>.

According to the preliminary recitals the rules are intended to ensure the availability of information related to the identification of the beneficial owners of legal vehicles, and also the identification of shareholders with nominative shares of companies with nominative or book-entry shares, limited partnerships, agrarian associations or any other legal entity authorized to issue nominative shares.

The rules follow the recommendations made by the FATF (Recommendations No. 24 and 25 of February 2012) and the Global Forum (Terms of Reference 2016 adopted in the meeting held on October 26th/27th, 2014 in Germany).

II.2. <u>Obligation to identify the beneficial owner</u>.

Since January 1st, 2017 certain entities will be obliged to identify the beneficial owner, counting with the corresponding supporting documentation.

It is understood as beneficial owner the individual that, directly or indirectly, owns at least 15% (fifteen per cent) of the capital stock or its equivalent, or voting rights, or which through other means has the final control over an entity (such as a legal entity, a trust, an investment fund or any other patrimony of affectation or legal vehicle).

II.3. <u>Entities obliged to identify and report. Excluded entities</u>.

The entities obliged to identify and report are the following:

(i) resident entities;

(ii) non-resident entities, provided that they met any of the following requirements: (a) operate in Uruguay through a permanent establishment, (b) locate in Uruguayan territory the place of its effective management for developing business activities in the country or abroad, and

(iii) foreign investment funds and trusts whose administrators or trustees are residents in Uruguay.

There are excluded from the obligation of identify and report:

(a) entities whose shares are quoted on national stock exchanges, international renowned stock exchanges or in other procedures of public offer, provided that such shares are available for its immediate sale or acquisition in the referred markets,

(b) investment funds duly incorporated and supervised in their country of residence, according to the criterion to be determined in the regulation, and

(c) joint ownership, community property and community property regulated by the Concubinage Act.

The Government is authorized to exclude other entities considering that due to its legal nature and capital structure they present low risk in matter of money laundering and tax evasion.

II.4. <u>Additional obligation for entities issuing nominative shares</u>.

Companies with nominative or book-entry shares, limited partnerships, agrarian associations or any other legal entity authorized to issue nominative shares must communicate, besides the information related to the beneficial owner, the data on its shareholders and the percentage of its participation in the capital stock.

In addition, any subsequent modification must be reported: (i) within thirty days as of such modification, or (ii) within ninety days in case that the shareholders of nominative shares are non-residents.

II.5. <u>Registry of the BCU</u>.

The information to be reported by the obliged entities will be comprehended, guarded and administered in the Registry created by Act No. 18.930 (Registry of shareholders with bearer shares) within the BCU (hereinafter "the Registry").

The information will remain confidential and the access will be limited to certain authorities under certain conditions expressly regulated. In any other circumstance, the disclosure only could be authorized in writing by the owner of the data.

II.6. <u>Proceedings</u>.

The obliged entities must report to the Registry, through a sworn statement, the beneficial owners that were identified, indicating the percentage of participation of who met the requirements of the concept of beneficial owner, who did not met such requirements, those that are unknown and who exercise its final control, if corresponds.

It is included in the referred obligation: (i) the information on the chain of title in case when the beneficial owner is indirectly configured or when the final control over the entity is exercised through other means, and (ii) the information on the shareholders and the percentage of participation in the capital stock of companies with nominative or entry-book shares, limited partnerships, agrarian associations or any other legal entity authorized to issue nominative shares.

The obliged entities must report, through a new sworn statement, any change on the registered information: (i) within thirty days as of said change, or (ii) within ninety days in case that the beneficial owners are non-residents.

II.7. <u>Exceptions to the reporting obligation</u>.

The following entities are not obliged to submit the sworn statement:

(i) personal entities or agrarian associations whose shares are wholly owned by individuals, provided that such individuals are the beneficial owners,

(ii) de facto business associations or civil associations whose members are only individuals, provided that they are the beneficial owners.

II.8. <u>Terms and conditions for register the information</u>.

The terms and conditions for the compliance of the obligations by the obliged entities will be determined by the Government. However, such terms cannot exceed of the following dates:

(i) entities obliged to report under Act No. 18.930: September 30th, 2017, and

(ii) entities issuing nominative shares, personal entities and other entities: June 30th, 2018.

II.9. <u>Control</u>.

The Authority in Control of Corporations (AIN) will be in charge of controlling the compliance with the obligations, impose penalties and collect its amounts (in case of fines).

II.10. <u>Fines</u>.

The Bill states the following fines:

(a) non-compliance with the obligation to identify the beneficial owners or shareholders: fine for an amount around USD 21.500 (twenty one thousand five hundred dollars),

(b) non-compliance with the obligation to keep the information and documentation, and omission to submit the sworn statement: fine for an amount

around USD 21.500 (twenty one thousand five hundred dollars).
It is necessary to remark that the legal and voluntary representatives will be liable for the referred fines considering its personal responsibility in the breach of the obligations.

II.11. <u>Prohibition to distribute profits or make certain payments</u>.

Entities cannot pay profits nor dividends, redemptions, recesses, the result of the entity's liquidation and any other payment of similar nature to the shareholders or beneficiaries regarding which there were not complied the obligation to identify the beneficial owners, for the corresponding quota share.

The same prohibition applies to the case of payment of profits by non-resident entities that are obliged by the Act.

In case of breach of the referred prohibition, there is a fine whose maximum amount will be equivalent to the amounts unduly paid or distributed.

II.12. <u>Suspension of the tax certificate</u>.

The omission in submit the sworn statements will determine the suspension of the entity's tax certificate *("Certificado Único").*

In addition, the Government is entitled to make public the list of entities that do not comply with the provisions of the Act.

II.13. <u>Penalties for the declaration or use of inappropriate legal structures</u>.

The Bill states a fine could increase up to around USD 215.000 (two hundred fifteen thousand dollars) in head of who declares or use inappropriate legal structures with the aim to prevent knowing the identity of the beneficial owner or to induce in error on the referred identity.

II.14. <u>Impossibility to register acts and transactions</u>.

The obliged entities cannot register any act or transaction in the Public Registries without proving the compliance with the provisions of the Act.

II.15. <u>Control to be implemented by persons obliged to report suspicious transactions</u>.

The persons obliged by the rules on prevention and control of money laundering (banks, professional trustees, investment's advisors, real estate agencies, auctioneers, public notaries, operators and direct users of Free Trade Zones, among others) must request to their clients, if corresponds and as a part of their due diligence procedures, the information comprehended in the provisions of the Act.

III. Rules applicable to entities which are resident in countries or jurisdictions of low or null taxation, or which are benefited from a special regime of low or null taxation.

III.1. <u>Background and purpose of the rules</u>.

The Bill is intended to introduce certain adjustments to the domestic tax system in order to discourage the use of entities which are resident in countries or jurisdictions of low or null taxation or which are benefited from a special regime of low or null taxation (hereinafter "LONT entities") with the purpose of reducing the tax burden.

To said purpose, the Bill regulates the operative with LONT entities introducing relevant adjustments in the rules of both corporate and personal income taxation (IRAE, IRPF, IRNR), capital taxation (IPAT), capital transmissions taxation (ITP) and control of companies taxation (ICOSA).

We will analyze the most relevant adjustments.

III.2. <u>Deletion of the limited list and establishment of criterions for consider countries, jurisdictions or special regimes as LONT</u>.

It is stated that the Government will determine the condition by virtue of which the countries, jurisdictions or special regimes could be considered as LONT, and also it is authorized to draft a list of countries, jurisdictions and special regimes that will be considered LONT on a mandatory basis.

III.3. Taxation on income from the transfer and other transactions over shares of LONT entities.

In case of corporate income taxation (IRAE), resident individuals taxation (IRPF) and non-resident taxation (IRNR) it is provided that it will be considered as Uruguayan source (and therefore subject to taxation in Uruguay) the income obtained for the transfer of shares of LONT entities, and also for the incorporation and assignment of the usufruct over such shares, in which more than 50% (fifty per cent) of the capital stock – computed according to the IRAE rules – is integrated, directly or indirectly through a chain of title, by assets located in Uruguay.

III.4. Allocation of income from non-resident entities.

It is stated that in case of resident individual who participate in the capital stock of LONT entities, the income obtained by such entities will be determined and allocated as dividends or profits distributed to the referred individuals, taken into consideration the percentage of their participation.

The income to be allocated will comprehend exclusively capital profits and capital increases obtained by the referred LONT entities. This criterion entails a significant extension of the allocation rule currently in force that is limited exclusively to profits obtained through movable property.

For the determination of said income it will be applicable the current rules, being authorized the Government to establish other mechanisms for the determination when such rules are not applicable.

It is presumed that the income to be computed by the taxpayer is earned in the opportunity in which such income is received by the non-resident entity.

III.5. Increase of the tax rate applicable to income obtained by LONT entities.

The Bill states that the income obtained by LONT entities – except for dividends and profits paid or credited by IRAE taxpayers – will be subject to taxation at a rate of 25% (twenty five percent).

III.6. Adjustments to the taxation over the operative of LONT entities.

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The Bill provides for a specific tax treatment for certain operatives developed by LONT entities:

(a) in which are involved IRAE taxpayers who verify the legal relationship hypothesis stated in the rules, or (b) regardless of legal relationship.

(a) Operative of LONT entities with related IRAE taxpayers.

The Bill states that the legal relationship is configured when the parties are subject, directly or indirectly, to the direction or control of the same individuals or legal entities, or those individuals or legal entities have the power to conduct the activities of the liable persons, in consideration of their participation in the capital stock, the level of their credit rights, or their functional or any other influences – contractual or not –.

The operative developed with LONT entities will be considered as rendered with related parties, unless the IRAE taxpayers declares, through a sworn statement, that the legal relationship requirements are not met.

The income obtained by LONT entities in those operations with related IRAE taxpayers will be subject to the following tax treatment:

(i) it will be considered as Uruguayan source the income obtained through the import of goods made by the IRAE taxpayer. There is a presumption – if the contrary is not proved – that such income obtained abroad is 50% (fifty per cent) of the corresponding price, and

(ii) it will be considered as Uruguayan source the income obtained by the sale of goods abroad, that were previously export by IRAE taxpayers. There is the same presumption described above, considering – if the contrary is not proved – that the income obtained abroad is 50% (fifty per cent) of the corresponding price.

IRAE taxpayers are jointly liable for the tax obligations of the LONT entities.

(b) Operative of LONT entities regardless the existence of legal relationship.

It is provided that the operative developed by LONT entities, no matter the existence of legal relationship, will be subject to the following tax treatment:

(i) it will be considered as Uruguayan source the income obtained through the transfer of intangible asset acquired by IRAE taxpayer, whose purpose is its economic use within Uruguayan territory,

(ii) the income obtained through real property located in Uruguay will be subject to an additional tax rate of 5,25% (five point twenty five per cent),

(iii) the income obtained through the transfer or enforceable promise to transfer real property located in Uruguay must be determined on a real basis,

(iv) in case of income obtained in other transfers of goods located in Uruguay, the fictitious percentage is increased to 30% of the transfer's price.

III.7. <u>Exemption on capital transmissions under certain conditions</u>.

There is an exemption of IRNR and ITP for capital transfers made by LONT entities provided that the following conditions are met:

(i) it must be executed until June 30th, 2017,

(ii) the purchaser must not be a LONT entity, and

(iii) in case of registered entities, they must request the cancellation of the register before DGI and social security authorities, within thirty days as of such date.

III.8. <u>Increase in the tax rate of the capital taxation of LONT entities</u>.

The tax rate of IPAT of LONT entities that do not act in Uruguay through a permanent establishment is increased to 3% (three per cent).

III.9. <u>Entry into force</u>.

The referred rules will come into force as of the publication in the Official Gazette.

IV. Adjustments to the transfer pricing regime.

IV.1. <u>Background and purpose of the rules</u>.

The Bill introduces certain adjustments to the transfer pricing regulation in order to comply with the commitments assumed by Uruguay under the scope of the BEPS (Base Erosion and Profit Shifting) Project, in which makes reference to the need of a review on international standards on transfer pricing documentation.

In this respect, it is stated the inclusion of both "master" and "country-by-country" reports in the transfer pricing documentation that must be submitted by IRAE taxpayers who are part of a multinational group, and also the possibility that the Government could dispose the application of the regime of advance pricing agreements with other Tax Authorities, on a bilateral basis, under the Double Taxation Agreements in force.

IV.2. <u>Multinational Group and Multinational Group of Large Economic Dimensions</u>.

The Bill clarifies what should be understood as multinational group and multinational group of large economic dimensions.

A multinational group comprehends two or more related entities that are resident in different jurisdictions, including the parent company and its permanent establishments.

The legal relationship is configured when the parties are, directly or indirectly, subject to direction or control of the same individuals or legal entities, or those individuals or legal entities have the power to conduct the activities of the parties considering its participation in the capital stock, the level of its credits rights, its functional or any other influences – contractual or not –.

A multinational group of large economic dimensions is a group with consolidated profits that exceed the threshold fixed by the Government.

IV.3. Master and Country-by-Country Reports.

The Bill specifies the information that must contain both Master and Country-by-Country Reports.

Master Report must contain information of the multinational group related to its organizational structure, activities rendered, functions developed, assets used, risks assumed by each entity of the group, intangibles, financing mechanisms and financial and tax situation of the group.

Country-by-Country Report must include information of each entity that is part of the group, their tax residency or the country where the entity was incorporated (if it is different from the country of residency), the activities rendered, gross consolidated profits (differentiating those obtained with related and independent entities), economic result prior to income taxation, income tax paid in the business year, capital stock, cumulative results, number of employees and tangible assets.

IV.4. Obligation to file the Country-by-Country Report.

There are obliged to file a Country-by-Country Report:

(i) IRAE liable parties who are part of a multinational group of large economic dimensions, when the legal relationship requirements are met,

(ii) parent companies with its permanent establishment when they are part of a multinational group of large economic dimensions and one of the entities is IRAE liable party, and also other resident entities that are part of multinational group with foreign subsidiaries, permanent establishments and other kind of entities related to them.

The referred entities must file, on annual basis, the Country-by-Country Report following the terms and conditions to be determined by the DGI, except for the case that such report must be filed by other entity of the group before a foreign Tax Authority of a jurisdiction with an agreement in force which allows the exchange of information.

IV.5. Use of the information.

The DGI is authorized to use the information contained in the Country-by-Country Report in order to comply with its own tasks and also for the exchange of information with foreign Tax Authorities.

IV.6. Entry into force.

The referred rules will apply for the business years beginning on January 1st, 2017.

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