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BEPS 2.0: Issues and Implications for Latin America

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Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Mexico, Panama, Peru, United States, Uruguay

INTRODUCTION

The new global digital environment that has emerged in recent years has driven innovation among companies, generating new ways of doing business around the world and reaching new customers and regions in a simpler way. At the same time, this new digital era has brought with it the need to review tax systems and environments and introduce new ways that allows jurisdictions to have effective tools to help promote better local tax systems and align international tax principles with current commercial reality.

In response, the Organization for Economic Cooperation and Development (''OECD'') has identified the challenges of the new economic environment as influenced by digital developments and has proposed a response to these challenges through two fundamental pillars. The OECD has set an ambitious timeline for adoption, with target implementation of 2023 for both Pillars 1 and 2 (although the Undertaxed Payment Rule of Pillar 2, discussed further in the article, is deferred until 2024).

The first, ''Pillar 1,'' would provide a basis for a fair determination and allocation of taxes on revenues earned by multinational companies. In general, Pillar 1 would address new business models by expanding taxation rights to jurisdictions where significant commercial activities are carried out or where the profits arise, as opposed to attributing said right solely to the jurisdictions of residence (in accordance with traditional international tax principles). Although the initial focus of Pillar 1 was automated digital services and consumer-facing businesses, Pillar 1 has been conceptually expanded to include most types of busi-

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nesses — excluding certain financial institutions and extractives companies — that meet specified revenue and profits thresholds.

In contrast, ''Pillar 2'' would address remaining base erosion and profit shifting (BEPS) challenges by ensuring that all large internationally operating businesses (''multinational enterprises'' or ''MNEs'') pay at least a minimum level of tax. Pillar 2 would accomplish this objective by establishing new rules to allow jurisdictions the right to ''top up'' their local income tax if a cross-border payment is otherwise subject to low levels of effective taxation (benchmarked against a globally agreed minimum threshold).

Pillar 1

The goal of Pillar 1 is to allocate a portion of revenue earned by large multinational companies, to market jurisdictions that are significant for them. In-scope MNEs include those with a global turnover above €20 billion and profitability above 10% (which may be applied on a business segment basis and is calculated using an averaging mechanism). Assuming successful implementation, this threshold may be reduced to € 10 billion after eight years of Pillar 1 coming into force.

Pillar 1 establishes three types of profits that may be designated for taxation by qualifying jurisdictions (''qualifying market jurisdictions''):

Amount A — Amount A represents an amount of operating profit that would be allocated to qualifying market jurisdictions, even absent the MNE's physical presence there. A jurisdiction is eligible to receive an allocation of Amount A if, pursuant to forthcoming rules, the multinational entity earns revenue of greater than €1 million from the jurisdiction in question. This threshold is reduced to €250,000 for jurisdictions, the GDP of which is less than €40 billion.

Amount A would be determined formulaically, as 25% of the MNE's ''residual'' profits (i.e., profits in excess of 10% of the MNE's revenue). The specific portion of Amount A attributable to each jurisdiction will be further determined under new, revenue-based allocation keys.

Amount B — Amount B represents a fair remuneration to the qualifying market jurisdiction, for the marketing and distribution functions performed by the MNE in that jurisdiction. In some cases, Amount B would provide a remuneration framework for distributors (subsidiaries or Permanent Establishments), in arrangements in which the distributors acquire merchandise from related parties for resale. Details related to the interaction of Amounts A and B are evolving, but Amount B may act as a cap for Amount A allocations.

The OECD also recognizes the possibility that additional profits may be warranted for excess (i.e., in addition to routine) marketing and distribution activities performed in a qualifying market jurisdiction. These additional profits are identified as amounts that would arise under dispute resolution between an MNE's residence jurisdiction and a qualifying market jurisdiction.

Notably, although these three concepts seek to address the same problem, i.e., achieving an inclusive taxation considering the new challenges of the digital environment, Amount A would introduce new assumptions on which the tax will be determined, while Amounts B and C would apply (albeit in a simplified and more direct fashion) current transfer pricing rules under traditional physical presence principles.

Implementation will require changes in both local laws and international treaties to remove the current barriers that exist. To address this, the OECD proposes to develop a Multilateral Convention (''MLC'') for the implementation of Amount A, including rules for identifying qualifying market jurisdictions, eliminating double taxation with respect to Amount A, facilitating information exchanges, and articulating dispute and controversy resolution processes related to Pillar 1. In addition, the MLC would require all signatory jurisdictions to remove all digital services taxes and similar unliteral measures (even for enterprises that would not otherwise fall within the scope of Amount A), and to commit not to adopt these measures in the future.

Pillar 2

As a general matter, Pillar 2 would establish a global, 15% minimum taxation threshold, applicable to MNEs with consolidated group revenue above €750 million (as determined for purposes of BEPS Action 13, country-by-country reporting). The GloBE rules would also provide a de minimis exclusion in jurisdictions where the MNE has revenues of less than €10 million and profits of less than €1 million.

The new global minimum tax standard would be implemented under three types of new rules. The order of discussion reflects the order in which they would apply. As noted, the Income Inclusion and Undertaxed Payment Rules (together, the ''Global anti-Base Erosion'' or ''GloBE'' rules) work interactively.

(i) **Subject to Tax Rule (STTR):** This is a treaty-based rule that allows a source jurisdiction to impose limited, top-up taxation (e.g., via a withholding tax mechanism) on certain related party payments that are subject to residence jurisdiction tax below a minimum, 9% rate. The STTR

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would be creditable as a covered tax under the GloBE rules.

(ii) **Income Inclusion Rule (IIR):** This rule would permit the MNE parent entity's residence jurisdiction to impose a top-up tax, if the income of a constituent entity (subsidiary or permanent establishment) was subject to tax at an effective tax rate lower than 15%.

(iii) **Undertaxed Payment Rule (UTPR):** Subject to startup exclusions, if an MNE constituent entity makes a payment to a low-taxed entity that is not subject to additional tax under an IIR, a UTPR would deny deductions or require an equivalent adjustment in the payor's residence country.

The GloBE rules also provide a substance-based carve-out that will exclude an amount of income equal to a specified mark-up on tangible assets (conceptually similar to the U.S. GILTI carveout for qualified business asset investment) and payroll. The initial markups are 8% for tangible assets and 10% for payroll, subject to an annual reduction that would ultimately result in a 5% markup for both by the end of a 10-year transition period.

Note: This article is not intended to discuss Pillars 1 and 2 in significant detail, but to survey the issues and implications that BEPS 2.0 might have with respect to specific Latin American jurisdictions. Nonetheless, this article provides a high-level description of the current Pillar 1 and Pillar 2 principles as a helpful baseline for the jurisdiction-specific discussions.

IMPLICATIONS FOR LATIN AMERICAN JURISDICTIONS

Although it is a little premature to predict with any certainty the BEPS 2.0 consequences for Latin American jurisdictions, it is possible to walk through the impressions of KPMG Latin American member firm colleagues and discuss some of the most pressing issues they have identified under Pillars 1 and 2.

ARGENTINA

General Background

Argentina is a federation with a tax system composed of three levels of taxation: federal, provincial and municipal. Federal taxes include, among others, corporate and individual income tax, VAT, personal assets tax, excise taxes and tax on debits and credits on bank accounts. Provincial taxes include, among others, turnover taxes, real estate taxes, taxes on automobiles and recreational boats and stamp taxes. Finally, municipal taxes mainly include contributions for services supplied by the local governments, like street lighting and cleaning services or health and safety inspections on commercial and industrial facilities.

In general terms, corporations, limited liability companies, foundations, associations, trusts, mutual funds and permanent establishments are subject to a 35% income tax rate on worldwide income. Dividends and profits distributed by corporations, limited liability companies, foundations, associations, trusts and mutual funds to individuals or non-resident persons are subject to a 7% withholding tax. Likewise, permanent establishments are subject to a 7% additional income tax on the profits remitted to their foreign headquarters.

Non-resident persons are subject to income tax in Argentina on their Argentine-source income. The tax is withheld by the Argentine resident payor at a rate of 35% on prescribed percentages of deemed income. For instance, the prescribed percentage of deemed income in the case of royalties paid in consideration for the license of trademarks is 80%, giving rise to an effective withholding tax rate of 28% (i.e., 80% × 35% = 28%). The tax treaties signed by Argentina generally reduce these effective tax rates.

VAT is applicable on most domestic sales, services, supplies, imports of goods and services, and digital services. The general VAT rate is 21%. Some goods and services are subject to a reduced VAT rate of 10.5%.

The main concerns officially expressed by Argentina in relation to BEPS Pillars 1 and 2 have been expressed by its Minister of Economy, Mr. Martin Guzman, during a G24 Event entitled, "A Global Tax Deal: A Victory for Whom?" held in October 2021. Mr. Guzman expressed concerns that the BEPS 2.0 package could represent a net loss for some jurisdictions, particularly developing countries.

> [We] are still concerned with the lack of proportionality between the commitments that developing countries are being requested as for instance the prohibition of unilateral measures for a universe of multinational companies that goes beyond the scope that is included in the Pillar 1 of the proposals and, on the other side, the benefits that this proposal will bring to developing countries; we don't see concomitancy between the commitments and the benefits.

This statement is consistent with the position of Argentina in the September 30, 2021, BEPS 2.0 steering group meeting during which, with respect to Pillar 2, most of the members supported a global minimum ef-

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fective tax rate no higher than 15%. Argentina asked for a higher minimum rate of at least 21%, and preferably 25%.

Pillar 1 Analysis

In 2020, Argentina's GDP was approximately €335 billion. Consequently, MNEs would need to obtain more than €1 million in revenues from Argentina, for Argentina to receive an attribution of Amount A. Together with the currently anticipated scope of Pillar 1 to only the largest MNEs in the world, the application of Pillar 1 to Argentina is expected to be very limited.

Argentina has not enacted a DST *per se*. However, it is important to consider that the National Tax Administration has recently resolved, in a binding ruling relating to digital advertising services supplied from a foreign web-based platform, that payments in consideration for such digital services gave rise to income of Argentine source. As a result, the payments were subject to a 17.5% withholding tax, even though such services were fully performed outside of the Argentine territory and the service supplier had no physical presence in Argentina. The National Tax Administration expressed the view that the supply of digital advertising services had involved the transmission or projection of images and/or sound from abroad to the Argentine territory and, consequently, that the profits derived from such services should be regarded as having Argentine source under Article 14 of the Income Tax Law and subject to withholding tax.

Argentina has expressed its concerns regarding the blanket prohibition of unilateral measures, that would benefit a universe of multinational companies that would fall outside the scope of Pillar 1. Thus, the elimination of the withholding tax on certain digital services, especially in the case of companies that do not fall within the scope of Pillar 1, is uncertain.

Pillar 2 Analysis

As noted, although most of the members of the Inclusive Framework supported a minimum effective tax rate no higher than 15%, Argentina asked for a higher effective tax rate of at least 21%, but preferably 25%. While Argentina has generally accepted the 15% rate proposal, Argentina's Minister of Economy has articulated a number of issues that need to be addressed while the multilateral instruments are being developed.

Considering that Argentina currently has a 35% income tax rate on worldwide income and a 7% withholding tax on dividends, implementation of Pillar 2 in Argentina does not appear to present overall difficulties. Attention should be paid, however, to certain special tax regimes, like the one existing in the Province of Tierra del Fuego, which grant full exemption of income tax to companies residing in the Province for activities or operations carried on within its territory.

With respect to the UTPR, rights acquired by taxpayers under certain promotional regimes (for example, the mining investment regime) may be affected by the denial of expense deductions.

With respect to the STTR, interest, royalties and, in general, payments for the use of or right to use intangibles are subject to withholding tax rates above 9% in the tax treaties signed by Argentina. Rent or any other payment for the use of or the right to use industrial, commercial or scientific equipment is also subject to withholding tax rates above 9% in most of the tax treaties. Other items covered by the STTR, like amounts paid in consideration for the supply of marketing, procurement, agency or other intermediary services, would not be subject to taxation under the tax treaties and, consequently, could be captured by the STTR. However, in order to tax these types of items, a modification of the source rules of the domestic income tax law would be necessary.

Considering these implications and, in particular, the realistic possibility that BEPS 2.0 could result in an overall loss of revenue for Argentina, it is unclear whether Argentina will be able implement Pillars 1 and 2 before the 2023 deadline — and, if so, the extent to which the measures to be adopted would be fully consistent with the Inclusive Framework's solution.

BRAZIL

General Background

Brazil has a very complex tax system, with several different taxes intertwined for some of the transactions and intricate legislative process. Income tax is one of the main taxes for both companies and individuals. Aside from income tax, Brazil has many tax regimes, including a range of property taxes, inheritance tax, and real estate and commercial transactions taxes. In addition, Brazil has several social contributions levies for specific facts or types of transactions, the most relevant ones being those that tax all Brazilian companies' gross revenues.

Brazil also poses a challenge when it comes to the taxation of international services transactions rendered to Brazilian companies or individuals. For those transactions, there can be up to six different taxes applied, with some affecting the tax basis of the others. The effective tax rate may be higher than 40%. On the other hand, Brazil is an outlier regarding the taxation of dividends, which are exempt in all cases, whether

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paid to Brazilian residents or to foreign companies or individuals.

Moreover, taxes are imposed by several different agencies. Some of the taxes are federal, some are due to the Brazilian States and some to the municipalities, and this is a cause for constant and serious jurisdictional friction between levels of government.

With so much complexity, Brazil's current struggle is to simplify the system. Discussions regarding a wide tax reform that would unify the consumption taxation and eliminate various federal, state, and municipal taxes have been undergoing for the past few years, with very little advancement.

On the other hand, Brazil needs do deal with a severe fiscal situation due to years of deficits and lack of deep reforms. One of the main initiatives to deal with this scenario is to increase tax collection, approaching parts of the legislation where it is easier to do so. Another significant reform would address the Income Tax, including imposition of dividend withholding tax. This has been widely discussed during 2021 but is now on standby.

With this background, little has been said by public authorities in Brazil regarding BEPS 2.0, which is understandable in some sense. While the Brazilian tax authorities have been very active in discussions regarding BEPS at the OECD, it seems that Brazil is choosing to deal with its more pressing problems right now rather than trying to bring yet another very complex issue to the table. Besides that, 2022 is a year of general elections which is likely to absorb much of the attention and effort of the Government and Congress. Finally, in many cases new tax rules can only enter into force at the beginning of the following year after approval, as per the Brazilian Constitution. All things considered; it seems difficult that BEPS 2.0 implementation will happen within the proposed timeframe.

Pillar 1 Analysis

At a first glance, the Brazilian scenario for adoption of Pillar 1 does not seem especially complex since Brazil does not have a DST as such. There are some proposed bills to create a DST, but none have advanced.

However, this first impression may be deceiving. One of the main reasons for the underdevelopment of the DST initiatives is the fact that there is no consensus on whether Brazil really needs a DST. Brazil has some unique circumstances when compared to other jurisdictions, which may undermine the need for a DST and pose significant obstacles for Pillar 1 implementation.

First, Brazil ordinarily taxes services, interests and royalties remitted abroad (with very few exceptions pursuant to some of Brazil's double taxation conventions). The tax burden levied on such remittances is very heavy, many times exceeding 40% with up to six different taxes applied in case of services, for instance. In addition, taxation of international remittances and the related compliance requirements can be very complex for an importer of services; this often causes the international enterprises to set up a local Brazilian presence. Considering that domestic companies are subject to a high tax burden due to several different taxes, including the taxes on gross revenues (like many DSTs), this may already mimic the effect of Pillar 1.

These two circumstances should reduce (but not eliminate) the attractiveness and impact of Pillar 1 as a potential factor for revenue increase regarding enterprise transactions, from a Brazilian standpoint.

Considering the impact of Pillar 1 over Brazilian entities, one aspect that might minimize any potential problems is the fact that most Brazilian companies that would have enough revenues to fall under the scope of Pillar 1 are either extractive industries or regulated financial services companies, and therefore generally excluded.

However, it is very likely that there is room for an increase of tax revenue with Pillar 1 if transactions where Brazilian individuals are the consumers are considered, since Brazil is primarily a market jurisdiction and transactions with individuals are not nearly as controlled and taxed as those involving companies.

In any case, a key part of the implementation will probably be the discussion of what will be done to harmonize the complex and burdensome internal tax legislation that already applies to most of the remittances abroad and Pillar 1 amounts. To offset these two competing systems, many changes would need to be done to domestic laws. This is no easy task, especially if all changes must be done at the same time. If the necessary changes involve Brazil abandoning the taxation at source that it currently applies, it is reasonable to expect some resistance.

There has been no discussion regarding Amount B in Brazil. As a matter of fact, the discrepancy between Brazilian and OECD approaches to transfer pricing is widely known, with Brazil being considered to sometimes depart from the arm's length principle. This issue is so important that it is even being discussed by a jointly formed group by Brazilian IRS and OECD personnel. The results of this joint effort are likely to impact the discussions regarding Amount B and vice versa.

It is important to bear in mind that 2022 is a year of general elections and that due to Brazilian constitutional limitations, changes to tax rules can only enter into force in the following year in many cases. Therefore, it seems unlikely that changes will be made in time to be applied in 2023.

Pillar 2 Analysis

Implementation of Pillar 2 in Brazil is probably much simpler than that of Pillar 1. In fact, adoption of an IIR may be unnecessary in Brazil, since Brazil already has very strict CFC rules that tax all profits generated abroad by subsidiaries at year-end, regardless of whether the profits are distributed. This system already provides for a credit mechanism for offsetting the taxes paid at subsidiary level. Brazilian current corporate income tax rate is 34% (split into Federal Corporate Income Tax of 25% and Social Contribution on Profits of 9%); even though the Income Tax reform under discussion aims at reducing this rate to 26%, the Brazilian corporate tax rate would still exceed the 15% minimum rate for Pillar 2. If any adjustment to these CFC rules is necessary to transform into a Pillar 2 rule, it can be done by an ordinary law.

The STTR is also probably not applicable in most cases, since Brazil already taxes most remittances made abroad; there are very few exceptions caused by a few tax treaties that could be affected. In addition, the withholding rates established by the Brazilian tax law are always higher than 9% — most commonly, rates are 10%, 12.5%, 15% and 25% — even if payments are made to residents of Brazil's tax treaty partners. Finally, Brazil does not have privileged regimes that reduce the income tax rates to less than 9% except for the regional incentives mentioned below.

The UTPR, on the other hand, could be implemented in Brazil and applied to situations where a Brazilian subsidiary of a foreign parent is the payor, if neither payee nor the parent company is taxed on the income at the minimum effective tax rate of 15%. The effect, however, should be limited because, as already mentioned, Brazil taxes most of the remittances made abroad at a 10% or higher rate.

If a subsidiary of a Brazilian company pays anything to another subsidiary, considering that Brazil has a tax rate of 34% and strict CFC rules, UTPR should produce only limited impact. On the contrary, it would be important in such cases to confirm that Brazilian CFC rules don't create a double taxation, since they would capture and tax all profits of the subsidiaries at the Brazilian parent's level with a tax rate of 34%.

Brazil does have regional tax incentives for the Corporate Income Tax that may reduce the effective rate of companies that are in the North and Northeast of the Country. This is established by the Brazilian Constitution with the declared objective of developing such regions which are historically less developed than the south. Because of its importance and constitutional status, these incentives are extremely unlikely to change, but would probably be accommodated by means of carve-out provisions.

CHILE

General Background

The Chilean corporate income tax system is based on a worldwide principle, under which both local and foreign sourced income is taxable.

Within this context, Corporate Income Tax (CIT) applies at the rate of 27% on net income obtained by resident companies, as well as permanent establishments of non-resident entities. The Chilean income tax system works on an integrated basis, where the CIT paid by resident companies is later deducted from the 35% withholding tax (WHT) triggered on dividends remitted to non-resident shareholders. In case of non-resident shareholders in treaty countries, the CIT credit is fully deductible, which means the effective WHT rate on dividends is 10.96%, and the overall effective taxation between profits and dividends is capped at 35%. (This regime is also applied to U.S. non-resident shareholders, even though the treaty is not yet in force.) On the other hand, when non-resident shareholders are resident in a non-treaty country, only 65% CIT paid by the local taxpayer can be deducted, resulting in an effective WHT rate on dividends of 23.90%, and the overall effective taxation between profits and dividends amounts to 44.45%.

In case dividends are paid out of book profits in excess of tax profits, the WHT on dividends remitted to foreign shareholders is 35% with no CIT credit deduction. Notably, that treaties signed by Chile do not limit the ability of the Chilean State to apply full taxing powers on dividends.

Although Chile has adhered to the new taxation framework contemplated by BEPS 2.0, there has been concern with respect to the impact that the changes envisaged in Pillars 1 and 2 could have, both in terms of revenue collected and of the overall business and investment environment in Chile.

This is due to several factors, among them:

a) A newly adopted tax on digital services (since June 2020), which would have to be dismantled after the implementation of Pillar 1;

b) The impact that the implementation of Pillar 2 could have on multinational companies operating in Chile which, due to specific local regulations and adjustments, may be subject to an ETR of less than 15%.

Pillar 1 Analysis

It is not clear yet how many Chilean MNEs could be included in the scope of the Pillar 1 rules. Some proxy could be obtained through the public informa-

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tion for regulated companies subject to the supervision of the *Comisión para el Mercado Financiero* (the Chilean SEC). Notably, as Chile is a significant mining country and has a sophisticated financial market, the exclusion of extractives and regulated financial services will leave out many significant Chilean MNEs from the application of Pillar 1.

On the new nexus rule for allocating Amount A, Chile should be subject to the general rules (requiring €1 million of revenue generated in Chile in order for the country to receive an Amount A allocation) as Chile's annual GDP is greater than € 40 million.

Once Amount A is allocated, Chilean legislators would have to determine how the taxation applied on Amount A coexists with the income tax system, where the CIT paid by the local taxpayer is ultimately credited against the final WHT on dividends. One approach may be applying the same integration and allow taxes applied on Amount A to also be credited against the WHT triggered on dividend distributions.

Likewise, a significant aspect to consider is that as from June 2020, Chile incorporated a 19% VAT/DST applicable on B2C digital services provided by foreign taxpayers to local taxpayers. The scope of this new tax includes:

(i) Intermediaries (e.g., marketplaces) with respect to services rendered in Chile, whatever their nature, or of sales made in Chile or abroad, provided that the latter gives rise to an import;

(ii) Digital entertainment content, such as videos, music, games or other analogues, through download, streaming or other technology, including for these purposes, texts, magazines, newspapers and books;

(iii) Supply software, storage, platforms or computer infrastructure, and

(iv) Online advertising.

This new tax on digital services does not look at the size of the foreign service provider and imposes no specific thresholds on revenue from local consumers for the tax to apply. Accordingly, any B2C service of this nature will be subject to a 19% VAT, where the foreign service provider must be registered before the Chilean IRS and is directly liable for compliance with the tax, either on a monthly or trimestral basis. In case of B2C, a reverse-charge mechanism is implemented, and the local VAT taxpayer is the one in charge of complying with the VAT payment.

Despite the relative difficulty of enforcing a self-reporting tax regime, local tax authorities have found that the most relevant foreign companies subject to the new rules have voluntarily registered and are complying with their tax obligations. After one year of full implementation, tax revenues from the new VAT on digital taxes amounts to approximately USD 200 million. It is expected that this sum will increase, as more Chilean residents embrace the new and different forms of the digital economy.

It remains to be seen whether the new Pillar 1 rules could offset the foregone VAT revenue on digital services, once fully implemented.

The implementation of Pillar 1 will require relevant changes being introduced in Chilean domestic tax law, both for purposes of integrating Pillar 1 with the taxation rules regarding amounts A and B, and also for dismantling digital measures previously described. Specifically, with regards to dispute resolution, there is some skepticism, as Chilean Tax Authorities in the past have not been keen on the application of binding arbitration to solve tax disputes.

The proposed implementation timelines seem very ambitious, perhaps unrealistic, considering the complexity of the changes that will be required and the specific political situation in Chile. In this regard, it is worth noting that in 2022, Chile will have a newly elected president and substantial internal tax reforms are expected to be discussed. Furthermore, by the end of 2022, Chile will have to vote on a new constitution that is being drafted by the elected constituent assembly. Although the content of this new constitution is still unknown, it is expected to include substantial changes in the Chilean political system.

Pillar 2 Analysis

As mentioned, the Chilean taxpayers are generally taxed on their worldwide sourced income. Net profits are taxed with a 27% CIT, and this tax may be credited against the WHT on dividends that is ultimately triggered when dividends are remitted to non-resident shareholders. Taxes at corporate level, at least at a nominal rate, are not low comparatively speaking within the OECD.

However, some specific areas and industries do benefit from preferential tax regimes. In some cases, due to specific tax deductions, book-to-tax differences, credit deductions, and other exemptions like free-trade zones and investments in specific regions, Chilean companies could have an ETR even below the proposed 15% minimum tax rate under Pillar 2.

Many exemptions are expected to change in the near future, as there is a certain degree of consensus in the political spectrum regarding the need to modify, attenuate or simply eliminate a series of tax exemptions that could make Chile even more of a taxing country.

Inclusion of the proposed IIR and UTPR would require a new understanding and modifications to Chilean domestic law, as current CFC Rules and other SAARs may not account and be effective for what is expected from a Pillar 2 perspective. Moreover, the coexistence of an STTR with the Chilean treaty network is an issue that will require special attention and may force foreign investors to rethink their current tax structures.

Regardless of the implementation of Pillar 2, the number of Chilean parented entities that may fall within the concept of MNE for Pillar 2 purposes could be limited to a few cases. This has been the experience in companies implementing BEPS Action 13 Country-by-Country Reporting. Implementation of Pillar 2 could therefore require an enormous effort in terms of legislative work, administration, and compliance, but is unknown how relevant this could be from a domestic tax policy perspective.

As the Pillar 2 provisions require significant strategic analysis by the Government — and as implementation of the new rules would require substantial amendment of domestic law provisions and applicable international tax treaties (even if these are implemented through multilateral instruments) — the current implementation timeframes for Pillar 2 seem very ambitious and possibly unrealistic for Chile.

As mentioned before, in years 2022 and 2023 Chile will probably have to face huge political and legislative initiatives in two fronts: a new elected president proposing substantial tax reforms to cope with incremental cash needs for social public policies, and the implementation of a new political system from a new constitution.

COLOMBIA

General Background

As it applies to legal entities and corporations, Colombia's tax system covers worldwide income plus a unilateral tax credit (where requirements are met) to prevent double taxation. Non-resident persons are subject to income tax on Colombian source income except where a permanent establishment exists — whereupon worldwide income attributable to the permanent establishment is taxable in Colombia.

In addition, Colombia has in force a multilateral tax treaty with Andean Countries (Peru, Bolivia and Ecuador) and bilateral tax treaties with over 10 countries, to mitigate double taxation on cross-border income between those countries.

Other key features of the tax system include:

- Source rules that are typically (with limited exceptions) based on the place where transactions are executed, or services are provided;
- Anti-deferral measures, such as CFC rules over passive income;
- A transfer pricing regime consistent with OECD standards;
- Thin capitalization rules; and
- Anti-tax haven/low/no tax preferential regime rules.

With respect to BEPS 2.0, no unilateral income tax measures, such as DST, have been adopted in Colombia, and there are no specific income tax source rules to collect taxation with respect to digital economy transactions. This implies that the Colombian Government expects to participate in revenues derived from the digital economy once BEPS 2.0 is implemented.

The current Colombian Government is supportive of deadlines proposed to introduce Pillar 1 and Pillar 2 measures. However, a presidential election in May 2022 may change this situation, particularly to the extent that a new government is not aware of the precise mechanics agreed to introduce the Pillars. It may also be the case that a new government would simply prefer to avoid a political discussion in its first year of administration. (Colombia recently experienced a failed tax reform in relation to proposals submitted to Congress without proper consultation, which in turn resulted in a complex social crisis and political and economic ripple effects.) In either case, a postponement of domestic measures may occur.

Pillar 1 Analysis

Based on size, Colombian companies are unlikely to fall into the thresholds applicable for Pillar 1. Consequently, Colombia is expected to participate in Pillar 1 as market jurisdiction.

For these purposes, the current Colombian Government is aware that domestic changes to tax law should be required. Once model rules are issued, a tax reform will be proposed before the Congress, with application generally expected in 2023. No estimation of the potential revenue allocation is publicly available by the time of this document.

However, as noted, there is a potential obstacle to timely adoption of Pillar 1, in that both the Colombian Congress and president will be changing in 2022. This raises some uncertainty as to whether the right climate will exist for tax reform. Furthermore, ratification of the multilateral convention required to become national law is also a matter of concern, as Colombia's experience shows that the Congressional process may fall outside the scope of the lawmakers' main agenda. For these reasons, Colombia may be delayed in adopting the full application of the rules.

As no DST exists in Colombia, tax reform should focus on changes over source rules (Amount A). However, great uncertainty exists over Amount B, as no precedents exists in the Colombian tax rules of applying a fixed percentage that operates as a transfer pricing safe harbor. In fact, practice shows that arm's length percentages of transactions to be covered by Amount B generally exceeds the proposal of applying 5% over costs. Therefore, limited interest may exist to introduce fixed percentages and unfavorably impact future collection.

Pillar 2 Analysis

Unlike Pillar 1, Pillar 2 is expected to have a material impact with respect to companies headquartered in Colombia. In this regard, according to an initial estimation, no more than 16 to 19 companies will fall within the scope of Pillar 2. To date, no estimates have been made public regarding the potential revenue collection related to this Pillar.

Domestic changes to tax law should also be required in 2022 for the rules to be applicable in 2023, but the same political uncertainty applies regarding whether a tax reform would be undertaken by the new government, which would begin on August 7, 2022. However, in case tax reform takes place, it is expected that Colombia will adopt both an IRR and a UTPR within Colombia tax provisions.

An expanded STTR clause is a matter of importance to the current Colombian Government, as it is of interest that the concept of "other payments" covers business income and capital gains as well. However, as this is a matter of negotiation, it is unclear whether an expanded scope will be adopted in the model rules and commentaries. Furthermore, as previously explained with respect to Pillar 1, the ratification of the multilateral convention required to become national law is also a matter of concern for STTR to be in force in 2024 or earlier.

Colombia offers different regimes and corporate income tax benefits to attract foreign investment. Some of these regimes, but not all, may be impacted by IRRs adopted in other countries. For instance, Colombian Free Trade Zones carry a 20% corporate income tax rate (i.e., a reduction of corporate income tax but not a complete elimination). The Free Trade Zones are not expected to be impacted, as the tax rate is high; the carve out benefits should serve as a second line of protection, as the companies benefitting from Free Trade Zones tend to have significant payroll and assets in Colombia.

Depending on carve out results other benefits or regimes, such a 9% corporate tax rate applicable to hotels, may be also protected; however, calculations are suggested on a case-by-case scenario to confirm this initial assumption. "Super deductions" offered with respect to renewable energy investments also necessitate calculations to determine if carve out can mitigate GLoBE impact.

As Colombia has adopted CFC rules over passive income, it is expected that GLoBE and current CFC can coexist. However, clarification of this coexistence is expected to be considered in domestic tax changes to be required.

One final consideration is the fast depreciation of the exchange rate. In this case, it is likely to cause the GLoBE threshold to be adopted in Colombian Taxable Units (UVTs) instead of euros, in order to capture more taxpayers.

COSTA RICA

General Background

An OECD and Inclusive Framework member, Costa Rica is a Central American country with a consolidated democratic system and a stable economy. As a general matter, the country follows a territorial taxation system, pursuant to which profits generated from services, rendered, assets located, and capital used in the Costa Rican territory are subject to Costa Rican income taxation. In December 2018, Costa Rica adopted modifications to the Income Tax Law in order to tax the capital income and capital losses; there were no changes to the territorial system.

Costa Rican taxable income is subject to a 30% tax rate. Likewise, movable, real estate and capital gains income are subject to a 15% rate. However, since the 1990's, Costa Rica has offered a Free Zone Regime to national and foreign companies that wish to develop their operations in the country, with the aim of encouraging direct foreign investment, commercial exchange and job creation in Costa Rica. Among other things, Free Zone benefits include an exemption from income tax and dividends for a period of time or the application of a reduced rate of 6% to manufacturing companies. Approximately 400 companies operate under different categories of the Free Zone Regime. These companies are required to have economic substance within the Costa Rican territory and must comply with a series of investment requirements and controls. The Free Zone Regime was analyzed and assessed by the OECD and found to be in compliance with BEPS Action 5.

The Costa Rican Government Authorities are currently analyzing the consequences that could derive from the implementation of BEPS 2.0 in Costa Rica.

Pillar 1 Analysis

One of Costa Rica's most significant considerations with respect to Pillar 1 is the extent to which the country would receive an allocation of revenue under Amount A.

Costa Rica has not established a specific tax on digital services and, in fact, generally does not tax services provided onshore unless they relate to consultancy services or royalties. However, the Costa Rican tax authorities have begun interpreting these rules very broadly in regard to services provided online or digital services. As a practical matter, if a digital service is utilized in Costa Rica — particularly in the cases where a specific software, platform or network link has been used to render the service — and if payments for the service is deductible by a Costa Rican taxpayer, the Tax Authorities have taken the position that such payments are subject to 25% Costa Rican withholding tax.

In practice, the interpretative criterion adopted by the Costa Rican Tax Authorities has been applied to transactions between companies, i.e., in ''B2B'' settings. However, the tax has not been applied in transactions with final consumers because, in practice, final consumers do not withhold any tax on cross-border remittances; nor do they deduct the expense for income tax purposes. The structure, features, and implications of the Costa Rican tax on digital services income will need to be analyzed carefully under the Pillar 1 guidance that is ultimately adopted.

A perhaps trickier issue is whether Costa Rica could receive any significant allocations of Amount A. Costa Rica's GDP is above the 40 billion threshold that would allow the lower (€ 250,000) nexus rules to apply. In addition, the country's population is relatively small (approximately 5 million), making it unclear whether the higher €1 million threshold could be consistently reached.

Overall, regarding Pillar 1, the Costa Rican Tax Authorities preliminarily foresee that the country could obtain some revenue; however, to date there is no certainty as to the projections regarding the revenue that Costa Rica could achieve.

There are a few additional, relevant factors for the success of Pillar 1 adoption in Costa Rica:

First, with respect to amount B, the governmental authorities have not issued any opinion to date. They are awaiting final agreements regarding the attribution of revenues derived from distribution activities.

In addition, the process of ratification of a Multilateral Agreement requires compliance with the legislative process and be ratified by the Executive Power. This process can be complex. The potential for these new rules to result in additional tax collections and the OECD support for these measures are favorable factors for the approval of the required changes in a short period of time. However, this will depend on the then-current political makeup of the legislature.

With regard to compensation for activities in excess of routine marketing and distribution, it should be noted that Costa Rica has deferred the application of BEPS Action 14. The Costa Rican Tax Authorities historically have denied the application or arbitration to solve tax disputes. The country has not agreed to mandatory arbitration on its tax treaties and MLI. This may make it more difficult to implement Pillar 1, once adopted. Once this matter is clearer, an aspect to be analyzed would be whether the dispute resolution mechanisms provided for in Pillar 1 are compatible with those of domestic law in Costa Rica. In the case that they are not, a legislative reform would be required.

Pillar 2

The implementation of Pillar 2 in Costa Rica would require a deep analysis in the country's fiscal policy. The Free Zone Regime has had a positive impact on the economy and is a significant source of jobs, and Costa Rica's, like many LATAM jurisdictions, has relied heavily on Free Zone tax and investment benefits to attract direct foreign investment.

Among other benefits, the Free Zone Regime law grants exemptions to qualifying taxpayers, from the corporate and dividends tax for a specific term of years. To qualify, the companies must comply with several commitments agreed with the government. Among other conditions, the companies must make an initial minimum investment, backed by new fixed assets subject to depreciation and real estate. In general terms, the minimum amount for operating in the Metropolitan Area inside a Free Trade Zone park is USD150,000; outside a park is USD2,000,000. If the company operates outside the Metropolitan Area, the investment amount is reduced to USD100,000 and to USD500,000, respectively.

In addition, companies have to specify the level of employment that the operation will require. Although there is no specific employment level required *per se*, it is expected that the indicated quantity of employees will be substantial. The company will also undertake to maintain the established level of employees while it is enjoying the benefits of the Free Zone Regime.

These Free Zone benefits and reciprocal commitments are incorporated into the Costa Rican law. In principle, any reform that is intended to be implemented must be respectful of the taxpayers' acquired rights. It is anticipated that tackling this issue would be challenging because the outcome of the solution should take into account the possible tax consequences of other jurisdictions, i.e., application of a UTPR in the residence jurisdictions of the payer of a services fee or the buyer of the goods produce by the Free Zone Regime.

In addition, it will be very important to have clarity on the way in which the carve outs operate, since

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the companies operating in the Free Trade Zones have significant investments in fixed assets and personnel. The Costa Rican Tax Authorities will review in detail the impact that the carve out would have with respect to the determination of the minimum tax. This will be a critical factor for balancing the objectives of a global minimum tax while maintaining the attractiveness of specific locations for foreign investment.

Notably, Costa Rica has already implemented a limited form of UTPR. In 2018, Costa Rica adopted a rule that limits the deductibility of payments if the recipient's residence jurisdiction has not signed an information exchange agreement with Costa Rica, or the jurisdiction has an equivalent rate of income tax that is lower than the then-current Costa Rican income tax rate (30%) by more than forty percent, i.e., an 18% tax rate. However, the Costa Rican Tax Authorities subsequently narrowed the rule's application, to payments to residents of jurisdictions that were considered non-cooperative. The resolution issued by the General Directorate of Taxation No. 02-2020 establishes as a list of non-cooperating countries the following: Bosnia and Herzegovina, North Korea, Cuba, Iraq, North Korea, North Korea, Kyrgyzstan, North Macedonia, Maldives, Montenegro, Oman, Palestine, Timor-Leste, Uzbekistan and Wallis and Futuna.

All in all, it seems challenging for Costa Rica to ratify the Multilateral Convention and the modifications to the Income Tax Law and Free Zone Regime Law by the targeted, 2023 effective date. Added to that is the specter of 2022 presidential elections. The political complexity that could be generated by the approval of an eventual regulatory change affecting Costa Rican companies and foreign direct investors, cannot be underestimated.

DOMINICAN REPUBLIC

Background

In the Dominican Republic, the taxation regime is regulated by the Territoriality Principle. As such, all income considered to be of Dominican source shall be deemed taxable in the Dominican Republic. The determination of such source of income is done on a case-by-case basis, in accordance with Dominican written and non-written tax regulations. The main Withholding Tax obligations applicable to entities arise from the Corporate Income Tax and Value-Added Tax. As opposed to other countries, in the Dominican Republic, tax registration before the Dominican Tax Authority is all encompassing, meaning that by registering themselves taxpayers become subject to all taxes provided by local laws and regulations. The aforementioned applies to permanent establishment as well.

Regarding BEPS 2.0, the Dominican Tax Authority has yet to voice their thoughts on the provisions set forth by most of these guidelines. After informally consulting several officials from said institution, it is understood that the Dominican Tax Authority is still reviewing the impact that Pillar 1 and Pillar 2 will have on current taxing rights and future tax collection in order to issue formal guidelines on this matter. Similarly, the Dominican Tax Authority has not issued an opinion or working paper, detailing proposals to implement Pillar 2 into Dominican Tax Law.

Regarding Pillar 1 and more specifically, the taxation of digital services, according to recent meetings with officials from the Dominican Tax Authority, their goal is, by the first trimester of 2022, to issue a draft regulation by means of a Presidential Decree shall be issued, regarding the taxation of the digital economy services provided by non-residents and consumed in the Dominican Republic. However, as per the information disclosed to date by such authorities, the aforesaid timeframe is an estimate. Therefore, an exact date on when the Decree will become effective, cannot be expressly provided at this time.

In the current scenario, the compliance with the 2023 GloBE timeline seems unlikely, considering said implementation entails a challenging, complex, and long-lasting process for the Dominican Tax Authority. Such process will require the employment of many resources from several sectors of the legislative and executive branches, while also requiring the ratification of Congress. Additionally, the point of view of several private stakeholders within the Dominican economy will be sure to have a powerful impact on the chosen implementation strategy, and those discussions and public forums will likely take some time. Currently, tax matters, even if not directly affecting lower and middle classes, are a sensitive subject. In conclusion, while possible, the enactment into law of BEPS 2.0 might prove a complex endeavor due to political reasons.

Pillar 1 Analysis

As previously stated, an implementation strategy for the enactment into law of BEPS 2.0 has been informally shared by the corresponding officials. However, it is estimated that only a small pool of MNE Groups would be affected in the Dominican Republic by the provisions of Pillar 1. Most MNE Groups operating within the Dominican Republic typically have a limited local presence in the form of representative offices, manufacturing plants, or cost centers, or they operate through a local merchandise distributor/concessionary, typically entailing low-margin operations.

In regard to digital services, the Dominican Tax Authority estimates that, likely, by the first trimester

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of the 2022, they will issue a draft regulation regarding the taxation of digital services provided by non-residents and consumed in the Dominican Republic — more specifically advertising, commissioning and streaming services provided by non-resident through digital platforms. According to the information that was provided by said authority, the proposal would tax the income perceived by the aforesaid services providers with Value Added Tax (VAT) and Corporate Income Tax (CIT).

In order to comply with their tax obligations, potential taxpayers reached by the aforementioned Presidential Decree, will have the ability to locally register through a ‘‘simplified special tax registration regime’’ without the need of registering a permanent establishment in the Dominican Republic (and therefore, without the need to comply with further tax obligations applicable to resident entities). This simplified special tax registration regime shall likely allow non-residents providers of digital services to file and pay the corresponding taxes through special reporting Forms to be created, for both, VAT and CIT compliance.

In regard to the new special purpose nexus rule, considering the Dominican Republic exceeds the €40 billion GDP threshold — therefore falling under the €1 million revenue threshold for said rule — many MNEs would not be considered in scope for Amount A in the Dominican Republic. For certain goods and services, sourcing rules might prove difficult to uphold, due to limited information available to local tax authorities. However, more detail would need to be known to properly assess any gaps therewith. Notwithstanding, it would appear that the Dominican Republic could likely benefit from additional tax collections due to Pillar 1.

Considering previously stated political complexities, a taxation higher than the current general corporate tax rate at 27% could be difficult to implement. Consequently, at this stage, it is unclear how the new taxing right will be calculated for Dominican tax purposes.

It is important to note that, when it comes to international commitments, due to tax collection interests and/or technical complexities, a divergence of interpretation between the administration and taxpayers may give way to aggressive claims from the tax authorities; the proper resolution mechanisms are not in place. However, it is unclear that dispute resolution under Pillar 1 will be an easy answer, considering that, though adopted, the Dominican Republic has yet to implement mandatory arbitration on its tax treaties in connection with Action 14 of BEPS 1.0. Nowadays, tax litigation sits exclusively within the jurisdiction of the Dominican administrative courts. The corresponding authorities' point of view on this matter will have to be observed in order to assess the tax certainty for in-scope MNEs.

Pillar 2 Analysis

In terms of Pillar 2, the impact for the Dominican Republic will be particularly significant in connection with exemptions and reductions granted to special tax regimes, such as tax-free zones and other important tax holidays. This includes but is not limited to, free trade zones, tourism sector, border, and agricultural investments. The successful achievement of the carve-out of these regimes will be vital for the implementation of BEPS 2.0 in the Dominican Republic, considering that special tax regimes —particularly free trade zones — are greatly relied upon for the attraction of foreign investment, transfer of technology and contribution of employment opportunities.

In this sense, the effective tax rate for entities that benefit from a special tax regime or tax holidays is well below 15% at present. It would be necessary to consider whether these proposals would effectively increase the rate, or if the Dominican Republic would place its costs above special regimes as a way to attract investment. The aforementioned analysis would be crucial for the Dominican Republic to adopt GloBE rules. If adopted, Pillar 2 may introduce some important changes to the Dominican tax system, considering that Dominican fiscal policy relies greatly on the application of the territorial principle of income taxation. The corresponding authorities will consider the impact that the adoption of Pillar 2 will have on Dominican fiscal policy, in connection with the country's current strategy for the attraction of foreign investment.

Regarding the STTR, the network of agreements in the Dominican Republic is very limited, currently only two are in place. As a result, its impact could be minimal.

In addition to the previously referenced impact of Pillar 2 in the Dominican Republic, another aspect worth noting is that the impact for the Dominican Republic parented companies would be limited. The €750 million threshold is high for jurisdictions like the Dominican Republic. Therefore, a reduced pool of Dominican MNE Groups would be affected by the enter into force of BEPS 2.0's Pillar 2.

Furthermore, a de minimis exclusion, which contemplates at least €10 million in revenue or €1 million in profits, could have a great impact in the Dominican Republic due to the type of activities that are usually performed by qualifying MNE Groups in the country, generally generating low margins. The relevant Dominican Republic authorities will likely consider exclusions by the de minimis thresholds, or other mechanisms that seek to reduce complexity in countries where profits are non-material.

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In conclusion, the implementation of Pillar 2 translates to necessary legal modifications of the current tax system, which would convey a significant amount of resources to be implemented towards this objective. This would also require special scrutiny, as it would imply the amendment of current income tax rate provisions, particularly regarding the exemptions and reductions granted to special tax regimes.

MEXICO

General Background

Under the Mexican Corporate Income Tax (CIT) system, individuals and legal entities are required to pay Income Tax on their worldwide income when they are Mexican tax residents. 0n the other hand, and in the specific case of foreign residents, they will be required to pay Income Tax when is deriving it through a permanent establishment, or when the foreign resident obtains income from Mexican sources and it is not attributable to a PE located in Mexico. Mexican legal entities as well as permanent establishments of foreign residents, are obliged to pay CIT in Mexico by applying the 30% rate on their taxable profits obtained on the fiscal year.

As noted, all foreign residents without a Mexican PE are required to pay income tax in Mexico on income derived from source of wealth located in the Mexican territory. Tax applies to all forms of income including cash, payments in kind, in services, or in credit when such income arises from sources of wealth located in Mexican territory.

Mexico has expressed its intention to apply the new taxation framework contemplated by BEPS 2.0. There have been concerns expressed at a public and private levels in terms of the potential impact of the changes envisaged in Pillars 1 and 2, both in terms of revenue collected and of the overall business and investment environment in Mexico.

Pillar 1 Analysis

With respect to Pillar 1, Mexico does not anticipate that many of its Mexican-based multinationals will be within scope for an Amount A allocation.

In relation to amounts that would be allocated to Mexico pursuant to dispute resolution, Mexico has only accepted voluntary arbitration, and has historically declined to incorporate mandatory arbitration provisions, in its tax treaties. This includes the OECD's Multilateral Instrument. Nonetheless, the government has stated that it will accept the proposed mandatory dispute resolution mechanism.

Finally, it is worth mentioning that no tax initiatives have been presented to/by the Mexican Congress regarding digital services taxation at the federal legal. There are, however, certain non-federal tax measures that must be considered under Pillar 1, including as follows:

- Local taxes on certain activities, such as traditional lodging and transportation, where the services are provided or offered to customers utilizing digital platforms.
- A Mexico City tax reform that establishes the imposition of ''passenger transportation tax'' on food and goods delivery, if delivery has been contracted through digital platforms.

Even though our current impression is that Mexican companies — those parented in Mexico as well as those parented elsewhere, with Mexican commercial activities — will not be significantly affected by Pillar 1, certain issues have the capacity to change this impression, possibly significantly. These points must be watched carefully as they develop and be assessed for their ongoing impact on taxation of an MNE that views Mexico as a significant market.

- The scope of industry or sector exclusions;
- The definition of the tax base and treatment of losses;
- Sourcing rules, including potential B-to-B applications;
- The scope and operation of the marketing and distribution safe harbor mechanism, including the basis for taxation (return on local sales, local tangible assets, local costs) and the magnitude of routine returns;
- Elimination of double tax, including identification of the taxpaying entity, definition of ''residual profit,'' and prioritization among multiple paying entities; and
- The scope of the ''unilateral measures'' that would need to be eliminated.

Pillar 2

In accordance with the latest communications, Mexico expressed its intention to apply the GLoBE (IIR and UTPR) and STTR rules once adopted. Based on current revenue expectations, it is expected that around 100 Mexican companies (public and private) will be within the scope of Pillar 2.

More specifically, with respect to the Undertaxed Payment Rule and as part of the Mexican Tax Reform for 2020, an ''anti-tax haven'' was introduced (the ''deduction disallowance rules,'' which are currently in effect). At a high level, the rule provides that, in case of direct or indirect payments made by a Mexican taxpayer to a foreign related party, if the payee is taxed for such income at an effective rate lower than 75% of the rate that would have applied in Mexico (i.e., 22.5%) the Mexican deduction for the payment will be disallowed. In many cases, the payee may demonstrate economic substance to rescue the deduction, including the conduct of business activities using the personnel and assets of the payee.

The clearest consequence of Pillar 2 would be a review and modification of the deduction disallowance rules, with respect to two issues. First, as noted, the threshold effective tax rate for the deduction disallowance rules is 22.5%, which is higher than the 15% minimum tax rate established by Pillar 2 (15%). Consideration should be given to whether there are any grounds or appetite for retaining a 22.5% target rate in whole or in part (e.g., as part of the Mexican CFC rules). If not, the current deduction disallowance rules should be modified to eliminate the discrepancy. In addition, modifications may be required to align the determination of the payee's effective tax rate for Mexican purposes (e.g., current and future period taxes taken into account), with the global standard that is ultimately adopted for Pillar 2 purposes.

In addition, because the Undertaxed Payment Rule applies automatically once the payee is determined to be low-taxed, the Mexican government will need to consider whether the current, economic substance exception would remain, either as a specific carve-out to the deduction disallowance rules or as an application of general Mexican tax principles.

Mexico may also have implications from the recent version of the OECD's STTR. On October 8, 2021, the Inclusive Framework released an updated statement, providing that the minimum rate should be applicable to interest, royalties and a defined set of other payments, and that the taxing right in the payor's residence country would be limited to the difference between the 9% minimum rate and the tax rate on the payment. Notably, in the case of Mexican royalty payments, almost all of Mexico's double tax treaties establish a reduced rate of 10%; no risk is expected to arise for such payments, since the prevailing withholding rate exceeds the anticipated minimum tax rate of 9%.

Similarly, with respect to interest payments, almost all the double tax treaties between Mexico establish reduced interest rates between 10% and 15%. For banks and financial institutions, however, the treaty (and, for banks, the statutory) withholding rate for interest is reduced to 4.9% or 5%, respectively. In case the minimum tax of 9% established in the subject-to-tax rules were applied and the income is not taxed in the other jurisdiction, query what criteria the Mexican Government would apply, and whether this situation would lead to any modification of the Mexican tax provisions.

Almost all of Mexico's double tax treaties — except in the case of the Treaty between Mexico and Brazil — establish that income from services will not be taxed absent physical presence in Mexico. There are also cases in which the double tax treaty establishes a reduced tax rate on general services (e.g., the treaty between Mexico and Costa Rica) or for technical assistance services (such as the tax treaties signed with Argentina, Brazil, India, Indonesia, and Jamaica). With respect to these provisions, it would be necessary to review if Mexico would apply the STTR rule in all cases with respect to services, particularly as the prevailing withholding rate of 10% is higher than the minimum tax.

Finally, Mexican tax treaties commonly contain restrictions that would prevent treaty benefits from applying to income that is exempt from tax in the beneficial owner's residence jurisdiction, or that is taxable at a rate lower than the rate that would be applicable to the same item of income if derived by other residents of that jurisdiction who do not receive such exemption or rate benefit. Query whether those provisions must be modified to align more closely to the STTR provisions.

PANAMA

General Background

The Republic of Panama has established its income tax system on a territorial principle. In accordance with article 694 of the Panamanian Tax Code, all income generated from local or domestic operations is subject to Panamanian income taxation, while income arising from foreign source (generated from operations or activities carried out and perfected abroad) is excluded. According to this principle, any income generated or earned within Panamanian fiscal territory by any individual or legal entity, regardless of their nationality, residence, place where payments are received, or even the place where the contract is signed, is considered as Panamanian source of income, therefore becoming taxable.

Article 699 of the Panamanian Tax Code establishes that corporations performing commercial or industrial activities in Panama, which generate Panamanian source of income, are subject to a 25% corporate income tax rate. In addition, withholding tax applies to dividends from companies that: require a Notice of Operation to carry out commercial and industrial activities in the national territory; or generate taxable income in the Republic of Panama. The general rate of dividend withholding is 10%, but the rate is reduced to 5% for dividends distributed out of foreign source profits or export profits, or by companies located

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within Panama's Free Trade Zone. Subject to certain conditions, royalties, interest and services fees are also subject to withholding tax at 12+%.

In the case of Panama, implementing Pillars 1 and 2 in compliance with developing international standards will be a challenge. The Panamanian Government has manifested their intentions to do so, but Panama will need to accomplish a significant internal political agenda in order to achieve the 2023 deadline.

Pillar 1 Analysis

At this point in time, the Panamanian Government has not announced any specific position with regards to Pillar 1 besides forming part of the Inclusive Framework. No calculations of impact in the tax collection have been made public.

However, any impact of Pillar 1 in Panama would need to be analyzed from the perspective of a capital import country, and take into consideration that the population of the country is a very small market of approximately 4.5 million people.

Panama does not have any specific digital services tax, although a project of Law to enact one was submitted to the National Assembly in 2020. Based on the mandatory character of Pillar 1 and the commitment made by Panama as part of the Inclusive Framework, it would be expected that the project of law will be withdrawn.

One of the concerns in the country is whether the repeal of digital services taxes will also imply the limitation on the withholding tax mentioned previously, that is also generally applicable to service and royalty fees. The withholding taxes are not related to any specific type of payments (digital or otherwise) but apply if the payer is claiming a taxable deduction. Although some indications have been made in the sense that the repeal of DST does not necessarily involve the abolishment of other measures such as a general income withholding tax applicable to services, this will not be entirely clear until model rules are issued. If income tax withholdings need to be repealed in order to comply with Pillar 1, then the balance of tax collection arising from Pillar 1 to Panama could be marginal or even negative.

Another point of attention from a Panamanian perspective is how the specific rules regarding amount B will develop and, specifically, whether the standard remuneration for baseline marketing and distribution activities will leave a rather low margin to market jurisdictions.

Finally, mandatory dispute resolution mechanisms may pose both constitutional concerns and practical issues about the experience and technical ability of tax officials in developing countries such as Panama, and the disadvantageous position that this could create.

Pillar 2 Analysis

As of publication of this article, the Panamanian Government has yet to release a statement on whether the Country will adopt Pillar 2 rules. Nor has the Panamanian Government released a statement addressing how Pillar 2 will be implemented in Panama. However, being a member of the BEPS inclusive framework, it is likely that Panama will comply with Pillar 2 dispositions and standards. It is assumed that the Government will take a reactive approach, which will emulate the actions of fellow jurisdictions from the region with similar tax regimes and/or incentives.

Even though it seems that very few Panamanian multinational groups would be above the threshold to be considered in the scope of Pillar 2 rules, it is possible that the potential adoption of said rules may affect Panamanian holding companies that function as intermediate parents.

It should be noted, however, that even if Pillar 2 rules could affect only a small percentage of Panamanian multinationals, the application of these rules will probably have groundbreaking impact on the different special tax regimes which provide tax incentives, including reduced tax rates of 5% or lower on corporate income tax, provided that certain conditions are met. As such, it is foreseen that Pillar 2 application will affect multinational enterprises established under regimes such as: Colon Free Trade Zone, Oil Free Trade Zones, Panamá Pacific Area, Barú Free Trade Zone, Special System of Multinational Corporation Headquarters (MHQ — SEM) regime, among others. It should be noted that Pillar 2 will affect these regimes regardless of whether Panama decides to adopt and implement the rules or not. This is to say that, assuming that Panama decides not to adopt these rules, in principle no changes would have to be made to the rules of these special regimes, however, this would also mean that the excess income (compared to the lower CIT tax rates provided by said regimes) would be taxed in other jurisdictions. As such, it is believed that the Panamanian Government will consider applying changes to these special regimes, in order to benefit from Pillar 2 rules, rather than allowing the income to be taxed elsewhere.

This approach may raise concerns related to the legal stability benefit granted by many of the special regimes (such as Panamá Pacific Area, MHQ, among others), that is guaranteed according to the legal mandate for a period of 10 years. Therefore, the tax incentives/benefits provided by such regimes to companies established therein could not be eliminated or modified until the legal stability period expires.

On the other hand, the implementation of Pillar 2 (and its three main components) could also imply that the Panamanian Government will at least consider making changes to its tax regime, which as discussed is based on the territoriality principle, as the country would be resigning its taxing rights on revenue that will be taxed elsewhere. As a practical matter, a change on the territorial tax regime of the Country will be unlikely.

Additionally, Panama should consider a reevaluation of the concept of "permanent establishment" and applying changes to the double tax treaty network, as it will specifically be affected by the "subject to tax rule". These issues have not been addressed yet; however, the latter will require engaging in negotiations with the 17 countries which have signed DTTs with Panama.

All of this implies that both the Panamanian Government and MNEs established in Panama will suffer an important administrative burden, driven by the changes that will likely be made to the special tax regimes.

PERU

General Background

Peruvian resident corporations are subject to a 29.5% Corporate Income Tax on their worldwide-source net income. The distribution of outbound dividends is subject to a 5% withholding Income Tax on a gross basis after Corporate Income Tax. Both rates result in a combined rate of 33.025%. Peruvian branches of foreign head offices are also subject to the 33.025% income tax burden, but for their Peruvian source income only.

On the other hand, nonresidents are subject to Income Tax in Peru for their Peruvian source gross income only. Rates vary depending on the underlying nature Peruvian source income, and range from 4.99%; 5%; 15%; or 30%.

Currently, the Peruvian Government is seeking greater legislative authority to increase revenue collections. Among the tax measures being considered by the Peruvian Congress is a proposal to increase the Corporate Income Tax rate from 29.5% to 31.5% for large companies, along with a proposed increase in dividend withholding Tax rate from 5% to 10% or possibly 15%. The Government has also generally proposed to align Peruvian tax legislation to OECD standards, especially in relation to the Transfer Pricing Rules.

At the moment, there are no proposals in relation to Pillar 1 or Pillar 2. It is possible that the Peruvian Government and the Ministry of Economy are not fully aware of the international taxation trends, or perhaps that they do not believe that the BEPS 2.0 measures will be adopted on their intended timetable. Evidence of this includes the fact that the Government wants to impose more direct and indirect taxes on Digital Economy — unilateral measures that are supposed to be removed by 2023.

Pillar 1 Analysis

Since 2007, Peru has imposed a 30% withholding tax on the gross amount of payments to foreign persons, for "digital services rendered from abroad, but economically used within Peru." "Digital Services" are generally defined to include any service that is made available to the user through the Internet or through any adaptation or application of the protocols, platforms or technology used by the Internet, or any other network (public or private) through which equivalent services are provided through online accesses and characterized by being essentially automatic and not being feasible in the absence of information technology. The definition is quite broad, and also includes an open list of related services, such as software maintenance, help desk services, data warehousing, application or website hosting, the provision of online auctions or sale portals, etc.

Digital Services are deemed as "economically used within Peru" if the Peruvian service recipient can claim the outbound consideration as cost or expenditure for Corporate Income Tax assessing purposes (i.e., within a Business-to-Business (B2B) commercial relationship only). ADS and CFB both fall within the definition of Digital Services (giving rise to a 30% Peruvian withholding tax charge); Business-to-Consumer (B2C) Digital Services are out of the scope of the Peruvian Digital Services Tax.

As noted, there are projects of law at the level of the Peruvian Congress that would expand the tax on Digital Services income, as well as apply 18% Value Added Tax, to income arising in a B2C relationship. The Peruvian Treasury would like to increase tax collections in this manner because these services seem to be subject to an inflexible demand that may allow the taxes to be borne by the end customers. Given the current proposals, does not appear likely that Peruvian Digital Service Taxes would be eliminated by 2023.

In addition, contrary to the Pillar 1 framework, OECD model double taxation treaties (DTTs) signed by Peru with Chile, Canada, México, South Korea, Portugal, and Japan grant exclusive taxing power to the service provider's country of residence, without giving rise to a permanent establishment in Peru. Generally, Brazil and Switzerland DTTs grant taxing power to Peru over business profits in line with Pillar 1.

Pillar 2 Analysis

In Peru, taxes are created by rule of law. Pillar 2 is a programmatic guideline ("soft law") that requires specific measures to be fully enforceable in Peru, either as implemented by the Peruvian Congress or by the Executive Branch. So far there has not been any specific implementation of Pillar 2 in Peru. However, Pillar 2 is expected to be implemented under the ''social profitability'' approach that new government wants to apply to business activity. As noted, Peru taxes cross-border income at an aggregate Income Tax rate of 33.025% (the combined effect of a 29.5% Corporate Income Tax plus a 5% withholding tax upon distribution of outbound dividends). Book-to-tax adjustments could drive the effective Income Tax Rate to 34%-38%, which is comfortably higher than the 15% Global Minimum Tax (GMT) rate. In any case, specific legislation is required to assess the 15% GMT benchmark, to confirm that Peruvian Income Tax achieves the effective tax rate (ETR) standard.

There is no specific carve-out provision that may allow excluding any mark-up on the net carrying value of tangible assets and payroll from GloBe Rules (Income Inclusion Rule — IIR) to protect business expansion activity.

Peru's current tax system includes Controlled Foreign Companies (CFCs) as well interest limitation rules. Briefly, the Controlled Foreign Companies rules oblige Peruvian resident companies to accrue current income from foreign subsidiaries if: i) the Peruvian taxpayer controls the foreign entity; ii) the foreign entity resides in a low taxation jurisdiction; and iii) the foreign entity derives ''passive'' income. There are no rules that require low-taxed non-passive income to be currently recognized and included in shareholder income. In addition, Peru imposes a thin capitalization limit of 30% Tax EBITDA. Financial expenditures in excess of the cap are limited to a four (4) year expiring carry forward period without affecting the corresponding withholding Income Tax of 4.99%, 15% or 30%. Although originally adopted to implement principles of BEPS 1.0, these rules could possibly be expanded or modified in the coming years to implement BEPS 2.0 measures.

URUGUAY

General Background

The Uruguayan corporate income tax system is based on the source principle, under which locally sourced income is taxable (basically that obtained from activities developed, goods located or rights used economically in national territory), while foreign source income is in general not subject to tax.

Within this context, Corporate Income Tax (the Spanish acronym for which is ''IRAE'') applies at the rate of 25% on net Uruguayan source income obtained by resident companies as well as permanent establishments of non-resident entities.

When taxable income is obtained by non-residents the applicable tax will be Non-Resident Income Tax (the Spanish acronym for which is ''IRNR'') at a general rate of 12%, with lower rates levied on specific types of income (e.g., dividends paid to non-residents are subject to a 7% rate).

Although Uruguay has adhered to the new taxation framework contemplated by BEPS 2.0, there has been certain concern at a public and private level in terms of the impact that the changes envisaged in Pillars 1 and 2 could have, both in terms of revenue collected and of the overall business and investment environment in Uruguay.

This is due to several factors, among them:

a) The existence of a special tax regime currently in force for the digital sector (in place since January 2018), which would have to be dismantled upon implementation of Pillar 1; and

b) The incidence that the implementation of Pillar 2 might have on multinational companies operating in Uruguay that, either as a result of the source principle or of special exemption regimes (e.g., free zones, software sector, etc.), are subject to a lower tax rate than 15%.

Pillar 1 Analysis

In relation to Pillar 1, a significant aspect to consider is that as from January 1, 2018, Uruguay established temporary measures applicable to certain foreign entities from the digital economy sector. These recent measures (digital measures) applied to the following activities developed by non-resident entities, and which were previously not subject either to IRNR or to Value Added Tax (VAT):

a) Audiovisual services (e.g., video, film and music streaming services) provided from abroad by electronic means to customers located in Uruguayan territory; and

b) Mediation or intermediation services provided from abroad by electronic means between the supply and the demand of services (e.g., accommodation, transport, etc.) in which one or both parties are located in Uruguayan territory.

As from January 1, 2018 the indicated services became subject to IRNR at a 12% rate, and to VAT at a 22% rate. As opposed to requiring local withholding agents to administer these taxes, the digital measures required the foreign taxpayers to register, declare and pay the corresponding taxes under simplified procedures specially established for that purpose. Despite the relative difficulty of enforcing a self-reporting tax

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regime, the main foreign companies subject to the new rules have voluntarily registered with the Uruguayan tax authorities and are complying with their tax obligations.

The implementation of Pillar 1 will require relevant changes being introduced in domestic tax law, both for purposes of integrating Pillar 1 with the taxation rules regarding amounts A, B and C, and also for dismantling digital measures described. In this respect, it seems clear that the IRNR tax regime currently in place should stop applying, but it is also likely that for consistency reasons the VAT regime — which is not directly implicated by Pillar 1 — should also be modified.

The implementation timeframes contemplated under BEPS 2.0 seem very ambitious considering the complexity of the changes that will be required. This is particularly the case because it is unclear whether Pillar 1 will result in a net gain — or, perhaps more likely, a net loss — of tax revenue.

In this respect, it is worth noting that, unlike Pillar 1, the digital measures currently in force do not establish a minimum threshold for their application; they apply to all non-resident companies performing the digital activities described in the legislation, regardless of their global turnover or the amount of revenue generated from Uruguayan consumers. Furthermore, considering the small size of the Uruguay market (approximately 3.5 million people) and the minimum, yet significant, € 1 million threshold established for attributing taxing rights to market jurisdictions under Pillar 1, it seems unlikely that Uruguay would consistently receive an allocation of Amount A. Whether Amount B could compensate for foregone digital measures revenue remains to be seen as the guidance evolves.

Pillar 2 Analysis

As mentioned, the Uruguay system uses the source principle as the main nexus criteria for income taxation purposes, based on which foreign source income is not subject to tax. In addition, although the IRAE rate is 25%, a number of exemption regimes have been established mostly for the purposes of promoting productive investment in Uruguay.

As a result, although Uruguay has adhered to the BEPS 2.0 inclusive framework paradigm, it has not been without concerns about the effects that its implementation might have on different sectors of the national economy.

This is the case of Uruguay free zones, defined as areas of the national territory in which economic activities can be developed subject to a special tax regime, which includes a complete tax exemption of practically all national taxes, including IRAE.

The indicated treatment determines that the implementation of Pillar 2 will almost certainly generate effects on the tax position of the free zone user companies covered by its scope, most likely resulting in the income tax benefits granted by Uruguay being neutralized by the tax treatment applied by foreign jurisdictions under Pillar 2.

Within this context, the national Government is analyzing potential options for maintaining the advantages of free zones for foreign investors, while at the same time preventing Uruguayan tax sacrifices made via the free zones regime from benefitting neither Uruguay nor the investors, but other jurisdictions. Consider, for example, a U.S.-parented MNE that operates through a controlled subsidiary in Uruguay. If the subsidiary is not taxed at a targeted effective tax rate due to free zone benefits, the U.S. "GILTI" rules — which implement IIR principles — would result in an additional income inclusion at the U.S. parent level.

The situation of the free zones regime is particularly relevant to Uruguay given the huge investments that have been made under it (some of the most important direct investments in the history of Uruguay correspond to industrial projects located in free zones), as well as the fact that the maintenance of the tax exemptions has been guaranteed by the Uruguayan State in the Free Zones law itself. The Government is not free to impose new or increased taxes on these investments.

Major free zone investments are generally labor and asset intensive (even with relevant substance in Uruguay, this being a requirement for receiving the free zone tax benefits). Thus, the carve out mechanisms contemplated by the last BEPS 2.0 developments could to a certain extent alleviate the position of the bigger investments made under free zone regime. However, it is not anticipated that the carveouts will make a relevant difference on smaller ones.

Other situations that may be affected by Pillar 2 implementation are those in which effective taxation at a lower rate than 15% does not result from exemptions, but rather from the direct application of the source principle. These include companies that have income of foreign source as their main source of revenues such as dividends, interest or royalties from the exploitation of IP outside Uruguayan territory. Offshore trading companies, i.e., those engaging in the purchase and sale of goods located abroad which do not have Uruguay as country of origin or destination, earn foreign source income under similar rules. As a result of the application of the source principle, the income from these trading activities is notionally determined as 3% of the difference between the purchase price and the selling price of the goods or services, which is then subject to the general 25% IRAE rate.

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As the Pillar 2 provisions require significant strategic analysis by the Government — and as implementation of the new rules would require substantial amendment of domestic law provisions and applicable international tax treaties (even if these are implemented through multilateral instruments) — the current implementation timeframes for Pillar 2 seem very ambitious and possibly unrealistic for Uruguay.

CONCLUSION

The 140 different jurisdictions in the Inclusive Framework vary significantly in terms of the structure of their existing tax systems, as well as political and economic readiness to implement the changes required by BEPS 2.0. In describing some of the most immediate issues implicated by BEPS 2.0 in Latin America, the hope has been to trigger consideration of more of the challenges posed in lesser-known jurisdictions, including but not limited to developing countries with small populations. How should the rules address high and hyper-inflationary currency environments? Pre-existing taxpayer entities under legal stability contracts, government concession agreements or a jurisdiction's constitution? What are the realistic expectations of jurisdictions for which Pillar 1 allocations are not adequate to replace foregone DST revenue (particularly if Amount B is affected by MNE operating losses)? As a common (as opposed to minimum) standard, BEPS 2.0 will not be implemented as a uniform set of rules. Hopefully the OECD's guidance will incorporate enough flexibility to realistically facilitate adoption at the member state level.

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