

DESCRIPTION

1. INTRODUCTION TO CORPORATE TAXATION IN URUGUAY

1.1. Concepts of taxation on income

The system for taxation on income is structured as described below.

1.1.1. Personal income tax

There is no personal income tax, as it was repealed in 1974.

1.1.2. Corporate income tax

Income from industry and commerce obtained through a business enterprise is subject to corporate tax, which is imposed at a flat rate of 35%, basically on annual business profits. Corporate tax is also assessed on royalties and income from authors' rights and, in certain cases, on technical service fees and on profits and dividends when paid abroad (see [1.2.2.](#)).

1.1.3. Farming income tax

Income derived from farming business is subject to farming income tax at a rate of 35%. Farming businesses may choose between being subject to farming income tax or the tax on sales of farming products, which is applicable on the price of the goods sold at rates that vary from 0.7% to 2%, depending on the type of goods sold. If the taxpayer elects to be subject to farming income tax, the tax on sales of farming products is considered as a payment on account of farming income tax. If this option is not taken, the tax on sales of farming products paid is considered a final payment.

1.1.4. Tax on salaries

There is a tax imposed on the compensation, whether in cash or in kind, received by individuals who render personal services in the public or private realm, and whether in an independent or dependent working relationship. This tax is also applicable to pensions paid by either public or non-public funds. This tax is applied on the amounts received by those who contributed to the funds, at rates ranging from 3% to 20%.

1.2. Corporate income tax

1.2.1. Annual income tax

1.2.1.1. Income subject to annual tax

Corporate income tax is levied on annual business profits derived from industry and commerce. Taxable income is based on income obtained by business enterprises. Income derived from personal services, such as salaries or professional fees, as well as income derived from capital investments in buildings, other tangible assets, or financial assets, is generally non-taxable. However, corporations and branches of foreign companies are subject to tax on all their income, which includes not only business profits but also income from personal services and/or from capital investments.

1.2.1.2. Head offices and shareholders domiciled abroad

Head offices of Uruguayan branches or shareholders of Uruguayan corporations domiciled abroad may be subject to withholding tax on profits or dividends

remitted abroad. This tax applies only when such remittances are taxed in the recipient's country and the Uruguayan withholding tax is creditable there. See [1.2.2.1.](#)

1.2.1.3. Taxable entities

All types of legal entities and business enterprise owners who carry out taxable activities are subject to the tax on annual business income from industry and commerce. A business enterprise is defined as a production unit combining capital and labour with the purpose of carrying out activities to generate income through the sale of goods and/or services.

1.2.1.4. Territoriality

Income taxes are assessed only on Uruguayan-source income, defined as income derived from activities performed, property located, or rights used in Uruguay, regardless of the nationality, domicile or residence of the parties to the transactions and regardless of the place where the transactions are agreed upon or become legally effective.

1.2.1.5. Foreign corporations

There is no specific concept of "foreign corporation" for income tax purposes. Uruguayan-source income of foreign individuals or companies, if taxable because of the nature of such income, is taxed irrespective of whether or not such foreign individuals or companies have a permanent establishment in Uruguay.

1.2.1.6. Computation of taxable income

1.2.1.6.1. Components of taxable income

The main component of gross income subject to corporate tax is income derived from the sale of goods and/or services. Capital gains and, in general, all types of changes in equity (i.e. assets less liabilities) during the year, arising from transactions and other events or circumstances stemming from non-owner sources, are part of gross income. As a general rule, all expenses necessary to obtain and preserve taxable income are deductible. Expenses incurred abroad are also deductible, but only if they are absolutely necessary to obtain and maintain taxable income and if they fall within reasonable limits, as judged by the Uruguayan tax authorities.

1.2.1.6.2. Tax year

Taxable income is determined on the basis of income and expenses accrued in the financial year of the business entity (the fiscal year).

1.2.1.6.3. Inventory

The taxpayer may elect to value inventory at either cost or the year-end market value. Valuation at the lower of cost or market value is not allowed for tax purposes. Marketable securities must be valued at their year-end market value.

1.2.1.6.4. Depreciation

Depreciation of fixed assets is usually determined on a straight-line basis. However, an alternative method may be authorized by the tax authorities when it is demonstrated that the yield of the assets is not uniform during their useful life. Amortization of goodwill paid upon acquisition of business assets is not allowed for tax purposes.

1.2.1.6.5. Exempt income

Profits, dividends and the financial result stemming from holding participations in the capital of Uruguayan business taxpayers is exempt income to corporations and branches of a foreign company.

1.2.1.6.6. Adjustment for inflation

A partial attempt to neutralize distortions caused by inflation is made by computing, for tax purposes, a special adjustment for inflation.

1.2.1.6.7. Tax losses

Tax losses may be carried forward and deducted from taxable income in the following 3 fiscal years. For this purpose, losses are restated for inflation. There are no tax loss carry-backs.

1.2.1.6.8. Foreign tax credit

As corporate tax is imposed only on Uruguayan-source income, there is no foreign tax credit allowed.

1.2.1.7. Rate of tax

The rate of annual income tax is a flat 35%.

1.2.2. Withholding tax

Corporate tax is also assessed on royalties and income from authors' rights, and in certain cases on technical service fees and on dividends and profits when remitted abroad.

1.2.2.1. Dividends and profits

Dividends remitted by Uruguayan corporations to shareholders domiciled abroad are subject to withholding tax, at the 35% rate, only when such remittances are taxed in the recipient's country and the Uruguayan withholding tax is creditable there. If the foreign recipient cannot use the credit due to the existence of fiscal losses, Uruguay will not impose income tax by way of withholding on the amount of the remittance.

When applicable, withholding tax is imposed on the amount of the dividend remittance, independently from the tax treatment afforded to the corporation's income in its annual tax computation.

Profits remitted by Uruguayan branches of foreign companies to their head offices domiciled abroad are also subject to the withholding tax, but again only if such remittances are taxed in the recipient's country and the Uruguayan

withholding tax is creditable there. However, unlike for local corporations, if the withholding tax is applicable to profit remittances, such remittances will be taxed up to the amount of taxable income computed for purposes of the annual income tax.

In connection with the applicable rate, there is also a difference between branches of foreign companies and local corporations. In the case of branches, the withholding tax is variable, ranging from zero to 21%, in such a way that, added to the annual 35% tax rate, the aggregate does not exceed the rate of the tax credit allowed in the host country of the head office.

Finally, although remittances made by a branch to its head office for any reason are generally not deductible in the branch's annual income tax return, for the purpose of the withholding tax the remittances for transactions of a trading, technological or financial nature made within the same business and under financial conditions that would prevail between independent entities (i.e. arm's length charges; see [3.1.](#)) are not considered profits and are thus not subject to withholding tax.

1.2.2.2. Royalties

Royalties remitted abroad are subject to a 35% withholding tax in all cases. The withholding tax is applied on the gross amount of the royalties, and there is no deduction for expenses related to the creation of such income.

Law 17.453 (passed on 28 February 2002) adopted a definition of the concept of royalties similar to that used by the OECD Model Treaty (Art. 12), abandoning a more restrictive concept previously in force. Uruguayan law defines royalties as the amounts paid for (Art. 2, Letter B, Title 4, Tax Coordination Law 1996):

- (1) the sale, lease, use, or assignment of use of trademarks, patents, industrial models and privileges;
- (2) the sale, lease, use, or assignment of use of information relative to industrial, commercial or scientific experiences; and
- (3) the lease, use, or assignment of use of industrial, commercial or scientific equipment.

The first four taxable hypotheses (in (1) above) remain from the restricted concept of royalties that Uruguayan law adopted prior to the approval of Law 17.453. Regarding the scope of the concepts of trademarks, patents, industrial models and privileges, these are defined by commercial law, which should be referred to in the absence of a legal definition under tax law. The following meanings should be applied:

- *trademarks*: all the symbols (e.g. names, emblems, engravings, letters and numbers) used with the intention of distinguishing a product;
- *patents*: industrial invention patents, industrial improvement patents, and in general patents foreseen in the 1883 Paris Patents Convention for the

Protection of Industrial Property, revised in Lisbon on 31 October 1958;

- *industrial models*: the visible aspect of an industrial product that confers upon that product a particular characteristic from which it can be easily identified; and

- *privileges*: the exclusive right to exploit a specific industry.

Even when excluded from the actual version of the OECD Model Treaty, Law 17.453 regarded the amounts paid for the lease, use, or assignment of use of industrial, commercial and scientific equipment as royalties because these items were included in the concept of royalties adopted by the income tax treaty between Uruguay and Germany. See [6](#).

Law 17.453 added another item to the concept of royalties, being the amounts paid for authors' rights on non-intellectual property (Art. 2, Letter E, Title 4) - the solution also adopted under both the OECD Model Treaty and the Uruguay-Germany treaty. Unlike the case of royalties included under Letter B of Art. 2 (which are taxable regardless of the domicile of their recipient), amounts paid for the lease, use, assignment of use, or sale of authors' rights on literary, artistic or scientific works are only subject to withholding tax when received by a foreign-domiciled entity or individual. The amounts paid for the lease, use, assignment of use, or sale of software were expressly excluded from the tax through a decree issued by the executive branch of the government (i.e. the Ministry of Economy and Finance).

1.2.2.3. Technical service fees

Fees for technical services remitted abroad are subject to a 35% withholding tax, although there is an exemption when such fees are taxed in the recipient's country and the Uruguayan withholding tax is not creditable there. As in the case of royalties, the withholding tax rate is applied on the gross amount of the technical service fees, and there is no deduction for related expenses.

At variance from the OECD Model Treaty, Uruguayan law follows the majority view of the leading legal experts in Latin America, distinguishing between the concepts of royalties and technical service fees. While royalties are construed as the remuneration for the transfer of previously acquired knowledge (which represents a capitalized value generating income derived from intangible property), technical service fees imply the simultaneous rendering of an advisory service (being income of a generally personal nature).

Law 17.453 defined the concept of technical service fees as income stemming from the rendering of services in the fields of management, technology, administration or advice of any kind. From the legal definition, one can see that the range of cases subject to income tax withholding was broadened as compared with the previous hypothesis of taxation, that is, income arising from the rendering of technical assistance (under the restricted interpretation of the concept by the majority of Uruguayan and Latin American legal commentators). Those commentators agreed that the type of advice comprised by technical assistance included only advice of a technological nature, and not any other type

of advice, such as trading, administrative, financial, legal or accounting advice. One of the conclusions of the Seventh Latin American Congress of Tax Law, held in Caracas in 1975, was that "technical assistance covers the services of advice of an industrial, technological, or similar nature, but not professional services per se".

The adoption of this definition by Law 17.453 ended a long-standing conflict between the pronouncements of the majority of Uruguayan legal commentators and judicial decisions on one hand, and the tax authorities on the other, regarding the scope of technical assistance fees, thereby resolving the controversy in favour of the broad interpretation traditionally maintained by the tax authorities.

2. THE ARM'S LENGTH PRINCIPLE IN URUGUAY

2.1. Legal basis

Latin American legal experts have analysed the problems of related enterprises. The existence of such enterprises generates conditions for obtaining tax savings of an illegitimate nature, resulting in loss of tax revenues for the countries in which such enterprises operate. In this regard, Recommendation 6 of the Seventh Latin American Congress of Tax Law (held in Caracas in 1975) established the general principle which, in the opinion of the majority of Latin American commentators, should be the basis for assessment, i.e. that "the tax treatment of related enterprises must follow the general rules applicable to independent companies". However, the following were also recommended:

- special regimes regarding unilateral and joint control should be established in interested countries in order to prevent the distortions that experience has shown to exist; and
- restrictions and legal formalities should be adopted in order to avoid the abuses that cannot normally be detected through the control mechanisms referred to above.

The supporting Consideration 8 of this pronouncement explains that the reference to "related enterprises" should be understood to refer to the enterprises included in the definition contained in Art. 9 of the OECD Model Treaty.

Particularly in relation to the tax treatment of financing results (interest and exchange differences), Recommendations 1 and 2 of the Twelfth Latin American Congress of Tax Law (held in Bogotá in 1985) provide that the financial charges owed by local affiliates to their foreign parents "must be deducted within reasonable limits, considering such limits to be those prevailing between independent companies". One of the authors of this chapter, together with other participants at the Congress, recommended that the same treatment be extended to the payments made by branches of foreign companies to their foreign head offices (motion presented by J.L. Shaw and A. Gorziglia).

The Uruguayan rules on corporate income tax do not expressly contemplate the arm's length principle. However, Art. 6 of the Tax Code requires that tax results be based on the principle of "substance over form". Para. 2 of Art. 6 provides

that if (as in the case of income tax) the tax-generating fact has been defined by taking into account the actual reality (and not simply the legal form), the legal form adopted by the taxpayers that is not in line with the real "business purpose" must be set aside and the current circumstances or acts encountered must be given a meaning in accordance with their substance. Consequently, in cases involving transactions between related parties in circumstances at variance from those seen in dealings between independent parties, and which cause illegitimate tax results for the related parties, the tax authorities may make the corresponding adjustments - even in the absence of specific rules that would authorize them to do so.

While the income tax rules do not expressly provide for the arm's length principle, there is a series of decisions and regulations that, to a certain extent, avoid or limit possible tax reductions through transactions between related parties. These include the following:

- The difference arising from comparing the value used for tax purposes and the current market sales price ("market value") of assets transferred to partners or shareholders (e.g. in liquidation of a company) or given in payment or withdrawn by them, is deemed to be taxable income under income tax law (Letter C, Art. 10, Title 4 Tax Coordination Law 1996 and Art. 12 Regulatory Decree 840/988 of 14 December 1988).
- In the case of loans granted to borrowers who are not corporate income taxpayers, the difference between the average interest rate collected by financial institutions within the Uruguayan market (as reported by the Central Bank of Uruguay) and the interest rate agreed by the parties (when this agreed rate is less than the average market rate) applied on the principal of the loan, is deemed to be taxable income under income tax law (Letter I, Art. 10, Title 4 Tax Coordination Law 1996 and Art. 18 Decree 840/988).
- The deduction of interest on loans made by individuals other than local financial institutions is limited to the deduction that would arise by applying the loan (interest) rate paid by the *Banco de la República* (Uruguayan State Commercial Bank). Should the loan be granted by an individual domiciled abroad, the deduction is further limited to the market rate of interest prevailing in the lender's country of residence (Letter Ñ, Art. 12, Title 4 Tax Coordination Law 1996 and Art. 32 Decree 840/988).
- The deduction of annual rent paid to non-corporate income taxpayers for the leasing of real estate is limited to 25% of the fiscal value fixed each year by the General Property Assessment Office (*Dirección General de Catastro*) (Letter Ñ, Art. 12, Title 4 Tax Coordination Law 1996 and Art. 30 Decree 840/988).

- Amounts withdrawn by the owners, partners or shareholders that substantially imply a profit participation are not deductible (Letter E, Art. 14, Title 4 Tax Coordination Law 1996).

- In the case of asset transfers by an enterprise, there is a legal rule regarding the valuation of such assets which, to a certain extent, prevents tax reductions that might otherwise be obtained through selling such assets between related parties. The rule requires that for tax purposes the buyer must value the assets purchased at the same fiscal value that the assets had in the hands of seller on the date of the transaction (Art. 20, Title 4 Tax Coordination Law 1996).

- With regard to cross-border transactions between related parties, the tax regulations contain two rules specifically permitting adjustments aimed at a precise determination of net Uruguayan-source income. The *first* rule, which refers to determining the income of branches of foreign entities (Art. 35 Decree 840/988), provides that net Uruguayan-source income of such branches will be determined on the basis of separate accounting records, but also effecting the adjustments necessary to fix the real profits of the branch. In this sense the rule provides that:

when the accounting records do not precisely reflect the net profits of Uruguayan source, the General Tax Office will estimate net income through an assessment for tax purposes, taking into account the business volume and the ratios considered adequate for such determination.

The rule further provides that "[t]he General Tax Office may require all duly authenticated antecedents or analytical statements as considered necessary to explain or clarify the trade relations between the local entity and the foreign head office ... " See [3.1](#). The phrase "antecedents or analytical statements" refers to any type of documentation which, in the opinion of the General Tax Office, clarifies the relations between the local branch and the head office, including invoices and financial records. The phrase "duly authenticated" means that the documentation requested by the General Tax Office should be certified by the authority or an independent professional (e.g. a notary public or attorney), regardless of the country of origin of the documentation. Such certification must attest to the authenticity of the documentation.

The *second* rule related to cross-border transactions prevents abuses through the manipulation of overbilling or underbilling between related parties (Art. 21, Letter E, Title 4 Tax Coordination Law 1996). This rule provides that source-source income derived from export or import transactions will be determined based on the FOB or CIF values of the goods exported or imported, and empowers the tax authorities to fix such income on a notional basis in the event that either no price has been fixed or the price declared is not in line with the prices prevailing in the international market. See [3.3.2](#).

2.2. The concepts of "associated enterprises" and "control"

2.2.1. General aspects

As indicated in 2.1., the corporate income tax regulations do not specifically adopt the arm's length principle, and within the tax framework there is similarly no definition of the concepts of "associated enterprises" and "control".

Consequently, looking at a specific transaction, on the strength of the powers afforded by Art. 6 of the Tax Code, the tax authorities have the authority to determine:

- whether there is - or is not - a relationship between the parties; and
- if, by virtue of such relationship, the business conditions are not in line with the real "business purpose" of the parties and, as a consequence, differ from the conditions that would be agreed between independent enterprises, causing a loss of tax revenue.

This is separate from the subsequent jurisdiction of the Judicial Administrative Court in the event that the companies involved appeal the decision of the tax authorities.

2.2.2. Existence of a relationship between enterprises

In order to determine whether a relationship between the parties to the transaction exists, under Art. 5 of the Tax Code, the tax authorities may apply the analogous regulations that may exist in tax legislation and, in the absence of these, of other branches of law which may be more closely related to the specific case. The pronouncements of commentators and court opinions are also important precedents.

2.2.2.1. The concept of "economic group" in the realm of tax law

2.2.2.1.1. Regulations

In tax law there are two statutes related to taxes that have been repealed (i.e. excess profits tax and the tax on sales and transactions) and a set of regulations currently in force regarding social security charges, all referring to the concept of "economic group". These could be taken into account by the tax authorities for corporate income tax purposes.

The excess profits tax (repealed in 1961) was assessed at progressive rates on business earnings in excess of 12% of capital. The tax authorities had the legal authority to consolidate into one income tax statement the results of companies formed by capital split-offs within the same economic group, if such split-offs would result in total or partial tax evasion. Because the law did not define the concept of economic group, the tax authorities issued a very broad definition, such that an economic group would be deemed to exist:

whenever simultaneously or successively, in two or more enterprises, the control of capital was in the hands of the same individual or group of individuals, so that it would be possible to control the actions of the said two or more companies through a decision taken by the individual or group of individuals exercising control over the companies.

It was also understood that the factors indicating that an economic group existed included "the similarity between the types of business, the common integration of industrial equipment, the identity of administration or trading organization, and so forth".

The tax on sales and transactions (repealed in 1968) was imposed only on the first stage of sale of goods by the manufacturer or by the importer (i.e. a monophasic tax as opposed to a pluriphasic tax, such as VAT that is imposed on each successive stage). The popular practice of creating distribution subsidiary companies in order to lower the price of the first sale led lawmakers to establish the concept of economic unit or group. The law provided that if there was an economic tie between the taxpayer and its distributors, the tax would be assessed on the distributors' selling price to third parties. There was a legal assumption that an economic group existed when (1) more than 50% of the equity of the taxpayer and of the distributors was owned by the same individuals or by their relatives or (2) the taxpayer channelled more than 40% of its goods through the same distributor. These assumptions did not apply if the taxpayer could unequivocally prove that its selling prices were those current in the market.

With regard to social security charges, the social security authority has legal powers to claim payment of the debts from any of the enterprises deemed to form part of an economic group. The regulations provide for a rebuttable presumption that there is an economic group when the same characteristics provided for the tax on sales and transactions (now repealed) are found, such as (1) a concentration of equity ownership of greater than 50% in the hands of the same individuals or their relatives or (2) when an enterprise conducts business with another enterprise which exceeds 40% of its total business volume.

Similarly, regulations establish an irrebuttable presumption with respect to the existence of the economic group when the following circumstances are found simultaneously:

- the majority of the shares of one or more of the companies is owned by the same shareholder;
- the companies conduct the same, similar or analogous businesses or activities, or successive or complementary stages of the same activity;
- industrial equipment is jointly utilized;
- there is identity in the administrative or trading organization;
- common premises are shared, with one or more of the enterprises being exempt from the payment of rent;
- there is identity in the composition of the directors or individuals holding company proxies, with reference to one or more of the group members; and
- there is control of one enterprise over the other in trading conditions or in

trading markets for their products, or in connection with services rendered, etc., in such a manner that there is a real dependence of one enterprise on the other.

2.2.2.1.2. View of commentators

With regard to the concept of related enterprises, tax commentators and legal experts basically adopt the criteria used in Art. 9 of the OECD Model Treaty.

2.2.2.1.3. Jurisprudence

Special consideration should be given to Verdict 8/982 of 5 February 1982, issued by the Judicial Administrative Court, which refers directly to the concept of economic group as "supposing the existence of several enterprises legally apparently different, but which in reality are artificial split-ups of the same capital group through abuse of the legal form". This verdict provides a definition of economic group and simultaneously determines the related tax effects. The case provided that the economic unit or group is considered to include the union of several legal entities dominated by one of those entities or by the same group of individuals, which under private law would be independent taxpayers. As such group has the purpose of transferring profits, or at least leads to this result in most cases so as to cause the related loss of tax revenue to the fisc, tax law regards them as one group for tax assessment purposes, assigning the total tax debt to any one of them or redistributing the profits in order to adjust them to what each of the group members would have obtained had they been independent companies.

More recently, in Verdict 149/997 of 17 March 1997, the Judicial Administrative Court ratified the concept of an economic group in the terms of the above-mentioned 1982 verdict.

2.2.2.2. The concept of "economic group" in the realm of commercial law

2.2.2.2.1. Regulations

Company Law 16.060 of 4 September 1989, while not containing regulations directly referring to the concept of economic group, includes certain regulations related to company concentration. Arts. 48 and 49 of that law distinguish between related companies and controlled companies. Companies are deemed to be related if a company owns more than 10% of another company's capital, which is the initial step leading to classification as controlled companies. Controlled companies are those being under the dominant influence of another company as the result of a number of factual circumstances (company ownership or shareholding, or special relations).

On the other hand, the Central Bank of Uruguay, through the Compilation of Regulatory and Control Regulations and Standards of the Financial System (CBU Compilation), has defined the concept of economic group in a general manner within the framework of specific regulations for classification of credit risks. Art. 86 of the CBU Compilation defines the general concept of an economic group as follows:

Two or more individuals or legal entities, Uruguayan residents or not, are considered to form an economic group when they are interconnected in such a manner that the decisions or the changes in the economic or financial structure of one or more of such entities or individuals have significant effect on the rest of the group entities or individuals.

2.3. Methods of establishing arm's length prices

Except for the regulation that sets forth specific criteria to adjust Uruguayan-source income in cross-border transactions (see [3.3.2.](#)), there are no legal regulations establishing what methods are to be used to determine arm's length prices in transactions carried out between related companies. Likewise, there are no guidelines established by the tax authorities or courts on this matter.

In the instances where the tax authorities have detected abuses in transactions between related parties, they have made the adjustments to taxable income on the basis of current market prices when possible, taking into account transactions between independent parties with similar characteristics as the transaction under review, or fixing values by using independent expert appraisers. Such adjustments are not without recourse and may be challenged by the taxpayer. In the event of a disagreement with the tax authorities related to the determination of arm's length prices, either of the parties (i.e. the taxpayer or the tax authorities) may refer to the methods developed under foreign legislation. In particular the methods to determine transfer prices recommended by the 1979, 1984 and 1995 OECD Guidelines could be applicable as having been adopted by the positive tax legislation in force and by the tax authorities in a number of countries.

3. SPECIFIC TRANSACTIONS BETWEEN ASSOCIATED ENTERPRISES

With regard to the tax problems arising when international economic groups operate in a country that, like Uruguay, recognizes the territorial principle as the basic taxation criterion, the main question is determining the net Uruguayan-source income of the local entity in relation to the group. This principally depends on the resolution of the following issues:

- the treatment of trade, financial and technological transactions between the local entity and its foreign related companies; and
- the distribution of the overall expenses incurred by the administration centres of the multinational company among its affiliates in the different countries which benefit from the activities carried out in such centres.

These matters are closely related to transfer pricing problems, which can be seen as two sides of the same coin.

The commentary in [3.1.](#) and [3.2.](#) will analyse how these aspects are taken into account by the corporate income tax regulations. The analysis in [3.3.](#) will consider the most common transactions between related international companies and the treatment thereof for corporate income tax purposes.

3.1. Differences in the treatment of branches and affiliates

When transactions involving finance or technology are carried out with foreign related companies, they are subject to a different treatment for income tax purposes, depending on whether the local enterprise is a branch of a foreign corporation, or an affiliate or subsidiary that is a local corporation economically related but legally independent. However, as explained below, commercial transactions (imports and exports) are considered in a consistent manner regardless of the legal form adopted by the local entity.

Due to the non-existence of legal regulations in this regard, the tax authorities have traditionally adopted the dual criteria (based substantially on private law), which were later reflected in some of the detailed rulings issued through regulatory decrees.

In the case of branches of foreign corporations, the treatment is based exclusively on the private law notion that a branch and its head office form part of the same legal entity. The conclusion from this starting point is that because a party cannot contract or be a creditor or debtor of itself, the accounts with a head office and its foreign branches may not be included in the assets or liabilities of the local branch, but should rather be included as equity accounts. Consequently, no exchange gains or losses are allowed for the branch resulting from changes in the value of the foreign currency balances with its head office or other foreign branches, and likewise no interest computation is allowed on such balances.

These criteria have been expressly recognized by Arts. 15 and 35 of Regulatory Decree 840/988 (and by other precedential regulatory decrees preceding this one), which prohibit computing exchange differences or interest on accounts maintained with a branch's head office, regardless of their nature. The same principle is applied by the tax authorities in order to disallow payments or credits made by a branch to its head office or other foreign branches for royalties and technical service fees that are not valid tax deductions for the local branch.

Given the formal legal argument supporting the position of the tax authorities, the contractual relationships of a Uruguayan corporation with its foreign affiliates, controlled more than 50% by an international company, are treated as relationships with third parties. Consequently, the Uruguayan corporate affiliate may compute exchange differences and interest on related company balances, and these balances should also be included as assets or liabilities in the local entity's tax returns. Similarly, royalties and technical service fees paid or credited are allowed as expenses and resulting balances as assets or liabilities in the same local tax returns.

The same treatment is applied to relationships maintained by a branch not with its head office or other foreign branches, but with other foreign affiliates that are legally independent. In this regard, the attitude of the tax authorities is to absolutely respect form over substance.

In the authors' opinion, and in line with a position unanimously taken by Uruguayan tax commentators, the formal criteria based in private law have no legal basis for income tax purposes in Uruguay. (1) First, there is no legal

regulation specifically imposing the tax treatment applied by the tax authorities to branches, much less the differential treatment between these and affiliates of foreign enterprises formed in Uruguay under a local company structure. On the contrary, in both situations, as a solution of principle and for reasons that will be explained later, respect for inter-group contractual relationships should prevail in determining the net Uruguayan-source income of the local entity based on its separate accounting records. This is apart from the powers of the tax authorities to effect adjustments in order to correct actual profits when the accounting records do not reflect the real "business purpose" of the taxpayers, subject to the subsequent legal control in the event that such adjustments are challenged by the taxpayer. The principle of calculating tax based on separate branch accounting is expressly adopted by Art. 35 of Regulatory Decree 840/988 and prior regulations. See 2.

In support of the treatment of balances with the head office as capital accounts, and as a consequence of disallowing the computation of exchange differences and interest, the tax authorities rely on the regulation of Letter F of Art. 15 of Title 4 of Tax Coordination Law 1996. Letter F, which reiterates prior legal regulations, provides that "the balances in the private, special or drawing accounts of the owner or partners will be considered as capital accounts". The tax authorities argue that this regulation may be extended to the branch accounts with its head office and other foreign branches, and has specifically expressed this in the regulating decree of this law. In addition, the tax authorities have extended this thesis to the rest of the transactions between branches of the head office. The position of the tax authorities has been confirmed by the Judicial Administrative Court (Verdicts 111 of 30 of July 1973 and 282 of 23 December 1985).

In the authors' opinion, this legal regulation is not applicable to the accounts between branches and their head office. As well expressed by J. Rossetto:

. . . a clear distinction can be drawn between the capital accounts per se, which connect the branch with its head office, and the trading or financial accounts in which both parties can operate as actually independent enterprises. If this is so and if on the strength of a factual analysis it appears that the parties do not afford each other a treatment different from the treatment that would prevail between independent parties, we believe that the same solutions should be applied as in the case of accounts with third parties. (2)

As previously maintained by one of the authors of this chapter,³ the position of the tax authorities implies a disregard for three basic principles, namely: the principle of territoriality, the principle of net income adopted by corporate income tax law, and the principle of substance over form applicable for tax law interpretation as adopted by Art. 6 of the Tax Code.

When the branch or affiliate and the head office conduct transactions between each other, behaving as unrelated companies, the results derived from such transactions for the branch or the affiliate must be considered as such, precisely through application of the above-mentioned principle of interpretation and on the

principle of territoriality adopted by corporate income tax law. By virtue of the latter, the object is not to determine the consolidated income of the group of international companies as a whole, but, rather, the net Uruguayan-source income of the entity located in Uruguay. Consequently, the expenses of this entity, as necessary to obtain and preserve Uruguayan-source income, cannot be disregarded because they are incurred with the head office or other foreign branches, when such expenses would be allowed if incurred in transactions with third parties.

As the branch and the affiliate are not different from an economic perspective, no distinction should be made in the manner of determining net income for both types of entity because the only reason that their legal nature differs is for purposes of private law, as sustained by the Uruguayan tax authorities.

The authors understand that it is entirely out of place to adopt a simplistic solution based on the *Organtheorie*, i.e. the theory developed in Germany that the tax obligations of controlling companies are transmitted to controlled companies. This theory implies denying the economic separation between a head office and its branch, only for the purpose of avoiding the abuses that may be committed in the future. The abuses possible by virtue of the legal identity, which on the other hand are the same as may exist between affiliates, should give rise to adjustments by the tax authorities, which, in the absence of express authority based on regulations, should be supported on the principle of substance over form as recognized by Art. 6 of the Tax Code.

The criteria used by the tax authorities to disregard royalties, technical service fees, interest, and exchange differences between a branch and its head office, apart from lacking support, are applied in an inconsistent manner. In effect, imports and exports between branches and their head office are treated by the tax authorities as transactions with third parties, because in these cases it is acknowledged that there is a real counterpart consideration for the transfer of tangible assets.

Starting from the concept that no one may contract or be a creditor or debtor of itself, there would be no reason to authorize a different treatment for import and export transactions compared to the treatment for other contractual relationships between the branch and its head office, such as the use of intangible assets in consideration for royalties, the rendering of technical services in consideration for corresponding fees, and monetary loans remunerated by means of interest. As in the case of imports and exports of goods, all these situations involve consideration being given by each party, which is as real as in the case of goods.

3.2. Distribution of overall expenses

The other substantial problem presented by the question of international companies operating in countries applying the territoriality principle (such as Uruguay), is seen in the distribution of the overall worldwide expenses incurred by the administration and management centres of such enterprises among the branches and affiliates in different countries that receive the benefits of the activities performed in such centres. To the extent that these expenses benefit the branches and local affiliates of international companies, a part thereof should

be apportioned to them and should be tax deductible in the local tax return. On the other hand, international companies may adopt different distribution criteria for these expenses.

The Corporate Income Tax Law does not contain any rules specifically addressing this issue. Consequently, deduction of these items must be resolved based on the general criteria of the deductibility of expenses made abroad. See 1.2.1.6.1. Following this criterion, such expenses will be deductible to the extent that they are essential for the realization of Uruguayan-source income, in amounts that are reasonable in the judgement of the tax authorities.

However, the regulatory decree expressly provides for allocation to Uruguayan branches of foreign corporations of the portion of the overall worldwide expenses paid by the head offices abroad, which can be attributed to foreign-source income. Art. 28 of Decree 840/988 allows the deduction of such expenses, provided that their origin and nature are fairly proven through an independent auditor's certification in the country of origin. Such certification must refer to the amount of the expenses and to the procedure used for their allocation, which must be analysed in detail by the auditor. It is also required that the certification establish that the expenses being allocated to the Uruguayan branch have not been deducted in any of the tax returns filed abroad.

An interesting aspect is that the overall expenses allocated to the different branches may include the cost of technological investigations carried on by a head office or acquired from third parties, which may be used by the branches. It may happen that the head office, instead of drawing up royalty or technical service contracts with its branches, may cede such technology on a gratuitous basis, charging the branches with the cost allocation of the overall worldwide expenses. The Uruguayan tax authorities allow such expenses to be imputed to the local branch, somewhat mitigating the negative effects of disregarding the royalty contracts and technical services contracts between a head office and its branches (pronouncement of the tax authorities dated 6 June 1974).

There is no detailed ruling similar to Art. 28 of Decree 840/988 that expressly provides for the allocation to, and absorption by, local company affiliates of a portion of the overall expenses incurred by the management and administration centres of international companies. However, as the actual existence of such expenditures is a common circumstance, their deductibility in the tax calculation of the affiliate appears to be as equally justified as in the case of branches. In this regard, the general principle establishing the deduction of expenses necessary to obtain Uruguayan-source income referred to in 1.2.1.6.1. should be taken into account. It follows that the deduction of the overall expenses in the case of affiliates is, in the authors' opinion, fully defensible; the tax authorities may, however, require the supporting information required by Art. 28 of Decree 840/988 to substantiate the appropriate deduction of the concepts included and the reasonableness of the distribution criteria adopted. (4)

3.3. Sales of tangible property

3.3.1. Local transactions

As indicated in 2.3., there are no legal regulations, guidelines issued by the tax

authorities, or jurisprudence establishing the methods that should be used for determining arm's length prices in sales of tangible property between related parties. As a result, in the case of disputes with the tax authorities, any of the methods developed under foreign legislation could be used. Particularly, the methods implemented by the 1995 OECD Guidelines could be applicable, as having been adopted by the legislation in force and by the tax authorities of numerous countries. These methods are:

- the comparable uncontrolled price (CUP) method, which consists basically of resorting to the price of comparable transactions between independent companies (external CUP), or between group companies and independent third parties (internal CUP);
- the resale price method, which starts from the final sales price to third parties and determines the purchase price from the related company based on such final price less a reasonable profit margin; and
- the cost-plus method, which starts from the production cost of the goods and adds a reasonable profit margin.

Three additional methods are commented upon in the OECD Guidelines, that are admissible when it is not possible to apply one of the three traditional methods. These additional methods are:

- the method of division of profits, by which the profit obtained by related parties in a transaction that involves many transactions is split as if the intervening companies were independent parties;
- the transactional net margin method, by which the net margin in a transaction between related parties is revised based on an appropriate basis (e.g. costs, sales or assets); and
- the global distribution formula, which is a method that is not based on the arm's length principle and consists of distributing the consolidated profits of a multinational group among the related parties in different countries.

In cases where the tax authorities have been able to detect transfer pricing abuses in sales of goods between related parties, they have made adjustments to the taxable amounts using the CUP method and resorting to current market prices for comparable transactions.

3.3.2. Foreign trade transactions

As indicated in [2.1.](#) concerning cross-border transactions, corporate income tax law contains specific control regulations aimed at avoiding overbilling or underbilling between related parties. As seen in [3.1.](#), with regard to trade transactions between related parties there are no differences between structuring a Uruguayan company as a branch or as an affiliate. The regulations in question are generally applied independently from the legal structure of the Uruguayan company.

Letter E of Art. 21 of Title 4 of Tax Coordination Law 1996 provides as follows:

E.

Uruguayan-source income derived from export and import operations will be determined considering the FOB or CIF prices of the imported merchandise.

When no prices are fixed or the price declared is not in line with the price prevailing in the international market, such income will be determined in accordance with the regulations established in Article 15. (emphasis added)

The first paragraph of Art. 15 of Title 4 of Tax Coordination Law 1996 provides that:

Art. 15. Notional assessment. The regulatory decree will establish the procedures for determining Uruguayan-source income whenever due to the nature of the business, or the mode of organization, or any other justified cause, such income cannot be accurately determined. *For purposes of this administrative assessment, the tax authorities may apply notional profit margins established as a general rule considering the type of business or exploitation. (emphasis added)*

As can be seen, Uruguayan-source income is to be determined based on the FOB or CIF values of the goods (depending on the type of transaction), i.e. considering the price declared by the parties. Then the rule adds that if such price differs from the international market price, it may be disregarded, and by virtue of Art. 15 above, notional profit margins will be applied.

Art. 19 of detailed Regulatory Decree 840/988 issued by the executive branch provides as follows:

Article 19. Uruguayan-source income from exports and imports. The Uruguayan-source income derived from exports and imports will be determined on the basis of the following principles:

(a)

The profit from export of goods (or assets) is to be considered Uruguayan-source. Net income will be established taking the wholesale price prevailing in the marketplace of destination, less the cost of the goods (or assets), transportation and insurance expenses to destination, sale commissions and expenses, and expenses incurred in Uruguay.

When no price is fixed or when the price declared is less than the wholesale price at destination, such wholesale price will be used as the basis for determining the related Uruguayan-source income.

(b)

The profits realized by foreign exporters from introducing products into Uruguay will be considered foreign-source. However, when the selling price to the buyer in Uruguay is greater than the wholesale price prevailing in the marketplace of origin plus transportation and insurance

to Uruguay, the buyer shall include the difference as Uruguayan-source income.

When wholesale prices at origin or destination would be used in accordance with the above rules and such prices are not publicly available for public knowledge, or there are doubts regarding the analogous nature of the goods exported or imported, or for any other reason that may render the comparison difficult, the basis for computing Uruguayan-source profits will be the income ratios realized by independent enterprises engaged in the same or similar activity.

As can be appreciated, instead of fixing a notional profit margin, the Ministry of Economy and Finance decided to use a mechanism that determines the international price based on the wholesale price at the point of origin in the case of imports, and at the destination in the case of exports.

In cases of underbilling of exports, an adjustment of taxable income should be made for the difference between the net Uruguayan-source income reported by the Uruguayan exporter and the net income that would arise considering the wholesale price prevailing at the destination, less the cost of the goods and all the related expenses incurred by the exporter. In the event of overbilling of imports, the Uruguayan importer should compute as taxable income the difference between the price paid to the foreign exporter and the price resulting from adding to the wholesale price at origin the transportation and insurance costs to Uruguay, provided that such difference is positive. Considering the difficulties involved in determining wholesale prices, the tax rule contemplates the possibility of resorting to profit margin ratios obtained by independent enterprises engaged in identical or similar business.

3.4. Payments for the use of tangible property

With regard to real property rentals, when the lessor is not a taxpayer (e.g. a foreign corporation with no branch in Uruguay that owns property in Uruguay that it rents to another group company established in Uruguay), the annual deduction for rent expenses is limited to 25% of the so-called "real value" assessed by the General Property Assessment Office (*Dirección General de Catastro*). See 2.1. Such value is generally less than the current market value. No other ceilings are fixed for rent paid for other tangible assets. Obviously, if these rent payments differ from the market value (if there is one), they may be challenged by the tax authorities.

As indicated in 3.1, in accordance with the criteria of the tax authorities, a branch may not deduct rent expenses (for either real property or other tangible assets) paid to its head office.

3.5. Payments for the use of intangible property

Because (as stated in 1.2.2.2.) corporate income tax is imposed without exception at a flat rate of 35% on the payment of royalties to foreign companies, the determination of an abusive price by a related company domiciled abroad becomes irrelevant. While the royalties are deducted by the local related company from its annual income, with a 35% tax saving thereon, there is a simultaneous 35% withholding applied. Consequently, establishing transfer

pricing rules in this regard would make no sense. However, in the case of payments for the lease, use, assignment of use, or sale of software, setting an abusive price would prejudice the Uruguayan fisc, as these payments are exempt from income tax withholding.

Unlike the situation found in other legislation, no regulations have been established for determining arm's length prices. Should there be a comparable uncontrolled price (CUP) in existence, it is likely that this would be the base used by the tax authorities to determine the related adjustment.

Finally, as indicated in [3.1.](#), according to the criteria of the tax authorities, a branch may not deduct any payment made to its head office for the use of intangible assets.

3.6. Rendering of services

Services rendered by foreign related companies may be classified in the following groups:

- services rendered by shared management and administration centres, the overall (worldwide) expenses of which are prorated between the branches and affiliates in countries using such services (see [3.2.](#));
- services of a "technical" variety which, as mentioned in [1.2.2.3.](#), correspond to amounts of any kind paid or credited for any kind of management, technical, administration or advisory services; and
- all other remaining services.

In connection with services rendered by shared management and administration centres, see [3.2.](#)

With respect to services qualifying as technical services, the following considerations should be made. As mentioned in [1.2.2.3.](#), payments made to companies domiciled abroad are subject to a 35% withholding tax, but there is an exemption when such fees are taxed in the recipient's country and the Uruguayan withholding tax is not creditable there. Consequently, when the withholding tax applies, as in the case of royalties, the setting of an abusive fee by the foreign related company is pointless, and establishing arm's length transfer prices would make no sense. However, when the withholding tax is not applicable, neutralizing abusive fees would make sense.

Although there are no regulations on "transfer pricing" as such, there are detailed rules intended to control the reasonableness of expenses. Art. 125 of Regulatory Decree 840/988 requires that (1) there be a direct and effective rendering of services by an advisor having adequate resources in that regard and (2) the consideration be in proportion to the service rendered.

In connection with all other services, there are no rules for determining arm's length prices, and such expenses are deductible in the annual income tax computation to the extent that the taxpayer can prove that they are necessary

to produce the income and that the amount paid for the service is reasonable. Both in the case of services qualifying as technical assistance (when no withholding tax is applicable), and in the case of services falling under the classification of all other services, transfer pricing methods such as the CUP method and the cost-plus method could be used by the taxpayer to prove the reasonableness of the fees paid to the foreign related company.

3.7. Interest on loans

In connection with interest on loans, the interest rate ceiling in fact operates as an adjustment of the deductible interest payable to a foreign related company. As stated in 2.1, the deduction of interest paid on loans received from foreign affiliates has a double ceiling:

- the deposit rate paid by the *Banco de la República* (Uruguayan State Commercial Bank) for 180-day deposits; and
- the interest rate prevailing in the lender's country (the rates charged by leading banks in such country are taken into account in applying this ceiling).

The ceiling for the deduction of interest is not applicable in the calculation of income tax for banks.

Such ceiling for financial loans is not applicable for interest that may be agreed upon in trading transactions. However, charging such interest must be a usual trade practice of the foreign exporter. If, for example in the commercial transactions of an exporter with independent parties, the exporter does not charge interest (or the interest is substantially less than the market rate), the tax authorities may limit the interest deduction as if it were a financial loan (on the basis of the principle of substance over form; Art. 6 of the Tax Code).

Finally, as discussed in 3.1, according to the criteria of the tax authorities, branches may not deduct interest on loans received from a head office.

4. OTHER ASPECTS OF TRANSFER PRICING

4.1. Customs value and arm's length value

The taxes imposed on the importation of goods, except for VAT (see 4.2), are imposed on the customs value, except in the case of goods for which the Ministry of Economy and Finance may have fixed special import duties by administrative decision. The definition of customs value adopted in Uruguayan rulings is the definition developed by the General Agreement on Trade and Tariffs (GATT) Convention, namely:

In the terms of the GATT Convention, customs value is the value of the transaction, that is to say, the price really paid or to pay for the goods when the sale fulfils certain conditions. Following GATT, the existence of a relationship between the parties intervening in the transaction does not implicate the need of making adjustments to the transaction value. If, for any reason, the National Customs Authority has reasons to believe that the relationship has distorted the price, it shall communicate these reasons to the importer and shall give him reasonable time to answer.

GATT recognizes six methods of valuation, namely:

- method of the value of the transaction;
- method of identical merchandise, applicable when the method of the value of the transaction is not valid. In this case, the customs value is the value of the transaction of identical merchandise, imported at the same time of the merchandise subject to valuation or at a near moment in time;
- method of similar merchandise, applicable when the previous two methods are not valid. In this case, the customs value is the value of a transaction of similar merchandise, imported at the same time of the merchandise subject to valuation or at a near moment in time;
- method of reduced value, which is based on the sales value of the merchandise in the market of the importer and not on the value of the transaction;
- method of reconstructed value, which consists of reconstructing the ex-works value in the exporter's country; and
- method of last resort, which is a residual method more flexible than the others foreseen by the GATT Convention, as it provides that the value may be determined using reasonable criteria.

To determine the customs value, the following concepts must be added to the price paid for the imported goods:

- both (1) commissions, except for purchase commissions and (2) the cost of packaging that are considered as a whole with the imported merchandise, to the extent that these are on the account of the buyer and are not included in the price paid for the imported goods;
- the value of certain goods or services that the purchaser has directly or indirectly supplied for free to the seller for their use in the production of the imported goods, and when their price has not been included in the purchase price of the imported goods;
- royalties paid for the imported merchandise that the purchaser has to pay directly or indirectly as a condition for the sale of such merchandise, and to the extent that such royalties are not included in the price paid for the imported merchandise; and
- any portion of the profits of the subsequent sale of the imported goods that is reverted directly or indirectly by the purchaser to the seller.

There is no connection between the customs value and the arm's length price that could be fixed by the tax authorities for income tax purposes. Rather, there are conflicting interests between the customs authorities and the tax authorities

because, while the customs authorities are interested in maximizing the customs value in order to increase their tax base, the tax authorities are interested in reducing the import price in order to maximize net Uruguayan-source income subject to income tax.

Finally, in connection with certain goods and for economic policy reasons, the Ministry of Economy and Finance may administratively fix the import prices (so-called "reference prices") used to compute the import taxes on such goods. Such values are fixed in order to bring the import prices that the parties may declare in line with the international prices considered to be normal. However, at times these operate as indirect mechanisms of tariff protection.

4.2. Arm's length value for VAT purposes

In principle, for all transactions the value of the consideration fixed by the parties is the taxable base for VAT purposes; this is also applicable to imports, in which case the VAT is computed on the normal customs value reported by the parties, plus the importation surcharges. In the case of barter agreements, the regulations provide that the consideration (taxable value) will be determined based on the current prices in the marketplace (market value).

However, if in a transaction between related parties the price fixed is not in line with the parties' real "business purpose" and, as a consequence, it is at variance from the price that would be agreed under arm's length conditions, or if an indirect or hidden payment exists compensating the difference, the tax authorities may, by virtue of the substance over form principle of Art. 6 of the Tax Code, make the necessary corrections to the declared values.

4.3. Arm's length value and company law

Art. 84 of Company Law 16.060 of 4 September 1989 (Company Law) provides as a general rule that the administrators and representatives of commercial companies may enter into contracts with the company related to its normal activities, under the same conditions prevailing for third parties, provided that this is communicated to the company's partners or shareholders. The Company Law provides that contracts drawn up in violation of this rule are absolutely null.

Art. 50 of the Company Law states that the administrators of a company may not favour a related company by which it is controlled to the detriment of the administered company, and the administrators must verify that the transactions between such companies are made under equitable conditions and are adequately compensated. If this is not done, the Company Law holds the administrators responsible for the damages and prejudice suffered by the company.

In the specific case of Uruguayan corporations, the Company Law provides rules regulating conflicts of interest, which rules apply to both shareholders and corporate directors.

In connection with shareholders, Art. 325 of the Company Law provides that shareholders and their representatives who engage in transactions with the corporation and have interests opposed to those of the corporation, for their own

account or for account of a third party, must abstain from voting on any agreement related to such transactions. If the shareholders or their representatives contravene this rule, they are responsible for the damage and prejudice caused when, without their vote, the necessary majority for a valid decision would not have been obtained.

With respect to the directors of the corporation, Art. 387 of the Company Law provides that directors who in certain specific transactions have a conflict of interest with the corporation, must disclose this fact to the rest of the board of directors and to the statutory auditor (*síndico*), refraining from intervening when these matters are discussed or decided. If this is not done, the directors will be responsible for any prejudice suffered by the corporation stemming from the transaction.

Under Art. 389 of the Company Law, directors likewise may not participate for their own account or for account of third parties in activities that may compete with the corporation, unless there is an express authorization of the general stockholders' meeting.

4.4. Arm's length value and free-trade zones

The promotion and development of free-trade zones (FTZs) in order to encourage investment, exports, employment and international trade has been declared by law to be of national interest. The establishment of new FTZs by the government or by private companies is encouraged. The following activities may be performed in FTZs:

- storage, trade classification, dismantling, assembling, handling, or blending goods or raw materials of domestic or foreign origin;
- setting up and operating factories; and
- financial services, data processing, repairs and maintenance, and professional and other services required for the operation of FTZs. These services may also be performed for foreign-resident individuals or companies.

Companies operating in the FTZs are exempt from tax and the partners or nominative shareholders of these companies are also exempt from capital tax. Social security charges, as well as withholding taxes on dividends or profits remitted abroad, when applicable, are levied. Companies qualify for the exemption provided that at least 75% of the personnel employed are Uruguayan citizens. Foreign personnel may choose to be excluded from the Uruguayan social security system, in which case no social security charges apply.

Goods, services, merchandise or raw materials, whatever their origin, entering the FTZs are free of all import duties as well as any other taxes, rates and charges. When such items derive from Uruguayan sources, their entrance into an FTZ is treated as a Uruguayan export. Goods, services, merchandise and raw materials entering an FTZ, as well as products manufactured therein, may be freely shipped abroad at any time. When they are introduced into Uruguay, they

are treated as imports.

Because companies located in FTZs are exempt from income tax, in order to prevent the fixing of abusive transfer prices between such companies and their related or affiliated companies located in Uruguayan territory outside the FTZs, the Ministry of Economy and Finance issued Decree 733/991, dated 30 December 1991, whereby such transactions are subject to the control standards established by Art. 21 of Title 4 of the Tax Coordination Law 1996. See [3.3.2](#).

4.5. Arm's length value and exchange control rules

There is no connection between arm's length value and the exchange control rules. In Uruguay there are no exchange controls. There is only one exchange rate applicable to all types of transactions, determined basically by currency supply and demand in a fluctuating market.

Any Uruguayan business or individual may hold an unlimited number of dollar-denominated or other foreign currency bank accounts at home and/or abroad, and may use or transfer funds without any restriction. Since 1974 there have been no restrictions on the transfer of profits or on the repatriation of capital abroad. Foreign investors may guard against the risk of future restrictions by seeking protection under the Foreign Investment Law.

5. OTHER METHODS IN URUGUAY TO DETERMINE THE PROFITS OF ENTITIES BELONGING TO MULTINATIONAL ENTERPRISES

No methods other than those discussed in [3](#) are used to determine the profits of entities belonging to multinational enterprises.

6. TRANSFER PRICING RULES IN URUGUAYAN TAX TREATIES

6.1. General

To date, only two tax treaties (with Germany and Hungary) have been ratified on this subject. Both treaties substantially adopt the provisions of the OECD Model Treaty, departing from the territoriality principle, and contain the provisions of Art. 9(1) of the OECD Model Treaty on income adjustments for related companies, but not those of Art. 9(2).

6.2. Provisions on excess interest and royalties

Both treaties contain a provision similar to those of Art. 11(6) and Art. 12(4) of the OECD Model Treaty on excess interest and excess royalties.

7. COMPLIANCE AND LITIGATION

7.1. Main features of the tax authorities

There are two tax agencies belonging to the Ministry of Economy and Finance, namely:

- the General Tax Office, in charge of administering and collecting nationwide taxes. Branch offices, empowered to deal with the assessment and collection of taxes within the zones assigned to them, exist throughout the country; and
- the National Customs Authority, in charge of administering and collecting

customs duties.

Municipal taxes (e.g. taxes on real estate and vehicle licences) are administered and collected by municipal government treasuries.

7.2. Authority to make adjustments

7.2.1. Tax returns and assessments

The tax system operates on the basis of definitive self-assessment, with audits conducted by the General Tax Office. On or before the tax return due date (which in any case is within 4 months of year-end), taxpayers must file returns for corporate income tax and capital tax on standard form declarations, supported by financial statements and exhibits in which all information relevant to the assessment is explained.

The General Tax Office does not require an audit report by an independent accountant and, in most cases, the statements are unaudited. At the time of filing the tax returns, and together therewith, taxpayers must pay the balance of taxes due after deducting any previous credit balances or advance payments. Such declarations are binding on the taxpayer, unless the taxpayer corrects any mistake of fact or of interpretation of the law by submitting amended declarations within the period before the expiration of the statute of limitations. The submission of corrected declarations is not allowed during a tax audit.

7.2.2. Tax audits

Tax audits are carried out by the Audit Department of the General Tax Office after tax returns are filed. Tax audits are carried out on a sampling basis; therefore, from the taxpayer's perspective, they are unpredictable. At times the tax audit is done internally by the tax authorities and is confined to an examination of the tax returns and supporting documentation filed by the taxpayer. As a result of this examination, certain points may be raised that must be explained by corporate management or by their professional advisors. In some cases, the tax authorities agree with the explanations offered. When there is no agreement, the points are documented in a formal report that is forwarded to the taxpayer together with the technical opinion of the Advisory Department of the General Tax Office. This gives the taxpayer further opportunity to formally support its opinion, which must be done within 10 days, following which a final assessment is issued.

The tax audit may also be conducted through an examination of all accounting and other relevant records of the taxpayer, including correspondence. Even in the event of an in-depth tax audit giving rise to adjustments to the returns filed, such audits or adjusted assessments are not final and, while unusual, may be reopened by the tax authorities before the expiration of the statute of limitations.

The tax authorities may make assessments of their own in cases where sworn declarations or books and other records are missing or insufficient. The assessments made by the tax authorities may be appealed as explained below.

7.3. Penalties

Total or partial failure to pay or withhold taxes is automatically punished by a

one-time 20% fine, plus monthly interest charges compounded every 4 months. In the case of failure to pay withholding taxes when they have been already withheld from the payee, the one-time fine increases to 100%.

The amount of the fine for non-payment may reach 15 times the amount of the taxes due for offences involving fraud. In such cases, the taxpayer must be notified and has a right to present a defence. Tax fraud is also punishable by the criminal courts.

7.4. Appeals

A taxpayer who has been over-assessed or improperly fined may appeal to the General Tax Office and, simultaneously, to the Ministry of Economy and Finance. Both appeals must be filed together. If the appeal is denied, the taxpayer may apply to the Administrative Court (the highest judicial body in tax matters) to have the assessment or fine nullified.

7.5. Statute of limitations

Tax liabilities related to any financial year become statute-barred 5 calendar years after the end of the fiscal year in which the closing date falls. This period is extended to 10 calendar years in case of failure to file sworn declarations, failure to register with the tax authorities, and fraud.

7.6. Advance rulings

The Ministry of Economy and Finance may issue decrees on the subject of nationwide taxes, which may not deviate from the general framework of the law. The General Tax Office may issue internal resolutions and instructions of a general nature only in those cases in which the laws or decrees enacted within their framework empower the General Tax Office to do so, and with the sole effect of facilitating the application of such laws or decrees.

7.7. Exchange of information

All information furnished by taxpayers to the tax authorities or obtained by them in the course of their investigations is required by law to be treated as confidential and may not be divulged under any circumstances, except before the courts dealing with criminal, family or special property rental cases, and only if the information required is considered indispensable (Art. 47 Tax Code).

In both the tax treaty with Germany and the one with Hungary, the solution differs from that of Art. 26 of the OECD Model Treaty. The article referring to exchange of information in both treaties requires that the signatories provide, through their respective tax authorities, the most comprehensive, ample and complete information in response to requests by the other signatory, but subject to certain conditions. Such exchange of information will not operate when it may disclose administrative measures to be taken by the tax authorities of one of the signatories, or when the exchange is contrary to the signatory's laws. Consequently, such exchange may not contravene the rulings contained in Art. 47 of the Tax Code.

1. See Rossetto, *Tax on Income of Industry and Commerce, Part II* (Montevideo: 1976), at 49-50; Shaw and Sujanov, "Taxation Problems of a Group of Companies as a Unit", 3 *Tax Magazine* 3 (July/August 1976), at 221 et seq.; Shaw, "Manual of Tax Law", Volume III, *Tax on Income of Industry and Commerce* (Montevideo: 1988), at 159 et seq.
2. See Rossetto, *supra* note 1, at 49.
3. See Shaw and Sujanov, *supra* note 1, at 235.
4. This position was asserted by Shaw and Sujanov, *supra* note 1, at 243.

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