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OUTCOME OF PROCEEDINGS

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	Uruguay's Foreign source income (FSIE) regime (UY008) – Final description and assessment

STANDSTILL REVIEW PROCESS (SEPTEMBER 2021)

Uruguay committed to reform its FSIE regime within a timeline that will permit adoption of the necessary legislation by the end of 2022. Uruguay also committed not to availing of any grandfathering, as requested by the COCG.

The Code of Conduct Group meeting of 21 September 2021 acknowledged the commitment of Uruguay. This conclusion was endorsed by the ECOFIN Council on 5 October 2021.

Annex 1: Assessment of the UY008 regime

ANNEX 1

Assessment of the UY008 regime (standstill)

Assessment of FSIE regime

	1a	1b	2a	2b	3	4	5
Uruguay – FSIE	V	?	V	?	V	X	X

V: Harmful; X not harmful

Gateway criterion – Significantly lower level of taxation:

"Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code"

The corporate income tax (CIT) rate in Uruguay is 25%. Under the territorial source principle, income generated abroad is in general out of the scope of the CIT.

According to the Income Tax Law in Uruguay, resident natural or legal persons, or a PE of a non-resident entity, are taxed at 25% rate on their net income (IRAE). Non-residents are taxed at 12% rate on their gross income ("IRNR"). Under IRNR, certain types of income are however taxed at a different rate: for instance, profits distributions and other remittances paid by Uruguayan companies are taxed at 7% rate; capital gains, interests, royalties from entities resident in Low or No Tax jurisdictions (LONT)[1] are taxed at a 25% withholding tax rate on certain conditions.

Uruguay applies the territorial source principle and income is taxable in Uruguay when activities are performed, goods are situated, assets located or rights are exploited for economic purposes in Uruguay, except for some cases[2] where income is deemed Uruguayan-sourced.

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[1] Low or No Tax jurisdictions (LONT) on the 2021 Uruguayan blacklist for IRAE purposes are: Angola, Antigua and Barbuda, Ascension Island, Brunei, Christmas Island, Cocos (Keeling) Islands, Djibouti, Dominica, Falkland Islands, Fiji, French Polynesia, Guam, Guyana, Honduras, Jamaica, Jordan, Kiribati, Labuan, Liberia, Maldives, Niue, Norfolk Island, Oman, Pacific Islands, Palau, Pitcairn Island, Puerto Rico, Saint Helena, Saint Pierre and Miquelon, Sint Maarten (former member of Netherlands Antilles), Solomon Islands, Svalbard, Eswatini, Tokelau, Tonga, Tristan da Cunha, Tuvalu, U.S. Virgin Islands, and Yemen.

[2] For instance, it is considered Uruguayan-source income: i) income from work or services performed abroad and earned by IRAE taxpayers under certain circumstances; ii) income from digital services (i.e., services rendered through Internet, technological platforms, computer applications or similar means) performed by non-resident entities, depending on the type of income and the location of the seller and the purchaser; iii) income (capital gains) from the transfer of entities resident in LONT jurisdictions which, directly or indirectly, have more than 50% of their value out from assets in Uruguay.

Income generated abroad like foreign-source dividends, interests and royalties, fees for services performed outside Uruguay or income from immovable or movable properties located outside Uruguay are therefore not subject to taxation in Uruguay. However, income generated abroad may be partially taxed in Uruguay under the IRAE when activities are carried out and/or assets are located partly abroad and partly in Uruguay.

As the Code of Conduct looks at the effects that tax legislation may have on the location of business activities in general terms, full tax exemption may be regarded as one of the reasons for a business to establish in one jurisdiction instead of another. In this sense, the provision is relevant for the Code.

The Code of Conduct uses a broad term (‘tax measures’) to describe what should be assessed under its criteria. This definition is not limited to specific pieces of legislation nor does it circumscribe the meaning of what should be understood as a ‘tax measure’. In the specific case of Uruguay, it is relevant to take into account the general tax system, in order to determine whether the legislation provides for a significantly lower level of taxation.

This is the case for Uruguay since income from a foreign source benefits, in general, from full exemption, thus resulting in no taxation, as opposed to Uruguayan-sourced income that is taxed at higher tax rates.

The provisions are therefore potentially harmful and should be evaluated under the Code.

Criteria 1 and 2 – Ring-fencing

“whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents”

The exemption from taxation of foreign-source income only applies in respect of transactions carried out with non-residents and it does not affect the national tax base. Such exemption is by its nature targeted to non-residents and ring-fenced.

We would therefore propose a tick (“V” – harmful) for criteria 1.a and 2.a.

Concerning possible de facto ring-fencing features of the regime, a self-assessment system is in place in Uruguay for taxpayers, who are required to fill in their tax returns and compute their own tax liabilities. Under this system, taxpayers jointly report amounts of exempt, non-covered and foreign-sourced income. For this reason, Uruguay clarified that it is not in the position to segregate domestic and foreign income and provide the relevant data on active companies that earn income entirely from abroad.

Considering lack of relevant data, we would propose a question mark (“?” – Insufficient information under the criterion) for criteria 1.b and 2.b.

Criterion 3 – Substance:

"*whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages*"

Uruguay's legislation does not require companies to fulfil substance requirements, either for domestic income or for income generated abroad.

Moreover, with regard to anti-avoidance rules, there is no General Anti-Abuse Rule (GAAR) or any other anti-avoidance rule in place in Uruguay qualifying as such according to the COCG Guidance.

We would therefore propose a tick ("V" – harmful) for criterion 3.

Criterion 4 – Internationally accepted principles:

"*whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD*"

<u>Permanent Establishment (PE) definition</u>

Article 10 of the CIT Law provides for the domestic definition of permanent establishment that is based on the UN model. However, concerning the tax treaties network, Uruguay applies, in most cases, the OECD model and the conventional PE definition appears in line with the latest amendments to Article 5 of the OECD MTC. In case of conflict, international treaty provisions prevail over domestic ones under Uruguayan law.

In addition, Uruguay ratified the MLI, which entered into force for the covered tax treaties in June 2020.

Considering all the elements above, we would therefore propose a cross ("X" – not harmful) for criterion 4.

Criterion 5 – Transparency:

“*whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"*

All conditions necessary for the granting of the exemption under the FSIE regime in Uruguay are clearly laid down in the legislation. The application of the territorial source principle appears to be based on clear and objective criteria and there seems to be no room for discretion at administrative level.

We therefore propose a cross ("X" – not harmful) for criterion 5.

Overall Assessment

In the light of the analysis above, Uruguay’s FSIE regime is considered as overall harmful.