KPMG

cutting through complexity

Doing business in South America

Holding & funding structure – Tax considerations

20 February 2013

Agenda

1. **Basics**
2. **Australia to South America holding structure**
   - Commercial considerations
   - Tax considerations
   - Withholding tax
   - Profit repatriation
   - Exit planning
3. **Funding**
4. **Transfer pricing**
5. **Snapshot of selected jurisdictions**
6. **Key messages**

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Basics

- Establish commercial imperatives first, ***then*** consider tax consequences
- Basic principle: ***paying tax in Australia preferred*** (versus offshore)
  - Franking credits for Australian tax paid
  - No flow through of credits for foreign tax (a permanent cost)
- Paying tax later is preferable to paying tax sooner
- Tax planning will not turn an unprofitable investment into profitable one; ***lack of tax planning can turn a profitable investment into an uneconomic one***.

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Basics – trade with South America

Country	Value of exports ($'000s)
Brazil	1,159,908
Chile	395,050
Peru	128,812
Colombia	28,396
Others	23,339

Source: DFAT data for 2011-2012

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Basics – trade with South America

Country/export category	Percentage of total exports
Brazil ($1.2bn)	
Coal, coke, petroleum	64%
Confidential items	18%
Iron & steel	7%
Chile ($395m)	
Coal, coke, petroleum	47%
Beef	27%
Measuring instruments/parts	6%
Peru ($128m)	
Confidential items	50%
Copper ores & related	15%
Goods vehicles	11%
Colombia ($28m)	
Electrical circuits equipment	27%
Iron & steel	20%
Civil engineering equipment/parts	18%

Source: DFAT data for 2011-2012

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Holding structure – Commercial considerations

- Commercial considerations
  - Substance required: representative office or branch?
  - Flexibility of branch
  - Limited liability of company
  - Acceptance in local market of foreign investment
  - Ease of subsequent transfer from branch to a company
  - Overseas legal requirements / restrictions

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Holding structure – Tax considerations

- Holding structure tax considerations
  - Company / Branch - both create a taxable presence
  - Clearer attribution of activity in company (arguably)
  - Withholding tax
  - Access to local tax concessions
  - Capital gains tax on exit / sale
    - host country rules
- Operational tax considerations
  - Funding
  - Transfer pricing on exports and services
  - Profit & capital repatriation

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Withholding taxes

- Withholding taxes on payments
  - Dividends
  - Interest
  - Royalties
  - Management Fees
  - Branch Profits
- Double tax treaties can provide some relief
  - Can reduce domestic rates of withholding taxes
  - Confirm who has the right to tax/avoid double taxation
  - Consider use of interposed holding company
    - Commercial purposes otherwise treaty shopping rules could apply
    - Note also Andean Community treaty

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Withholding taxes – Tax treaty status

	DTA with Australia	DTA with Chile
Argentina	✓	✗
Bolivia	✗	✗
Brazil	✗	✓
Chile	● (soon!)	n/a
Colombia	✗	✓
Ecuador	✗	✓
Guyana	✗	✗
Paraguay	✗	✓
Peru	✗	✓
Suriname	✗	✗
Uruguay	✗	✗
Venezuela	✗	✗

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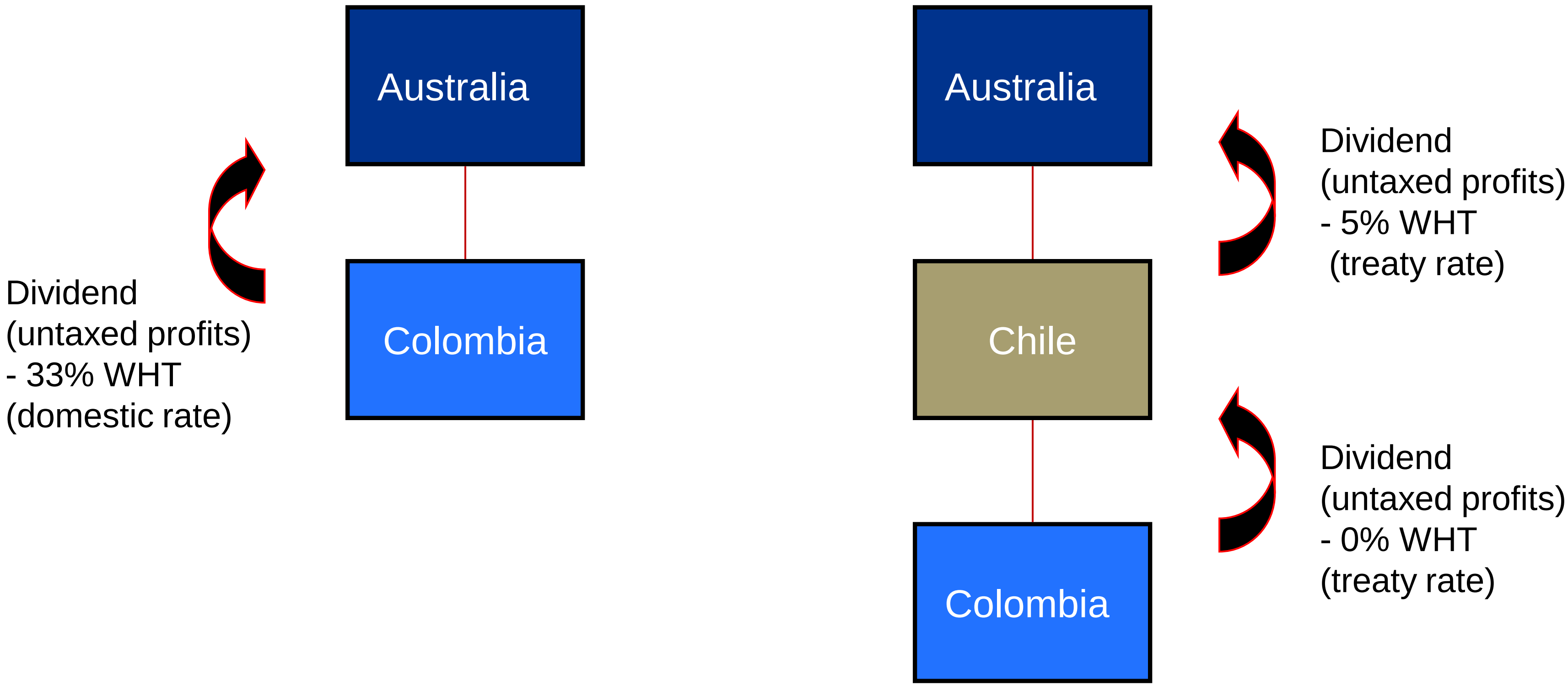
Withholding taxes – Tax Treaty example

Investment into Colombia:



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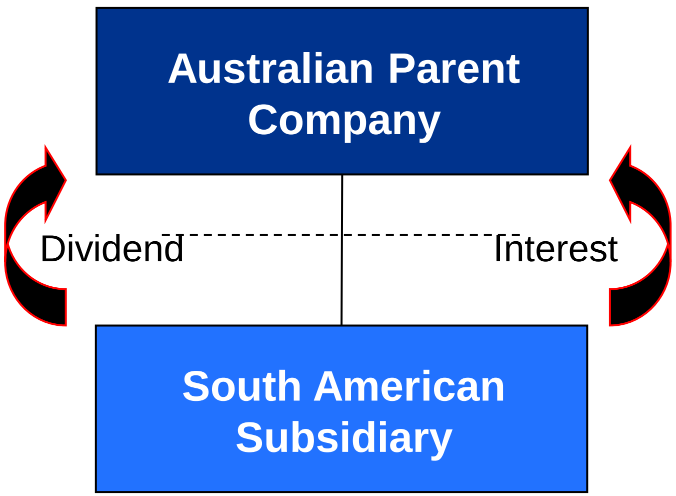
Profit repatriation - Australian tax treatment



Dividends

- Dividends received from foreign subsidiaries non-assessable where hold more than 10%
  - Only applies to company shareholders (not individuals/trusts)
  - No credit available for any South America withholding tax.

Interest

- Taxable in Australia
  - Potential credit for any South American withholding tax.

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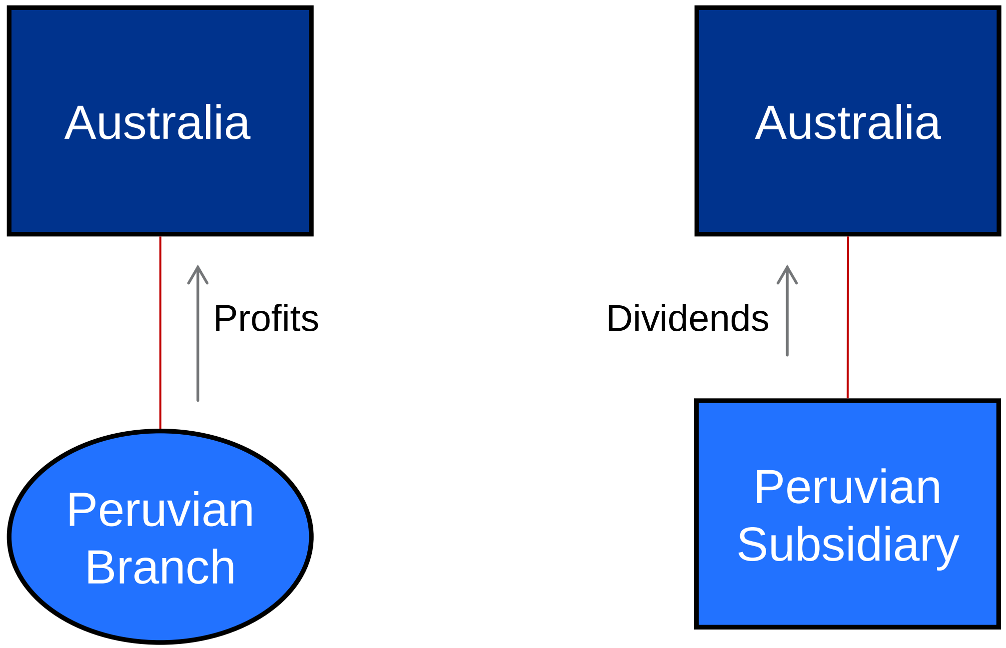
Profit repatriation – branch vs. subsidiary example

Branch profits exempt in Australia*

Branch subject to tax on taxable profits in Peru (34.1%)



Peruvian subsidary's profits not subject to tax in Australia*

Dividends exempt in Australia

Dividend withholding tax of 4.1% imposed by Peru on payment

Subsidiary subject to tax on taxable profits in Peru (30%)

* Australia can still tax 'passive' or 'tainted' profits made in Peru/other jurisdictions

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Australian taxation of passive/tainted profits

- If the foreign operations (either branch or subsidiary) derive more than a de minimis amount of certain types of income, then the profits will be taxed directly in Australia (with relief for foreign taxes paid)
- The rules target income that is easily transferrable between countries:
  - Interest
  - Royalties
  - Purchase of goods from Australia & on-sale overseas (without value add)
  - Purchase of goods from overseas & on-sale to Australia (without value add)

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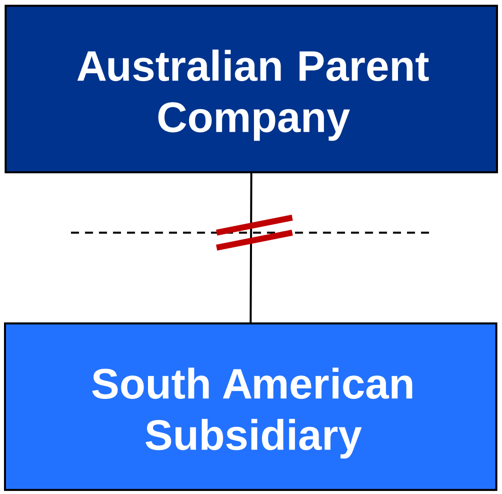
Exit planning - Australian tax treatment of gains on exit



- Future disposal of shares
- Sale of shares in foreign sub non-assessable in Australia where certain tests met
  - Hold more than 10% for at least 12 months
  - Active asset percentage of foreign sub >90%
  - Where active asset percentage is <90% - proportion of gain taxable
- Sale of foreign branch assets also non-assessable where above tests met

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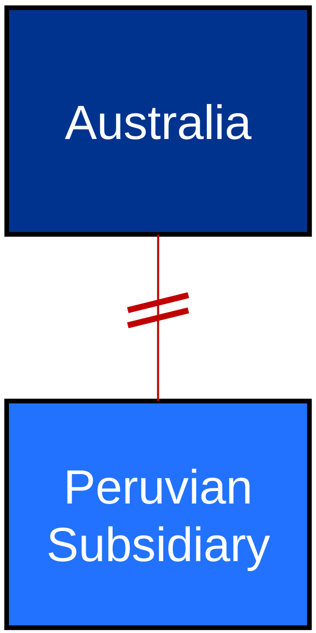
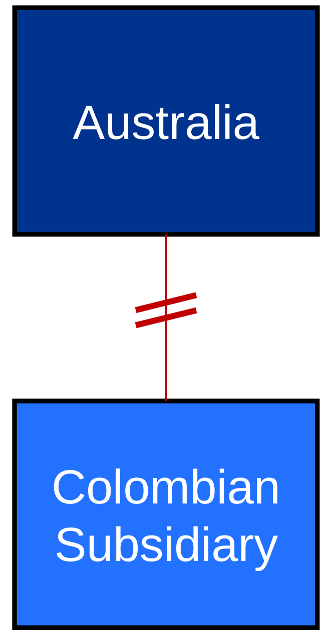
Exit planning – Foreign tax treatment of exit transaction



- Not subject to Australian tax (for “active” trading business)
- Peru can seek to tax transfer of shares in Peruvian companies



- Not subject to Australian tax (for “active” trading business)
- Colombia does not seek to tax transfers of shares in Colombian companies

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Funding

- Source of funding (debt or equity)
- Funding obtained in Australia or through South American entity?
- If obtained in Australia, how deployed into South America?
  - Equity injection
  - Intragroup loan
  - Hybrid financing
- Tax considerations for funding
  - Deductibility of interest
  - Thin capitalisation
  - Transfer pricing
  - Overseas foreign exchange/hedging rules if funding denominated in A$
  - Australian foreign exchange/hedging if funding denominated in foreign currency

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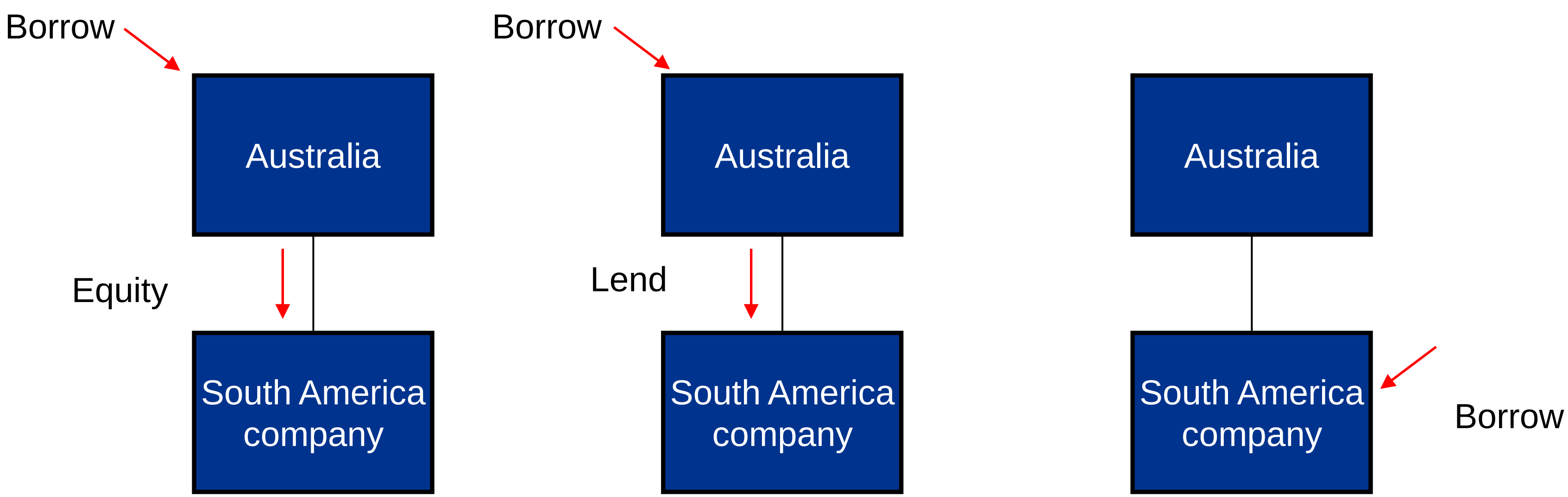
Funding example



- Australian thin capitalisation rules

- Australian thin capitalisation rules (limited impact)
- Transfer pricing rules on interest lent by Australia
- Foreign thin capitalisation rules need to be considered
- Interest withholding tax could also apply

- No Australian issues
- Foreign thin capitalisation rules may not apply
- May be no interest withholding tax

Value of deductions may vary between countries, but so may lending rates

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Transfer pricing

- Tax regime designed to prevent profit shifting between international related parties
- Must deal at arm’s length pricing
- Must consider from Australian perspective <u>and</u> other jurisdiction
- Relevant transactions to consider include:
  - Merchandise / goods
  - Licence (for use of intellectual property)
  - Management fees / head office charges
  - Interest on debt

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Overview of the Brazilian Tax System

Topic	Description
Corporate Tax Rate	▪ 34% (if profit>240,000 BRL)
Withholding taxes	▪ Dividends – 0% (out of after-tax profits) ▪ Interest – 15%, ▪ Royalties – 15% ▪ Other – 15% (e.g. import of services)
Tax losses	▪ May be carried forward indefinitely ▪ Only shelter up to 30% of profits ▪ No carry back
Participation exemption	▪ Foreign dividends are taxable ▪ Capital gains on sale of foreign stock are taxable
Deductibility of interest	▪ Thin capitalisation regime applies to debt from associates (2:1 Ratio)
Transfer pricing regime	▪ Yes (departs from OECD principles)
Indirect Taxes	▪ Complex - Federal, State and Municipal level taxes; ▪ Typically: 15% Federal, 17%-19% State, 3% Municipal

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Overview of the Chilean Tax System

Topic	Description
Corporate Tax Rate	▪ 20%
Withholding taxes	▪ Dividends – 35% (until treaty with Australia comes into force) ▪ Interest – 35% (until treaty with Australia comes into force) ▪ Royalties – 30% (until treaty with Australia comes into force) ▪ Other – 35% (e.g. services) (until treaty with Australia comes into force)
Tax losses	▪ Can be carried forward indefinitely ▪ Change of Control Rules apply
Participation exemption	▪ Foreign dividends are taxable ▪ Capital gains on sale of foreign stock are taxable
Deductibility of interest	▪ Thin capitalisation regime applies to debt from associates (3:1 Ratio)
Transfer pricing regime	▪ Yes (new)
Indirect Taxes	▪ General rate is 19%

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Overview of the Peruvian Tax System

Topic	Description
Corporate Tax Rate	▪ 30% (34.1% for branches)
Withholding taxes	▪ Dividends – 4.10% (out of after-tax profits) ▪ Interest – 30% (paid to associates) ▪ Interest – 4.99% (paid to third parties) ▪ Royalties – 30% ▪ Other – 35% (e.g. services provided by non-resident in Peru)
Tax losses	▪ Can be carried forward in their entirety for 4 years; OR ▪ Can be discounted by 50% and carried forward indefinitely
Participation exemption	▪ Foreign dividends are taxable ▪ Capital gains on sale of foreign stock are taxable
Deductibility of interest	▪ Thin capitalisation regime applies to debt from associates (3:1 Ratio)
Transfer pricing regime	▪ Yes (recently broadened) ▪ APAs are available
Indirect Taxes	▪ 16% standard VAT rate; 2% sales tax

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Overview of the Colombian Tax System

Topic	Description
Corporate Tax Rate	▪ 33%, plus local income tax
Withholding taxes	▪ Dividends – 0% (out of after-tax profits) ▪ Dividends – 33% (out of untaxed profits) ▪ Interest – 33% (loans < 1 year) ▪ Interest – 14% (loans > 1 year) ▪ Royalties – 33% ▪ Other – 33% (e.g. services importation, 10% rate for certain technical services)
Tax losses	▪ May be carried forward
Participation exemption	▪ Foreign dividends are taxable ▪ Capital gains on sale of foreign stock are taxable
Deductibility of interest	▪ No thin capitalisation rules
Transfer pricing regime	▪ Yes ▪ APAs available
Indirect Taxes	▪ 16% standard VAT rate ▪ Other rates include 0%, 1.6%, 10%, 20%, 25%, 35%, for scheduled items

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Key messages

- Upfront tax structuring can maximise efficiencies
- The financing structure of any investment should be carefully considered
- Transfer pricing is a perpetual hot topic for tax authorities around the world
- The domestic tax legislation across South American countries is varied and can be complex

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