

2011 Americas tax policy outlook



Photo: Rio de Janeiro, Brazil

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1. Introduction



Having emerged from the recent economic downturn, countries are focusing on reducing deficits and reforming their tax systems. Governments around the globe are looking to increase competitiveness and encourage investment while taking steps to ensure the collection of expected tax revenue. This is particularly true in the Americas, where the large number of emerging markets increases pressure on governments to develop policies and procedures to handle the influx of investment and currency into the region.

Policy trends in the Americas affect multinational companies operating in the region as well as those considering investment. For these companies, monitoring and engaging in tax policy discussions is an absolute imperative, as poorly managed tax policy can result in unexpected losses on major investments and missed opportunities, or escalate into significant tax disputes.

This report focuses on the Western Hemisphere, providing a 2011 outlook for tax policy in 16 of the largest countries in the Americas region. It discusses each country's political landscape, current tax policy and administration leaders, recent tax policy changes and pending tax proposals.

The report identifies several tax policy trends that are expected to continue in 2011 and provides an overview of the economic and fiscal situations across the region that may shape tax policy this year. It highlights leading practices that companies should consider in their global tax policy and tax risk management efforts as well.

It is an exciting time of growth and progress in the Americas. Designed not only for companies operating in the region, but also those considering investment, this report presents current tax initiatives, trends and tax administration focus areas that could shape tax policy this year.

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2. Expected 2011 tax trends across the Americas

Although each country's tax policy is different, most countries in the Americas are focused on growing their economies, increasing their competitive positions and enforcing existing tax laws. Tax reform is frequently mentioned – but for most countries in 2011, change is more likely incremental.

Key trends worth watching in 2011

Incremental tax changes. Tax changes across the Americas in 2011 will primarily be focused on simplification, competitiveness and increasing revenues. While some countries, such as the US, may discuss broader tax reform, the issue is not generally expected to result in enacted legislation this year. Instead, countries are more likely to enact incremental changes to their income tax base and/or to non-income taxes (e.g., value added tax (VAT), excise, payroll, property and sales taxes).

Interestingly, higher tax rates are not generally expected to be part of this equation for most countries in the region. In fact, several governments have indicated they do not intend to raise

taxes. Canada plans to continue its scheduled corporate tax rate reduction (from 22.1% in 2007 to 15% in 2012).

Some countries in the Americas, however, do plan to raise taxes or have recently increased their tax rates. Mexico and Chile, for example, enacted temporary higher income tax rates in 2009 and 2010. Mexico also added a temporary VAT rate increase. Costa Rica and El Salvador plan to enact significant tax increases this year (see Table 1).

As countries look for revenue, tax incentives and expenditures are widely expected to come under increased scrutiny. Brazil, Costa Rica, Peru and the US have stated their intent to examine existing income tax exemptions and business tax provisions closely. Only two countries, Argentina and Brazil, plan to enact significant new targeted tax incentives this year. Multinational companies should monitor the issue and expect to engage in dialogue with policymakers on tax provisions that affect their industry.

Table 1. 2011 expected tax policy changes

	Significant tax increase expected in 2011	Significant new tax incentives expected in 2011	Potential base broadening or anti-avoidance rules	Increase in tax enforcement	Increased information exchange
Argentina	No	Yes	No	Yes	Yes
Brazil	No	Yes	Yes	Yes	Yes
Canada	No	No	Yes	Yes	Yes
Chile	No	No	Yes	Yes	No
Colombia	No	No	Yes	Yes	Yes
Costa Rica	Yes	No	Yes	Yes	Yes
Dominican Republic	No	No	Yes	Yes	No
El Salvador	Yes	No	No	No	No
Guatemala	No	No	Yes	Yes	No
Honduras	No	No	Yes	Yes	No
Mexico	No	No	No	Yes	Yes
Nicaragua	No	No	Yes	No	No
Panama	No	No	No	Yes	Yes
Peru	No	No	Yes	Yes	No
US	No	No	Yes	Yes	Yes
Venezuela	No	No	Yes	Yes	Yes

Note: See individual country sections for more details



A number of countries have recently expanded their tax boundaries and their definitions of what constitutes locally sourced income. Many countries in the Americas, despite having territorial tax systems, are attempting to tax foreign income.

Increased tax enforcement. Most countries in the Americas are expected to increase their enforcement of existing tax laws. Reducing fiscal deficits is a priority in many countries, and tax administrators are responding by increasing their collection efforts and imposing new information reporting and withholding requirements. Companies should expect to see tax authorities conducting more audits, requesting more documentation, imposing more penalties and applying a narrower interpretation of existing tax laws.

Tax authorities will also continue to focus on international enforcement issues and collaborative efforts with foreign tax administrations (see Table 1). High net worth individuals will be a priority, as a growing number of tax administrations around the globe develop dedicated high net worth units designed to gain a more comprehensive understanding of the affairs and behavior of these individuals.¹

As part of this enforcement effort, a number of countries have recently expanded their tax boundaries and their definitions of what constitutes locally sourced income. Many countries in the Americas, despite having territorial tax systems, are attempting to tax foreign income. Central America became part of this trend two years ago when the Dominican Republic extended its tax reach to certain types of passive income derived abroad, such as dividends, interest and returns from foreign securities and investments. El Salvador and Honduras have made similar changes.

Shared services charges and intercompany charges, such as headquarter expenses, are also being

swept into this net. Tax administrators are focusing on where the benefit of the service is received rather than where the service is rendered. Guatemala, for example, taxes all services even if rendered from abroad.

Focus on transfer pricing. Legislation, regulations and enforcement of transfer pricing will continue to be a priority in many countries. As illustrated in *Ernst & Young's 2010 Transfer Pricing Survey*, tax authorities in key jurisdictions have demonstrated their commitment to transfer pricing issues by significantly increasing their transfer pricing staffing, adopting more centralized approaches to managing transfer pricing inquiries and establishing a more strategic, risk-based approach to prioritizing transfer pricing reviews.²

At the same time, the Organisation for Economic Co-operation and Development (OECD), which largely defines the transfer pricing rules adopted by member nations, continues to refine and update its transfer pricing guidelines. In 2010, the OECD issued an update of its guidance on comparability and profit methods. For 2011, the OECD is shifting its transfer pricing focus to better define issues related to intangibles, such as trademarks, patents and business models.

All of the Central American countries and the Dominican Republic agreed more than two years ago to adopt the OECD transfer pricing model. Panama and El Salvador have also passed transfer pricing legislation, but their laws differ in some respects from the OECD model. For example, in Panama, the new transfer pricing rules apply only to transactions between countries with which Panama has a tax treaty.

El Salvador adopted some, but not all, of the OECD concepts in its new law, and has yet to issue regulations. Costa Rica is using an aggressive interpretation of substance over form and "economic reality" principles under which local tax authorities are challenging related party transactions.

More tax treaties and information exchange agreements. Along with tax treaties containing exchange of information provisions, countries are signing more Tax Information Exchange Agreements (TIEAs). Many countries in the region, including Argentina and Brazil, are expected to sign TIEAs in 2011.

The growth of new free trade agreements, such as the Central American Free Trade Agreement, has resulted in an increase in countries negotiating tax treaties. These new tax treaties are designed to help countries provide a clear trade environment. Panama has taken the lead in creating a broad and diverse treaty network, having negotiated and/or signed 12 treaties in less than a year, with many more expected in 2011.

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¹ Robert Hanson, Charles Kowal, and Marnix van Rij, "Tax administration without borders: wealth under the spotlight," *BNA Daily Tax Report*, 20 December 2010.

² Ernst & Young LLP, *2010 Global Transfer Pricing Survey: addressing the challenges of globalization*.

Along with tax treaties containing exchange of information provisions, countries are signing more tax information exchange agreements.

Taxing dividends and foreign-source interest. One way countries have been expanding their revenue collection is by imposing withholding taxes on some dividends and interest payments. Panama, a traditionally strong territorial jurisdiction, recently introduced a new tax on dividends derived from foreign-source income generated by companies that have both domestic and international operations. Under recent Nicaraguan and Honduran tax reforms, previously tax-free dividends are now subject to a 10% withholding tax.

Several countries have expanded withholding tax obligations to new types of interest payments or have raised the tax rate on interest. Costa Rica is considering changing its taxation of interest income by taxing interest paid to banks recognized by the Central Bank of Costa Rica. These changes are affecting companies that use bank structures for domestic debt infusion strategies.

Increased indirect taxes. As governments continue to look for revenue, indirect taxes are rising around the world, including

in the Americas. Brazil, for example, is expected to re-enact its transaction tax in 2011. Colombia is considering changes in its mining royalty system. As mentioned above, Mexico enacted a temporary VAT rate increase. In the US, new excise taxes involving the health insurance, medical device and pharmaceutical industries were enacted in 2010 as part of health care reform legislation.

Timing of political elections. Many political analysts believe the timing and scope of tax policy changes are influenced by where a country is in its political cycle. While major tax legislation is typically not enacted in an election year, action on tax policy is often a priority of the newly elected. As an example, of the eight countries that held elections in 2010, four enacted significant tax changes. Table 2 provides a snapshot of political and legislative activity in the Americas and notes whether each country experienced a significant tax increase or decrease in 2009-10.

Table 2. Summary of election timing and 2009-10 tax changes

	Election timing			2009-10 tax changes	
	Election in 2010	Election in 2011	Election in 2012	Significant tax increase	Significant tax decrease
Argentina	No	President	No	No	No
Brazil	President	No	Yes	Yes	Yes
Canada	No	Possible	Possible	No	Yes
Chile	President	No	No	Yes	Yes
Colombia	President & Congress	Local	No	Yes	No
Costa Rica	President & Parliament	No	No	No	No
Dominican Republic	Congress	No	President	No	No
El Salvador	No	No	President & Assembly	Yes	No
Guatemala	No	President	No	No	No
Honduras	No	No	No	Yes	No
Mexico	No	Local	President & Congress	Yes	No
Nicaragua	No	President & Parliament	No	No	No
Panama	No	No	No	Yes	Yes
Peru	Local	President & Congress	No	Yes	No
US	Congress	No	President & Congress	Yes	Yes
Venezuela	Parliament	No	President	No	No

Note: See individual country sections for more details

3. Americas economic and fiscal backdrop

Companies considering long-term investment in a region put a premium on economic and policy stability. They weigh current and potential future levels of economic growth and government taxation. These companies recognize that countries' private sector economies and government fiscal conditions are determinants of tax policy outlook.

Recovery from the global recession is underway in most countries in the Americas. The US is growing at a modest 2% to 3% rate, while many countries, including Brazil, Chile, the Dominican Republic, Panama and Peru, have returned to their rapid precrisis rates of economic growth. Strong demand for natural resources has increased domestic and foreign investment in a number of countries, while government trade and fiscal policies have spurred economic growth in others.

The 2011 economic projection by the International Monetary Fund is uniformly positive across the region, but at growth rates slightly lower than during 2010.

Economic growth rates

Strong economic growth adds to countries' tax revenues and, with reasonable fiscal policy, can result in lower deficits and a declining debt-to-GDP ratio, both of which are favorable harbingers for investment. The 2011 economic projection by the International Monetary Fund (IMF) is uniformly positive across the region, but at growth rates slightly lower than during 2010 (see Table 3).

Table 3. Economic growth projections 2009-11 (Real GDP growth (%))

	2009	2010	2011*
Argentina	0.9	7.5	4.0
Brazil	(0.2)	7.5	4.1
Canada	(2.5)	3.1	2.7
Chile	(1.5)	5.0	6.0
Colombia	0.8	4.7	4.6
Costa Rica	(1.1)	3.8	4.2
Dominican Republic	3.5	5.5	5.5
El Salvador	(3.5)	1.0	2.5
Guatemala	0.5	2.4	2.6
Honduras	(1.9)	2.4	3.5
Mexico	(6.5)	5.0	3.9
Nicaragua	(1.5)	3.0	3.0
Panama	3.0	6.2	6.7
Peru	0.9	8.3	6.0
US	(2.6)	2.6	2.3
Venezuela	(3.3)	(1.3)	0.5

*Projections

Source: International Monetary Fund, World Economic Outlook database, October 2010

Government fiscal deficits

The recent debt crisis has resulted in an increased focus on fiscal austerity. Governments are looking to reduce their deficits and are paying particular attention to spending levels. Many countries have significantly lower levels of government debt than in the past, and in 2011, the IMF projects lower budget deficits in most countries in the Americas.

Table 4 shows how large budget deficits were in 2009, measured as a percentage of the countries' 2009 GDPs. IMF projections are shown for 2010 and 2011. Even at the height of the global

recession, many countries in the Americas had deficits of 3.5% of GDP or less. In 2009, the US (12.9%) and Venezuela (8.2%) had the largest deficits, followed by El Salvador (5.6%), Canada (5.5%), Mexico (4.9%), Honduras (4.6%) and Chile (4.3%).

In its World Economic Outlook, the IMF included another measure of national debt, "gross debt," which includes debt held by other government agencies. When 2009 gross debt is divided by GDP, the US (84.3%) is the most indebted nation in the Western Hemisphere, followed by Canada (81.6%), Nicaragua (81.3%), Brazil (68.9%) and Argentina (59.0%).

Table 4. Deficit projections, 2009-11 – Annual deficit (% of GDP)

	2009	2010	2011*
Argentina	(3.7)	(3.5)	(3.8)
Brazil	(3.2)	(1.7)	(1.2)
Canada	(5.5)	(4.9)	(2.9)
Chile	(4.3)	(1.6)	(0.6)
Colombia	(2.5)	(3.5)	(3.9)
Costa Rica	(3.2)	(4.7)	(4.4)
Dominican Republic	(3.5)	(2.4)	(1.6)
El Salvador	(5.6)	(4.9)	(4.4)
Guatemala	(3.1)	(3.4)	(3.1)
Honduras	(4.6)	(3.7)	(3.1)
Mexico	(4.9)	(3.6)	(3.1)
Nicaragua	(2.1)	(0.1)	(0.5)
Panama	(1.0)	(0.7)	(1.0)
Peru	(2.1)	(0.8)	(0.1)
US	(12.9)	(11.1)	(9.7)
Venezuela	(8.2)	(3.8)	(3.5)

*Projections

Source: International Monetary Fund, World Economic Outlook Database, October 2010

Table 5. Gross debt to GDP, 2009 (% of GDP)

	2009
Argentina	59.0
Brazil	68.9
Canada	81.6
Chile	6.2
Colombia	35.2
Costa Rica	28.0
Dominican Republic	28.4
El Salvador	48.5
Guatemala	23.0
Honduras	23.7
Mexico	44.9
Nicaragua	81.3
Panama	39.9
Peru	27.4
US	84.3
Venezuela	36.4

Source: International Monetary Fund, World Economic Outlook Database, October 2010

Level and composition of tax revenues

The level and composition of taxes play a key role in a country's economic growth and overall attractiveness to businesses. In the Americas, levels of spending and revenue as a percentage of GDP vary widely. Table 6 shows that in 2009, four countries collected more than 30% of GDP in tax revenue (national plus subnational): Argentina (33.9%), Brazil (36.1%), Canada (38.3%) and the United States (30.4%). Four countries had a ratio of tax to GDP of less than 20%: Guatemala (11.1%), the Dominican Republic (13.7%), El Salvador (15.4%) and Peru (18.9%).

With respect to the composition of taxes, the OECD recently ranked different taxes by their detrimental effect on economic growth. According to the OECD, corporate income taxes are the most detrimental to economic growth, followed by individual income taxes, consumption taxes and property taxes.¹

Table 7 shows the composition of national and subnational taxes in each country in the region. Most rely on indirect taxes for a majority of their tax revenues: general value added taxes, excises on specific goods or services, plus customs duties. Four nations – Costa Rica, the Dominican Republic, Guatemala and Honduras – derive more than 60% of their revenue from these indirect consumption taxes. Developed economies rely more heavily on income taxes and payroll taxes. Canada, Mexico and the US derive more than 40% of their revenue from these direct taxes.

The level and composition of taxes play a key role in a country's economic growth and overall attractiveness to businesses.

Table 6: Government revenue in the Americas, 2009 (% of GDP)

	2009
Argentina	33.9
Brazil	36.1
Canada	38.3
Chile	21.7
Colombia	26.7
Costa Rica	22.3
Dominican Republic	13.7
El Salvador	15.4
Guatemala	11.1
Honduras	24.8
Mexico	22.2
Nicaragua	28.8
Panama	24.6
Peru	18.9
US	30.4
Venezuela	24.9

Note: Revenue consists of taxes, social contributions, grants receivable and other revenue

Source: International Monetary Fund, World Economic Outlook Database, October 2010

Table 7. Composition of tax revenues, 2009 (% of total tax revenues)

	Argentina	Brazil	Canada	Chile	Colombia	Costa Rica	Dominican Republic	El Salvador	Guatemala	Honduras	Mexico	Nicaragua	Panama	Peru	US	Venezuela
Income taxes	14.2	32.0	45.7	30.8	37.2	29.7	24.6	32.0	29.7	29.5	44.9	28.1	31.2	36.9	40.9	38.5
Indirect taxes	41.9	27.8	23.2	57.4	41.3	62.5	68.3	52.5	65.7	61.8	37.2	51.4	30.0	48.1	16.9	54.7
Social contributions (payroll taxes)	31.6	35.1	16.1	9.3	13.7	2.3	0.5	12.0	2.8	7.7	14.8	20.2	33.6	12.1	26.9	6.7
Property taxes	9.1	2.7	11.2	0.0	6.8	5.3	6.7	0.5	0.0	0.9	1.5	0.2	3.1	1.6	13.6	0.2
Other taxes	3.2	2.5	3.8	2.4	1.0	0.2	0.0	3.0	1.8	0.0	1.7	0.1	2.1	1.3	1.7	0.0
Total fiscal revenue	100.0	100.1	100.0	99.9	100.0	100.0	100.1	100.0	100.0	99.9	100.1	100.0	100.0	100.0	100.0	100.1

Source: CEPAL (Central government revenues), OECD

¹ OECD, *Do tax structures affect aggregate economic growth? Empirical evidence from a panel of OECD countries*, October 2008

4. Leading business practices for companies in the Americas

As tax administrators respond to an increasingly global business environment, companies need to adjust how they manage tax policy change and tax controversy accordingly. Governments and tax administrations are increasingly working together to enforce their existing tax rules on global companies, cross-border transactions and high net worth individuals. This requires taxpayers to increase the amount of attention they pay to documentation, employ tax planning that considers potential future tax controversy, and understand and manage tax risk.

Understanding the links between tax policy and tax administration is also important. Changes in tax policy and legislation tend to foreshadow future controversy as tax administrations seek to understand and test the operation of new legislation.

Companies that are proactive about these changes are able to make tax decisions with a greater degree of certainty, a hallmark of good corporate governance. Certain leading practices outlined below can help satisfy both business objectives and tax administrators' requirements.

Tax policy leading practices

Monitor and assess possible future tax policy shifts.

Develop processes and channels to stay up-to-date with tax legislation and the tax policy environment in key jurisdictions. Communicate this process to your organization's key stakeholders. These steps help companies anticipate potential adverse policy changes and identify potential opportunities.

Be an active participant in tax policy development.

In such a rapidly shifting economic, legislative and regulatory environment, new tax laws may sometimes impede commercial decisions in ways unintended by policymakers. Companies faced with this issue can either adapt their business plans accordingly or work collaboratively with the government to explain the impediment, model the potential outcomes and develop alternative policy choices.

Join forces. Consider whether forming an industry or trade group is appropriate to develop a collective voice. Alternatively, assess opportunities to join an existing group.

Assess the impact of change. If change is clear and documented, create an impact assessment that contains economic modeling. Policymakers need information to develop good tax and economic policy. Comparative tax studies and insightful analysis of tax policy proposals' effects on competitiveness can help in this effort.

Tax controversy leading practices

Stay connected with tax administration shifts. By developing "tax administration intelligence," companies can better understand the key focus areas of the tax administration in jurisdictions in which they operate. Companies should also understand what tools and techniques can lower overall risk levels. Risk ratings models, risk assessments, advance pricing agreements, rulings and new dispute resolution tools are all evolving and useful for these purposes.

Adopt a global approach to tax controversy and risk.

Companies should develop and assess their tax controversy and risk management strategies and actions from a global perspective, because that is how tax administrations are increasingly viewing them. At a high level, companies should establish a global vision and strategy for tax controversy and risk management. The strategy should consider how to develop enhanced relationships with tax administrators in key jurisdictions; weave in all available tax administration intelligence; understand the methods that can be used in the jurisdiction to achieve a lower risk rating; and encompass – where culture permits – a more transparent, collaborative and responsive relationship with tax authorities.

As tax administrators respond to an increasingly global business environment, companies need to adjust how they manage tax policy change and tax controversy accordingly.



Photo: Los Cabos, Mexico

Policymakers need information to develop good tax and economic policy. Comparative tax studies and insightful analysis of tax policy proposals' effects on competitiveness can help in this effort.

Evaluate global systems and resources for tax risk management. Managing future controversy requires an understanding of both the scope and direction of a likely tax audit or examination. Companies need to ensure the right processes are in place to manage the risk of potential tax controversy. Global tax risk management systems should have processes to identify, assess, measure, mitigate and monitor actions and strategies. While many tax functions may have designated "tax risk manager" and "tax controller" positions to monitor and manage tax risks on an ongoing and proactive basis, controls and procedures should be integrated into the various tax and business processes as far upstream as possible – and not be treated as separate activities within the tax function.

Manage any controversies at a strategic level. For issues that advance to the controversy stage, it is necessary to assess the relative merits and weights of each issue and analyze the nature of disputes with tax authorities. For cross-border issues, it is important to evaluate how a settlement or adjustment in one jurisdiction will affect other jurisdictions. In addition, businesses should:

- ▶ Establish criteria to identify business transactions that require proactive management to avoid or mitigate controversy (e.g., documentation, pre-filing agreements)
- ▶ Track current controversies, as well as business transactions and decisions that may result in controversy
- ▶ Establish priorities for jurisdictions that have significant or potentially significant controversy issues

- ▶ Understand key tax jurisdictions' legislative and regulatory environment, information exchange policies and strategic direction
- ▶ Conduct, for each key jurisdiction, a technical risk assessment of tax return positions, considering existing documentation and recent enforcement activity
- ▶ Use resolution tools and processes to facilitate closure of disputes and issue resolution
- ▶ Understand the potential multiyear and multijurisdictional impact of the issues and the means by which they are resolved

Include global tax risk as a corporate governance issue. Tax administrations are working diligently to elevate tax strategy to the boardroom agenda. Policymakers and tax administrators expect corporate boards to understand their responsibilities with regard to their business tax strategies and outcomes. Some tax administrators are engaging CEOs and CFOs, as well as corporate boards, in dialogue regarding tax risk. In response, companies should consider ways to:

- ▶ Educate the board about the tax implications of business decisions as well as the structure, processes and policies related to tax controversy and risk management within the company
- ▶ Prepare for board-level inquiries related to tax risk management strategies
- ▶ Actively engage the C-suite and board in discussions related to tax risk management

Managing future controversy requires an understanding of both the scope and direction of a likely tax audit or examination.



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Toronto skyline, Ontario, Canada



Cordillera del Paríne, Chile



Los Glaciares National Park, Argentina



Sao Paulo, Brazil



2011 country tax policy outlooks

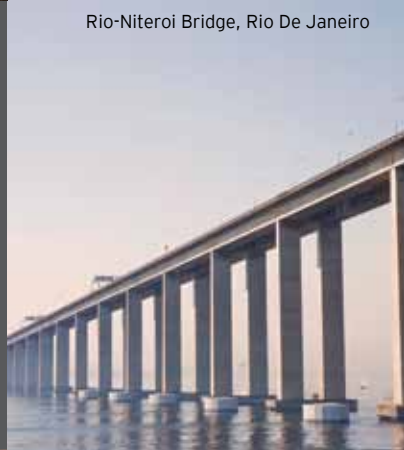
U.S. Capitol Building, Washington, DC



View of cranes, Valparaiso, Chile



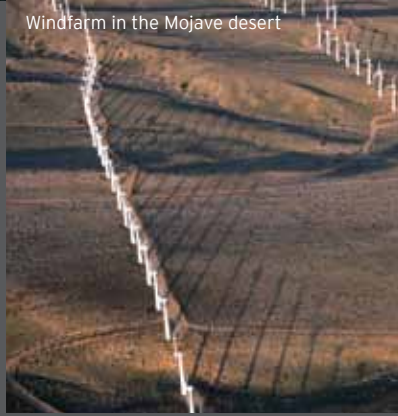
Rio-Niteroi Bridge, Rio De Janeiro



Iguazu Falls, Cataratas, Argentina



Windfarm in the Mojave desert



Key drivers

- ▶ Inflation would allow tax authorities to increase tax collections.
- ▶ Infrastructure improvements will require additional funds.

Political landscape

President Cristina Fernández de Kirchner is expected to run for reelection in October 2011. Recent polls indicate one-third of voters support the current Government, while another third supports the opposition. The remaining third will decide the election.

If President Fernández de Kirchner wins again, observers believe that her Government will continue to discourage foreign investment. If the opposition wins, attitudes toward foreign investors are likely to change.

Whatever the election result, the new Government will need to fund expensive improvements to existing infrastructure. Consumption and exports drove GDP up by 60% over the last eight years, but little was invested in infrastructure. New and improved highways, railways, airports and port facilities are now needed.

Existing Government policies have discouraged investment in oil fields, both onshore and offshore. A policy reversal would clearly present opportunities to foreign investors. Elsewhere in the energy sector, nuclear, hydroelectric and combined-cycle plants are expected to be built, and many observers are optimistic about Argentina's prospects for new energy resources (wind, biodiesel and hydrogen).

Current tax policy leaders and tax administrators

- ▶ Cristina Fernández de Kirchner, President
- ▶ Amado Boudou, Minister of Economy
- ▶ Ricardo Echegaray, Head of the Federal Public Revenue Agency (AFIP)

Outlook

- ▶ The October 2011 presidential election makes the imposition of new taxes or increases in existing tax rates unlikely this year.
- ▶ Corporate tax audits and inspections will likely increase to offset increased Government spending. Tax authority proceedings have already begun, focusing on export companies.
- ▶ Tax incentives for making capital asset investments in Argentina, which expired in September 2010, will likely be re-enacted and applied retroactively.
- ▶ A tax amnesty or a more-forgiving installment plan may become available to taxpayers.
- ▶ Argentina will continue to execute information exchange treaties with countries having low or nil tax rates.
- ▶ Provincial governments will likely set up new or additional withholding systems for local taxes or increase applicable rates and limit exclusions. Municipal governments will probably attempt to increase their tax audits.

Upcoming Tax policy and administrative activities: Congress's analysis and approval of the President's budget (March); Congress's analysis of the bill to mandate profit sharing with employees (March); presidential election (October); new Government takes charge (December)

Key tax policy changes 2009-10

Tax policy. During the past two years, the Government has enacted no significant changes in tax policy, tax legislation or related regulations. It has continued its annual inflation adjustments to personal income tax provisions. The AFIP has proposed increases in the "tax-free threshold" and the "personal deductions" for the 2010 tax year, but those increases await legislative action.

National tax incentives. Tax authorities have issued regulations clarifying details of important national tax incentives for investments in (1) new capital goods destined for industrial activities and (2) infrastructure works. The initial tax incentives applied to investments made from October 2004 to September 2007 (Law 25,924); similar tax incentives (Law 26,360) enacted in March 2008

were effective from October 2007 to September 2010.

The main benefits granted by Law 26,360 include:

- ▶ Early VAT reimbursement
- ▶ Accelerated depreciation for income tax purposes: over three, four or five years for depreciable movable assets or 50%, 60% or 70% of the estimated useful life for infrastructure works (depending on when the investments were made)

Taxpayers could not claim both benefits for the same project, unless (1) the project was exclusively export-oriented, and/or (2) the project involved clean production or sustainable industrial reconversion. To obtain these incentives, interested taxpayers had to participate in a bidding process that allocated the tax quota granted by the Government.

For tax incentive purposes, eligible infrastructure works were those declared "critical" by the Ministry of Planning, including:

- ▶ Generation, transportation and distribution of electric energy
- ▶ Production, transport and/or distribution of hydrocarbons
- ▶ Mining exploration and exploitation
- ▶ Works related to roads, railways and ports

TIEAs. Internationally, Argentine authorities have executed TIEAs with several countries in 2009 and 2010, including Andorra, the Bahamas, Costa Rica, Monaco and San Marino. The only agreement that has come into effect to date is the one executed with Monaco (August 2010).

Provincial and municipal tax incentives. Over the past two years, provincial governments have issued regulations on tax incentives for technology and software-related business activities, establishing benefits involving provincial taxes, such as turnover and stamp taxes. Among other benefits, Buenos Aires City (Law 2,972) created a “technological district,” and the Province of Buenos Aires included processing, services related to databases, software and consulting activities, among others, within the local industrial promotional regime (Law 13,656).

Pending tax proposals

New investment tax incentives. Although the tax incentives for investments in new capital goods expired in September 2010, enactment of similar incentives is likely. Based on the last round of incentives, which applied retroactively to investments made from October 2007 to September 2010, the next round of tax incentives could be retroactive to October 2010.

Reduced taxes for service export companies. In May 2010, the Minister of Industry and Tourism, Débora Giorgi, announced this change to companies engaged in service exports. The project seeks to create a yearly tax quota of ARS2 billion, with an exclusive minimum quota for small- and medium-size enterprises (SMEs). The benefits to companies would be substantial. The proposal would permit service export companies to credit the withholding taxes paid to foreign tax authorities against similar Argentine income taxes resulting from the export of the promoted services. Currently, this is not possible because credits obtained from taxes paid abroad cannot be used to offset taxes resulting from Argentine-source income. The proposal would also establish a non-transferable tax credit equal to the amounts paid in training human resources, which may be used to settle social security contributions.

Profit sharing. Another proposal would require corporations to distribute 10% of their taxable income to their employees annually, but would not make those distributions deductible for corporate tax purposes. Because non-deductible distributions would disadvantage investors – and allowing these distributions to be deductible is consistent with general tax principles – a push to make the distributions deductible is expected.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	35%
Top individual income tax rate	35%
Standard value added tax rate	21%

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Key drivers

- ▶ To sustain the economic growth of the past, Brazil will have to resume the debate on national tax reform, possibly in 2011. Social security reform may also be discussed.
- ▶ Infrastructure needs for the 2014 World Cup and the 2016 Olympic Games will probably increase tax incentives for infrastructure development.
- ▶ The new production sharing contracts regime, which will be used in future bids for oil and gas exploration in Brazil, will attract the attention of local and foreign investors.

Political landscape

Despite the election of a new president in 2010, Brazil's political landscape remained stable because outgoing President Luís Inácio Lula da Silva supported new President, Dilma Rousseff. Both are members of the Workers Party (PT), which, with its allies, has majorities in the House and Senate.

In her first speeches as the Brazilian President, Rousseff indicated her main goals will be reducing inequality and advancing economic growth. In the tax arena, President Rousseff has proposed reducing payroll taxes, creating tax incentives for investment and controlling harmful tax competition among Brazilian states. Although she opposes reinstating the Social Security tax on bank transfers and withdrawals (CPMF), she says she must discuss the matter with governors and political allies.

A reduction in the size and role of the Federal Government is not likely during President Rousseff's tenure. Rather, taxes are likely to increase to finance increased public spending.

The next election will be in November 2012, when city mayors, municipal legislatures and some senators will be chosen. The next presidential election will be held in 2014.

Outlook

- ▶ Following the 2010 presidential election, the new Government is looking for ways to finance its increasing expenses. Reinstating the 0.38% tax on financial transactions (CPMF) is possible.
- ▶ Instead of a major tax reform in 2011, targeted tax incentives for specific industries and new investments are likely.
- ▶ The valuation of the Brazilian currency (real) has been harming the local economy. The tax on exchange transactions has been and will probably continue to serve as a tool for exchange control.
- ▶ Increased enforcement of existing taxes, with a focus on high net worth taxpayers and cross-border transactions, is expected to continue and intensify. Issue-specific audit task forces and oversight of large taxpayers are expected to continue in 2011.
- ▶ Federal tax auditors are targeting corporate restructuring and tax planning and creating task forces to focus on these audits.
- ▶ The Government will focus on preventing abusive tax planning and the tax effects of the International Financial Reporting Standards (IFRS) implementation.
- ▶ The legislature may consider changes to indirect taxes and payroll taxes.

Other tax policy and administration activities: Congress returned to session 1 February 2011.

Current tax policy leaders and tax administrators

- ▶ Dilma Rousseff, President
- ▶ Guido Mantega, Ministry of Finance
- ▶ Rep. Pepe Vargas (PT-RS), Chairman, House Finance and Tax Committee
- ▶ Sen. Delcídio Amaral, Chairman, Senate Economic Affairs Committee
- ▶ Carlos Alberto Freitas Barreto, Treasury Secretary
- ▶ Fausto Vieira Coutinho, Treasury Sub-secretary, Customs and International Affairs
- ▶ Vacant, Treasury Sub-secretary, Tax Administration

Key tax policy changes 2009-10

Thin capitalization rules. Under Articles 24 and 25 of Law 12,249/2010, Brazil's thin capitalization rules apply to inbound loans with related parties or entities resident in tax havens or under preferential tax regimes.

Tax havens. Article 26 of Law 12,249/2010 tightens restrictions on remittances to tax havens. Under the provision, payments of any kind to entities resident in tax havens or established under a privileged tax regime will only be deductible if certain requirements are met. Requirements include proving (1) the beneficiary's operational capacity and (2) the beneficiary is the beneficial owner of the payment.

Blacklisted jurisdictions and preferential tax regimes. Tax authorities issued a new blacklist in June 2010, increasing the number of blacklisted jurisdictions from 51 to 65. Switzerland was the most notable addition, although tax authorities suspended the imposition of penalties at the request of the Swiss Government. The authorities also issued a list of preferential tax regimes, which included the US limited liability corporation regime.

Administrative Tax Court reform. Following its reform in 2009, the Federal Administrative Tax Court (CARF) reviewed 14,806 tax assessments. Under the reform, taxpayers that receive unfavorable CARF decisions can still

go to a judicial court. However, because Brazil does not have specialized tax courts, an administrative defense can stand a better chance of success than a judicial claim.

Enforcement. Brazil continues to broaden its tax base via electronic enforcement and compliance requirements to file monthly and transactional returns online. This has triggered hundreds of thousands of notifications of deficiencies, thousands of audits and numerous assessments each month.

Pending tax proposals

Abusive tax planning. During the second half of 2010, Federal tax authorities announced their intention to seek a proposal that would define abusive tax planning and specify the procedures that must be followed if authorities challenge a taxpayer's planning. While no law was enacted, the issue will likely be revisited in 2011 and is expected to result in enacted legislation. It is still unclear how this proposal would change the tax planning landscape in Brazil.

Accounting rule changes and tax regulations. Law 11,638/2007, which became effective 1 January 2008, was designed to align Brazilian accounting principles and standards with the IFRS. Since its publication, the law has generated debate on whether the new accounting principles would affect tax regulations. In response to the debate, the Brazilian Government enacted Law 11,941/2009, introducing the Transitory Tax Regime (TTR). Under the TTR, the new accounting

principles are neutral for tax purposes until a specific tax law regulating the effects of IFRS is enacted. The Government is expected to propose a law dealing with the tax effects of the IFRS implementation.

CMPF. The 0.38% tax on financial transactions was abolished in 2007, but talk of its return continues. Reinstating the CMPF will probably be one of the first tax propositions examined in 2011.

2011 tax rates (as of 1 January 2011)

Top federal corporate income tax rate	34%
Top federal individual income tax rate	27.5%
State value added tax (ICMS)	0%-25%
General rate on intrastate transactions	17%/19%
General rate on interstate transactions	12%
Federal value added tax (IPI)	Most rates range from 0%-20%, with higher rates on luxury or superfluous goods
Federal social contributions (VAT-type taxes) on revenues (PIS/COFINS)	1.65%-9.25%

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Key drivers

- ▶ With the economic recovery under way, the Government is focused on laying the foundation for long-term, sustainable growth. The finance minister has pledged that the 2011 budget will maintain the Government's focus on the economy, jobs and growth, and returning Canada's books to balance.
- ▶ The IMF continues to expect that Canada will have the strongest average economic growth among the Group of Seven countries in 2011.
- ▶ Expressed in relation to the size of the economy, the budgetary deficit is projected to decline from 3.6% of GDP in 2009-10 to 2.8% in 2010-11 to 0.1% in 2014-15. A surplus of 0.1% of GDP is expected by 2015-16.
- ▶ Corporate income tax revenues are projected to grow as the economy recovers. These revenues will be partially offset by additional reductions in the general corporate income tax rate. The rate will drop 1.0 percentage point in 2010 and 1.5 percentage points in both 2011 and 2012.

Political landscape

In the Canadian parliamentary system, the political party with the largest number of members in the House of Commons forms the Government. For the past several years, the Conservative Party, led by Prime Minister Stephen Harper, held the largest number of seats but not a sufficient number to form a majority government. A minority government must depend upon support from opposition parties on votes on matters of confidence (for example, finance measures including the budget).

The Government tabled the 2011 federal budget on March 22, 2011. It was a

Outlook

- ▶ The Canadian Federal Government is committed to balancing its budget in the near term without raising taxes or cutting transfers to individuals and other levels of government.
- ▶ To do so, the revenue base must be protected. The Canada Revenue Agency (CRA) will continue or increase its current audit focus on large business, especially those with international transactions involving transfer pricing.
- ▶ CRA officials will continue focusing on international tax planning "schemes." The CRA has recently expressed its belief that "a sustainable tax system is one where taxpayers appreciate that paying tax enables them to enjoy all the rights that accompany being a Canadian resident or business" and that it is seeing a "growing movement to include paying tax as a key element of responsible citizenship, at both the individual and corporate levels."¹
- ▶ Canada, with its long history of supporting OECD activities and involvement in the Forum on Tax Administration (FTA), will continue efforts for increased transparency, exchange of information and international tax administration cooperation.

stay-the-course budget with no major new proposed expenditures or tax policy directions such as rate or base changes. Before the budget was debated in the House the Government was defeated in a vote on a non-confidence motion from the opposition Liberal Party on March 25, 2011. A federal general election was called for May 2, 2011.

The tax policy of the previous Government had been shaped by priorities of fiscal sustainability, with the objective of returning to balanced budgets in three to four years. The finance minister had stated that this goal would be achieved by ending stimulus as the economy recovers; restraining growth in Government spending through targeted measures; and undertaking a comprehensive review of Government operations and costs.

These priorities will be continued by the Conservatives if they form the new Government. The fiscal priorities of the opposition parties will be articulated during the election campaign. The Liberals have already stated that they will reverse the recent corporate income tax cuts implemented by the Conservatives if

they form the next Government. This has become a significant election issue.

Current political tax policy leaders and administrators

- ▶ Stephen Harper, Prime Minister
- ▶ Jim Flaherty, Minister of Finance
- ▶ Keith Ashfield, Minister of National Revenue
- ▶ Scott Brison, Finance Critic, Liberal Party of Canada
- ▶ Thomas Mulcair, Finance Critic, New Democratic Party of Canada
- ▶ Michael Horgan, Deputy Minister, Department of Finance
- ▶ Linda Lizotte-MacPherson, Commissioner and Chief Executive Officer, Canada Revenue Agency
- ▶ Anne-Marie Lévesque, Assistant Commissioner, Appeals Branch, Canada Revenue Agency
- ▶ Terry McAuley, Assistant Commissioner, Compliance Programs Branch, Canada Revenue Agency
- ▶ Brian McCauley, Assistant Commissioner, Legislative Policy and Regulatory Affairs Branch, Canada Revenue Agency

¹ Interview with Linda Lizotte-MacPherson, CRA Commissioner and CEO, Ernst & Young *Tax policy and controversy briefing*, February 2011, www.ey.com/tpc

Key tax policy changes in 2009-10

Corporate tax rate reductions. The Government is committed to having the lowest corporate income tax rate in the G7 by 2012 and has enacted substantial broad-based tax reductions, under which it intends to lower the federal general corporate income tax rate from 22.12% in 2007 to 15% in 2012. In addition, the Federal Government is collaborating with the provinces and territories to achieve a goal of a 25% combined federal-provincial corporate income tax rate.

Clean energy generation. The country encouraged clean energy generation by expanding the range of heat recovery and energy distribution equipment that qualifies for the enhanced 50% accelerated capital cost allowance (CCA) for assets acquired on or after 4 March 2010.

Manufacturing and processing equipment. The temporary increase in the CCA rate for manufacturing and processing equipment to a 50% straight-line rate has been extended for eligible assets acquired in 2010 and 2011.

Tariff-free zone for industrial manufacturers. All remaining tariffs on manufacturing inputs and machinery and equipment were eliminated. The majority of these 1,541 tariffs were eliminated on 5 March 2010, with the remainder being gradually eliminated by no later than 1 January 2015.

Deductibility of employee stock options. Amendments were made to prevent both the employer and the employee from taking the deduction for stock options in situations in which employees "cash out" their stock option rights for a cash payment from the employer.

Information reporting of tax avoidance transactions. An "avoidance transaction" will be a "reportable transaction" if it features at least two of three "hallmarks" that commonly exist in a number of complex transactions.

Foreign tax credit generators. New measures target certain transactions that permit Canadian taxpayers to obtain tax relief for foreign taxes in situations in which there are tax arbitrage benefits as a result of the foreign tax treatment of the same transactions. The targeted transactions come in a variety of forms that involve direct or indirect investments by Canadian taxpayers in partnerships with foreign partners, or in foreign affiliates.

TIEAs. Since announcing its support of the TIEA program in 2007, Canada has 1 TIEA in force (Netherlands Antilles as of 1 January 2011) and 10 TIEAs signed but not yet in force. It has entered into negotiations on 14 additional TIEAs as of December 2010.

Harmonized sales tax adopted by British Columbia and Ontario. As of 1 July 2010, British Columbia and Ontario join Labrador, New Brunswick, Newfoundland, and Nova Scotia in harmonizing their provincial sales tax (PST) with the federal goods and services tax (GST). The GST is a form of

value added tax levied on the consumption of goods and services. Its cost is designed to be borne by the ultimate consumer or purchaser.

Pending tax proposals

International taxation. In December 2008, the Advisory Panel on Canada's System of International Taxation released its report. The panel's mandate was to recommend ways to improve the competitiveness, efficiency and fairness of Canada's system of international taxation. The Government is currently studying the recommendations in the report.

Taxation of corporate groups. In November 2010, the Department of Finance released a consultation paper for public comment, describing Canada's existing mechanisms for transferring losses and other tax attributes between related corporations and outlining a wide range of possible new approaches. The approaches range from adoption of a formal loss transfer system to full consolidation within corporate groups.

Foreign affiliates. Draft legislation and comfort letters still outstanding include measures that would affect the taxation of foreign affiliate reorganizations and internal dispositions. Several of the measures would produce very different tax results than under the current rules.

Foreign investment entities (FIEs) and non-resident trusts (NRTs). Proposals issued in August 2010 replaced prior proposals relating to FIEs with several limited enhancements to the current Income Tax Act and sought to better target and simplify the previous proposals relating to NRTs.

Tax treaty developments. The Department of Finance announced that negotiations to update the income tax treaty between Canada and the People's Republic of China would begin in December 2010. Earlier announcements of renegotiations include New Zealand (December 2009), Netherlands (September 2009) and Poland (December 2008). As of 1 December 2010, Canada had 87 bilateral tax treaties in force, 5 treaties that have been signed but are not yet in force (Colombia, Greece, Lebanon, Namibia and Turkey), and 3 amending protocols that have been signed but are not yet in force (France, Italy and Switzerland).

2011 tax rates (as of 1 January 2011)

Top general federal corporate income tax rate	16.5%; provincial general corporate income tax rates vary from 10.0% to 16.0%
Individual top marginal income tax rate	Varies by province from 39.0% to 50.0%
Value added tax rate	Varies by province from 5.0% to 15.0%

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Key drivers

- ▶ The Chilean earthquake triggered tax changes to encourage economic development and generate more resources for reconstruction.
- ▶ Chilean accession to the OECD is resulting in adoption of OECD tax rules.

Outlook

- ▶ There will be an increased focus on cross-border payments, and application of OECD transfer pricing rules.
- ▶ Companies will need to support reorganizations with a strong business case.
- ▶ Chile will be pursuing a progressive adoption of OECD tax rules.
- ▶ Additional tax increases for reconstruction or other major tax changes are not expected.

Political landscape

The Chilean political landscape changed dramatically in 2010 with the 20 January presidential election and the effects of the earthquake and the mining disaster.

After 20 years of center-left governments, President Piñera, representing the right wing, won the election in January 2010 and assumed office on 11 March 2010. The governing coalition (UDI, which represents a more conservative right, and RN, which often exhibits a more liberal approach) has had some disagreements, as has the current opposition coalition.

The next national elections will take place in 2013, when the next president, all the Chamber of Deputies and half of the senators will be elected.

One of the key events of 2010 was the massive earthquake that devastated large parts of the country in February 2010. The earthquake allowed the Government to gain support from the opposition for carrying out its reconstruction policy. However, as months have passed, controversy has arisen about the speed of the reconstruction efforts and efficiency in assigning funds to the most affected regions.

The earthquake also triggered many changes in tax policy to generate more resources for the reconstruction, such as a reduction of the stamp tax rate and a postponement of corporate income tax obligations for small taxpayers.

At the same time, the corporate income tax rate was raised from 17% to 20% for 2011 and 18.5% for 2012 (returning to 17% in 2013).

Although most supporters of the current Government did not support enactment of the mining tax in 2005, the Government has not attempted to repeal it since coming into power. In fact, during its first year in power, the Government permanently increased the tax on large mining companies. The main justification offered for this policy switch was to raise funds for the reconstruction of the country.

President Piñera has named a new Internal Revenue Service (IRS) Director, Julio Pereira. The IRS has issued several instructions that change the current interpretation of important issues. The current tax authority has also been less open to talk with taxpayers when they approach the IRS before reorganizations or to discuss other potentially contentious tax issues.

Current political tax policy leaders and tax administrators

- ▶ President, Sebastián Piñera
- ▶ Felipe Larraín, Treasury Minister
- ▶ Julio Pereira, Internal Revenue Service Director
- ▶ Bernardo Marchant, Large Taxpayers Director
- ▶ Juan Rojas, Normative Internal Revenue Service Director
- ▶ Mario Vila, Juridical Internal Revenue Service Director

Key tax policy changes 2009-10

The Government has implemented changes to tax laws and IRS interpretations over the past two years. In Chile, the IRS has the authority to interpret any tax law and issue instructions thereon by means of the issuance of Rulings and Circular Letters. Some taxpayers and commentators have objected that this change has given the IRS de facto legislative powers.

Law changes:

- ▶ Temporary increase of the corporate income tax rate to 20% in 2011; drops to 18.5% in 2012 and returns to its previous rate of 17% in 2013
- ▶ Permanent reduction in the stamp tax rate (from a 1.2% maximum to 0.6%)
- ▶ Permanent increase in the special mining tax applicable to large mining companies

Interpretation changes:

- ▶ Determination of the tax basis for investments made by limited liability companies
- ▶ Financial profits remittance
- ▶ Accounting and remittance for non-taxable profits

Pending proposals

There are a few pending law projects related to the financial system and regulation of derivative instruments.

A law on the tax treatment of derivatives is pending congressional approval. It has been qualified as urgent, but it is still in its first legislative stage after several months' delay, so the future timing of its consideration is uncertain.

In addition, the IRS has said that the following issues will be subject to new interpretations and regulations: transfer pricing rules, reorganization rules, facilities assessments and tax amortization of goodwill.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	20%
Top individual income tax rate	40%
Standard value added tax rate	19%

Key drivers

Significant legislative and economic changes will be related to economic proposals made by the Government for the next four years, which include:

- ▶ Growing exports and increasing direct foreign investment by more than 50%
- ▶ Entering into free trade agreements with Canada, the EU, Korea and the US
- ▶ Increasing oil production by 75% and carbon production by 70%
- ▶ Increasing integration with Latin American and Caribbean countries, improving relations with Asia Pacific and becoming part of the OECD

Political landscape

The Government of former President Álvaro Uribe lasted between 2002 and 2010. Running on a platform of "democratic security" and confidence for investors, he took a hard-line stance against the guerrillas. In recent years, Colombia has been putting an end to the climate of fear and has managed to create a safer environment by demobilizing and neutralizing paramilitary and guerrilla groups.

During Uribe's presidency, Colombia's economy thrived. Many multinational companies that once steered clear of the country now consider it among Latin America's top markets. With confidence restored, the investment rate rose from 15% of GDP when Uribe took office in 2002 to 25% of GDP at the end of his second term.

In August 2010, Juan Manuel Santos – journalist, economist and politician from the same party as Uribe – was elected to the presidency. In six months, he has formed a coalition government, giving participation to other parties, relaxing the political environment and improving relationships with neighbors such as Venezuela and Ecuador.

Outlook

- ▶ The President pledged not to increase taxes, and that commitment is expected to be honored.
- ▶ There will be continued focus on tax transactions between related parties and increased enforcement of existing taxes on high net worth taxpayers and businesses.
- ▶ Business loopholes will be examined as part of tax simplification and efficiency.
- ▶ There will be an increased focus on controlling and collecting royalties from natural resource operations.
- ▶ The use of information reporting requirements will increase.

A new Congress was also elected in 2010. The "U" party and Conservative Party, which supported the election of President Santos, hold the majority in both the Senate and the House of Representatives.

Because of improved security conditions and tax stimulus, Colombia is now considered an attractive country for foreign investment. Colombia has free trade zones with a 15% income tax rate as well as legal stability contracts that maintain favorable investor legislation for up to 20 years. The main sectors that attract foreign capital are mining, oil and manufacturing.

Current political tax policy leaders and tax administrators

- ▶ Juan Manuel Santos, President
- ▶ Germán Vargas Lleras, Minister of Internal Affairs
- ▶ Juan Carlos Echeverry, Minister of Treasury and Public Credit
- ▶ Juan Ricardo Ortega, National Tax and Customs General Director
- ▶ Bernardo Escobar, National Customs Director
- ▶ Juan Silva, National Tax Director
- ▶ Camilo Rodríguez, National Tax and Customs Legal Director
- ▶ Mario Villadiego, Sub-director, International Fiscalization

Upcoming Tax policy and administration activities: special congressional session (February); ordinary session of Congress (March); local elections (October)

Key tax policy changes 2009-10

Equity tax. The equity tax was extended to 2011, payable in installments over four years through 2014, with a graduated rate up to 6%. The equity tax applies to taxpayers with net equity (total assets less debts) of more than approximately US\$526,000.

Transfer pricing. Transfer pricing penalties were reduced.

Stamp tax. The stamp tax is being phased out.

Withholding tax. A 33% withholding tax was established on interest payments abroad. The rate drops to 14% if the loan is for one year or more.

GMF. The GMF, an indirect tax imposed on transactions made through the finance system, will be phased out over a four-year period starting in 2014.

Asset acquisitions. The special deduction for asset acquisitions was eliminated.

Pending tax proposals

During his campaign, President Santos said that a tax increase is not expected. However, changes to simplify and streamline the tax system will likely be introduced.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	33%
Top individual income tax rate	33%
Standard value added tax rate	16%

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Key drivers

- ▶ The OECD has classified Costa Rica as on the "gray list," i.e., a country that is willing to cooperate with other nations in reducing "harmful tax competition" but that in practice trails other nations in conforming to the OECD model.
- ▶ Costa Rica has signed a TIEA with the US.

Political landscape

Costa Rica's democratic system features a division of power: an executive branch headed by the President and assisted by Cabinet Ministers; a legislative branch formed by Deputies (Congressmen); and a judicial branch comprised of various courts under the Supreme Court of Justice. Members of the executive and legislative branches are elected to four-year terms. The President may not be re-elected to a consecutive term.

Presidential and parliamentary elections were held in February 2010. The former Government supported presidential candidate Laura Chinchilla, who was the vice president during the last administration and won the election with more than 40% of the vote. She began serving her four-year term in May 2010.

The political landscape has changed following the February 2010 elections, with a new Congress being seated in May 2010. The President's party, Partido Liberación Nacional (PLN), holds a majority of seats in the Congress.

Current tax policy leaders and tax administrators

- ▶ Laura Chinchilla, President
- ▶ Luis Liberman, Second Vice President
- ▶ Fernando Herrero, Minister of Finance
- ▶ Jenny Phillips, Vice-Minister of Finance
- ▶ Luis Gerardo Villanueva Monge, President of the Legislative Branch
- ▶ Luis Paulino Mora, President of the Supreme Court

Outlook

- ▶ The recently elected Government has made clear that significant tax reform is on its agenda. The Ministry of Finance has been working on a draft proposal that it shared in late November 2010 with tax policy groups and strategic sectors. The draft proposal was submitted to Congress on 17 January 2011 and is expected to be approved in the first half of 2011.
- ▶ Tax administrators will continue their increased enforcement of existing taxes, targeting high net worth taxpayers and business loopholes.
- ▶ Costa Rica is negotiating exchange of information agreements with Argentina, Australia, Canada, France, Holland, Indonesia, Ireland, Italy, Japan, Mexico and South Africa to improve its OECD qualifications.
- ▶ Bank secrecy for tax purposes may be eliminated.
- ▶ Costa Rica may follow the regional trend of negotiating and signing treaties to avoid double taxation. This could contribute to economic development and raise the possibility of new international loans.

- ▶ Desiderio Soto, Customs General Director
- ▶ Francisco Villalobos, Tax Director of the Costa Rican Tax Authorities

Upcoming Tax policy and administration activities: President's speech before the National Congress (May)

Key tax policy changes 2009-10

Although there have been no major changes in Costa Rican tax policy over the past two years, the following changes are noteworthy.

Tax treaties. The Costa Rican Congress recently approved a tax treaty with Spain.

Residential buildings. On 10 December 2008, Law No. 8683 established a new tax on residential buildings. This tax is applicable to residential buildings for habitual, occasional or leisure use and valued over CRC100 million (approximately US\$196,000). The tax was used to finance government housing grant programs.

Investment. On 22 January 2010, Law No. 8794 was published in the Official Gazette. The law amends the Free Zone Regime Law with the objective of

generating more productive investment in the country, promoting investment in less developed areas and complying with the World Trade Organization (WTO) agreements on this matter.

Pending tax proposals

Bank secrecy. On 27 May 2010, the executive branch sent Congress a draft bill that would eliminate bank secrecy for tax purposes in order to improve its OECD qualifications.

New taxes. On 2 September 2010, the executive branch sent Congress a draft bill creating an annual tax of US\$200 for active legal entities that have been registered in the Mercantile Registry.

Tax reform. On 17 January 2011, the executive branch sent Congress a draft bill for significant tax reform. The tax reform is likely to increase business taxation and includes a number of important provisions, including:

- ▶ New provisions for the taxation of capital gains (currently not subject to tax) at a 15% rate

- ▶ Elimination of the withholding exemption available under Section 61 of the Costa Rican Income Tax Law (ITL), which currently indicates that in the case of taxes on profits, dividends and equity stakes, interests, commissions, financial expenses, patents, royalties, reinsurance and insurance premiums of any kind referred to under Section 54 of the ITL, the Costa Rican tax authorities may grant a partial or total tax exemption when the recipient entity or its withholding agent can prove that the recipient cannot obtain a credit or deduction in its country of residence for the taxes paid in Costa Rica
- ▶ A single withholding tax rate of 15% for most payments abroad
- ▶ Introduction of transfer pricing rules and related party definitions

- ▶ Replacement of the current general sales tax with a VAT, under which all services will be taxable and only a reduced amount of merchandise will be exempt

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	30%
Top individual income tax rate	15%
Standard value added tax rate	13%

Dominican Republic

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Key drivers

- ▶ Deficit reduction and pursuit of foreign investment

Outlook

- ▶ The Government will work to restrain spending.
- ▶ Deficit reduction may include elimination of certain fiscal exemptions.
- ▶ The tax authority will implement more aggressive anti-avoidance rules.
- ▶ The tax authority will focus on high net worth taxpayers and businesses.

Political landscape

In May 2010, new senators and representatives of the National Congress were elected, and the governing party, Partido de la Liberación Dominicana (PLD), and its allies gained control. The PLD won 32 out of 33 Senate seats and almost obtained a majority in the House of Representatives.

The Constitution was amended in January 2010, and re-election of the President was expressly prohibited. However, there is still debate over whether President Fernández will run for a fourth term in 2012. Last November, a group of 26 senators published a letter expressing their full support for President Fernández. However, there are eight or more potential candidates, both from the PLD and from the opposition, preparing their presidential campaigns. The friction from this debate will make 2011 a politically contentious year.

Among other relevant constitutional amendments was the creation of a Constitutional Court empowered to interpret and resolve constitutional issues. The members of the new court will be elected by the National Judiciary Council, which is composed of seven members, most of them from the governing PLD.

After signing a US\$1.7 billion standby agreement with the IMF, the Dominican Republic is projected to grow between 5.5% and 6% in 2011. The IMF recommended that the central

Government cut expenses in social and electric energy subsidies, construction, and administrative expenses, and eliminate some tax benefit regimes. Currency exchange control and inflation rates will help drive the Government's economic policies.

No significant tax reform is foreseen for 2011; however, it is expected that the tax authority will continue to implement targeted anti-evasion measures.

Current tax policy leaders and tax administrators

- ▶ Leonel Fernández, President
- ▶ Temistocles Montás, Minister of Economy, Planning and Development
- ▶ Vicente Vengoa, Minister of Treasury
- ▶ Germania Montás Yapur, National Director of the Tax Authority
- ▶ Rafael Camilo, National Director of the Custom Agency
- ▶ Felix Bautista, President of the House of Senate Economy, Planning and Development Committee
- ▶ Rafael Calderón, Vice President
- ▶ Tommy Galán, Secretary
- ▶ Marino Antonio Collante, President of the House of Representatives Treasury Committee
- ▶ Felix Castillo, Vice President
- ▶ Hugo Nuñez, Secretary

Upcoming Tax policy and administration activities: President speaks before the National Congress (February and August); President's FY2012 budget proposals (November)

Key tax policy changes 2009-10

No significant broad-based tax legislation was introduced in 2009-10. However, the tax authority issued several regulations implementing anti-avoidance measures. Norm 2-10 established the tax assessment procedure on behalf of the tax authority. Decree 408-10 regulated the tax-free reorganization procedure before the tax authority as well as other anti-avoidance provisions.

Pending tax proposals

Currently, the National Congress (House of Representatives and Senate) is rushing to comply with the terms established in the new Constitution to create and renew institutions (e.g., Electoral Board, Constitutional Court, Audit Chamber).

A bill for the amendment of Law 8-90, which establishes a free trade zone regime to comply with WTO requirements, is pending approval.

The opposition party, Partido Revolucionario Dominicano, has a well-established record of supporting higher income tax and VAT rates. The fate of tax reform depends on the results of the 2012 presidential election.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	25%
Top individual income tax rate	25%
Standard value added tax rate	16%

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Key drivers

- ▶ By executing its first income tax treaty, El Salvador has become part of the international tax community.
- ▶ Free trade agreements with a number of countries are being reviewed.

Outlook

- ▶ To comply with WTO regulations, Congress repealed the income tax 6% drawback benefit for those who export their products.
- ▶ New regulations that include important tax benefits are expected to promote foreign direct investment.
- ▶ New transfer pricing rules, which are not completely aligned with OECD standards, will be introduced.

Political landscape

The political landscape changed following the March 2009 election, when Frente Farabundo Martí para la Liberación Nacional (FMLN), the left-wing political party, won for the first time after 20 consecutive years of leadership by Alianza Republicana Nacionalista (ARENA), the right-wing political party. The vote was 51.3% for the FMLN and 48.7% for ARENA. Additionally, FMLN won 35 out of the 84 seats in the Legislative Assembly.

The next national election for president will be held in March 2014, and the Legislative Assembly will be chosen in March 2012. The presidential term is five years, and no re-election is permitted.

Current tax policy leaders and tax administrators

- ▶ Carlos Mauricio Funes, President
- ▶ Alexander Segovia, Technical Secretary to the President
- ▶ Carlos Enrique Caceres, Finance Minister
- ▶ Carmen Elena Pineda Colorado, Director of Internal Taxes
- ▶ Carlos Alfredo Cativo, General Customs Director

Upcoming Tax policy and administration activities: President's speech before Congress (February); Secretary of Finance's speech before Congress (February)

Key tax policy changes 2009-10

Significant tax reforms in El Salvador went into effect in January 2010. The following are the most relevant amendments to the tax legislation.

Income earned abroad. Income earned abroad will now be taxed under some circumstances if the income is generated by securities, financial instruments or derivative contracts; when the issuer entity is a national entity or domiciled in El Salvador; the capital is invested or employed in El Salvador; or the risk assumed is placed or located within the Salvadoran territory. Additionally, interest income from bank deposits abroad will be taxable, though tax crediting rules will apply.

Transfer pricing. Comparability elements for transfer pricing transactions were introduced. Items such as business strategies, economic circumstances, contractual conditions, characteristics of the operations, analysis of employed assets and analysis of risks assumed by each party involved in the transaction should be considered. The following should also be considered when applying the comparability elements: (i) payment term; (ii) quantities; (iii) marketing and advertising; (iv) intermediation costs; (v) accommodation, freight and insurance; (vi) physical nature and content of the item(s); and (vii) execution date of the contracts.

Tax havens. A definition of tax havens (e.g., preferential tax regimes, null or low-tax jurisdictions) was introduced. Tax havens are defined as jurisdictions where there is no income tax or the corresponding income tax rate over net income is less than 80% of the Salvadoran income tax rate, and jurisdictions classified as tax havens by the OECD and the Financial Action Task Force.

Capital income. Some types of previously non-taxable capital income are now taxable. Before the 2010 changes, interest payments made to non-domiciled financial institutions that were qualified as "International Financial Institutions" by the Salvadorian Bank were not subject to withholding tax. Under the new law, this interest income is now taxable. However, non-domiciled financial institutions that were qualified by the Salvadorian Central Bank (SCB) prior to these amendments and maintain that qualification will continue to pay tax-exempt interest until the country in which the financial institutions are domiciled have legal mechanisms to avoid double taxation or sign tax treaties with El Salvador. Individuals' income and gains derived from investments – the sale, exchange, barter or disposal of shares, bonds or other securities – realized through a legal stock exchange and duly registered within and approved by the stock market and the Superintendent of Securities are now taxable. In addition, interest, premiums and other yields derived directly by individuals from bank deposits whose monthly average is equal to or exceeds US\$25,000 are now taxable.

Reporting requirements. A new asset statement reporting requirement applies. Individuals who are subject to taxes and earn income or own assets above certain thresholds must file an asset statement with their income tax returns. Individuals who earn income equal to or less than 362 minimum monthly salaries (approximately US\$75,000) in a tax year, or have real estate assets whose value is equal to or less than 1,446 minimum monthly salaries (approximately US\$300,000) are exempt from this requirement.

Withholding rates. Reduced withholding rates apply for international transportation services; services provided by Insurance and Reinsurance Companies; and payments related to the use of some tangible and intangible property such as films, videotapes, phonograph records, radio dramas, soap operas, novels and comics by any means of reproduction, recording videos or tracks, transmission of television programs via cable, satellite or other similar systems.

Pending tax proposals

The following tax proposals have been unofficially discussed:

- ▶ A tax on dividend distributions, which are currently exempt
- ▶ A single tax applicable to small taxpayers
- ▶ An individual asset tax based on equity holdings

2011 tax rates (as of January 1, 2011)

Top corporate income tax rate	25%
Top individual income tax rate	25%
Standard value added tax rate	13%

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Key drivers

- ▶ Guatemala is on the OECD's "gray list" as a country willing to cooperate in the effort to reduce "harmful tax competition," but trails other nations in conforming to the OECD model.
- ▶ The presidential election in November 2011 may defer the approval of any tax reform proposals currently on Congress's agenda.

Political landscape

The current President and members of Congress were elected in 2007, and their four-year terms will end in November, when the next national elections are to be held.

Even before that election, the new Constitutional Court must be elected by the end of March 2011. Many expect the current first lady, Sandra Torres de Colom, and former President Alvaro Arzu to run in November. The legality of their candidacies is in doubt, however, and both the Supreme Court and the Constitutional Court will decide this contentious matter.

Current tax policy leaders and tax administrators

- ▶ Álvaro Colom Caballeros, President
- ▶ José Rafael Espada, Vice President
- ▶ José Roberto Alejos Cámbara, President of the Legislative Branch
- ▶ Luis Arturo Archila, President of the Supreme Court
- ▶ Roberto Molina Barreto, President of the Constitutional Court
- ▶ Alfredo Rolando Del Cid Pinillos, Minister of Public Finance
- ▶ Rudy Baldemar Villeda Vanegas, Superintendent of the Tax Authority

Upcoming Tax policy and administration activities: first session of Congress (January-May); second session of Congress (August-November); general elections (November)

Outlook

- ▶ Major tax policy changes are not expected to take place during 2011.
- ▶ Guatemala intends to start negotiations of exchange of information agreements with Argentina, Canada, France, Mexico and the Netherlands to improve its OECD qualifications.
- ▶ The Government has announced efforts to eliminate bank secrecy for tax purposes.
- ▶ A Government effort to eliminate bearer shares issued by corporations is expected.
- ▶ The Government intends to introduce transfer pricing rules and an extended source principle of taxation (e.g., to tax some offshore transactions).
- ▶ Guatemala may follow the regional trend of negotiating and signing treaties to avoid double taxation, which could contribute to economic development and raise the possibility of new international loans.

Key tax policy changes 2009-10

No major tax changes have taken place in Guatemala during the past few years. However, the Government has enacted some minor changes that could be relevant for 2011. For example, the Government created a new exemption from the financial products tax (i.e., 10% tax on interest income earned by domiciled taxpayers not subject to the supervision of the banks' authorities) for legally authorized cooperatives, provided that all their income and assets are exclusively used for their core business purpose and that no benefits, profits or goods are distributed among their members.

In January 2010, the tax authorities issued a resolution that contributions to pension funds contracted by financial institutions would not be accepted as deductible expenses for employees. However, in October 2010, the Constitutional Court decided to temporarily suspend the resolution issued by the tax authorities until a definitive decision is taken.

Because the Government has had difficulties implementing tax reform, it has issued bonds to finance its budget.

Pending tax proposals

Since 2008, the Government has been discussing several proposals to amend the tax laws. The proposals have included: (i) an extended source principle of taxation (e.g., to tax some offshore transactions); (ii) transfer pricing regulations; and (iii) an increase in income tax, solidarity tax, stamp tax and VAT rates.

The last proposal that was submitted to the Congress in February 2010 includes the following amendments to the tax laws.

Active trade or business income.

Income generated from an active trade or business would be taxed under the territorial principle of taxation: simplified regime (7% of income rate); lucrative taxpayers regime (25% of income rate).

Employment income. Employment income would also be taxed under the territorial principle.

Passive income. Passive income earned by Guatemalan residents would be subject to local taxation if obtained either within or outside the country.

Other changes. The proposal currently under discussion also contains a specific set of rules for: defining residence, income taxation on dividend distributions, imposing capital gains taxes on direct and indirect transfers of stock in specific situations (e.g., 10%, including dividend withholding tax).

Since February 2010, the executive and the legislative branches have circulated unofficial drafts of other tax reform proposals aimed at obtaining additional financial resources and alleviating the fiscal deficit. In addition to the tax reform proposals, the executive branch has been working on draft proposals that would eliminate bank secrecy for tax purposes and the ability of corporations to issue bearer shares.

It is uncertain which of the proposals will succeed. However, with the upcoming 2011 elections, any attempt at tax reform could be stalled until the new Government takes over.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	31%
Top individual income tax rate	31%
Standard value added tax rate	12%

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Key drivers

- ▶ The economic downturn has increased the need for higher tax revenues.
- ▶ Focus on a number of non-tax issues is likely to overshadow tax policy changes.

Outlook

- ▶ The tax authorities will continue their focus on increased enforcement of existing taxes, with particular attention paid to high net worth taxpayers.
- ▶ The Government will focus special attention on existing tax exemptions.
- ▶ Official approval of transfer pricing regulations and tax code amendments that would increase penalties for late filing and payment is pending, but is not certain to occur in 2011.

Political landscape

The political landscape changed following the November 2009 elections, with the National Party gaining a majority in the National Congress. Since his inauguration in January 2010, President Porfirio Lobo Sosa has taken important steps indicating his Government's commitment to human rights, including the appointment of a special advisor for human rights issues. He has also shown concern for the worldwide economic crisis, which has affected the Honduran economy and resulted in a crisis over the public finances.

2011 is a non-election year in Honduras. The next national election will be in November 2013, when the President, all of the members of the unicameral Congress, and all the mayors of the municipalities in the country's 18 departments will be chosen. President Sosa is barred from running for re-election by the Honduran Constitution.

Tax policy will be shaped by officially approving transfer pricing regulations for 2011 and amendments to the tax code that will result in higher penalties for late filing and payment of tax returns.

Current tax policy leaders and tax administrators

- ▶ Porfirio Lobo Sosa, President
- ▶ William Chong Wong, Finance Secretary
- ▶ José Oswaldo Guillén, Income Executive Director
- ▶ Javier Hernández, Internal Revenue Director

Tax policy and administration activities: Congress returned to session 17 January 2011.

Key tax policy changes 2009-10

Significant tax legislation included: (i) strengthening of the public finances to support health, education, national security sectors and other vulnerable groups of the population; (ii) elimination of some tax exemptions; (iii) an increase in the non-deductible temporary social contribution tax rate to 10% on net income; and (iv) a decrease in the income tax withholding rates applicable to payments made to non-residents.

Pending tax proposals

The FY2011 budget was approved in December 2010. Income tax collections constitute one of the most important parts of financing the country's economic development. For FY2011, income tax collections are estimated to be approximately 66.5% of the total amount of the budget. That estimate reflects a growth rate of 15.7% relative to FY2010, which was affected by measures aimed at economic slowdown. The growth rate is expected through strong economic performance, resulting in higher income and sales tax collections.

Transfer pricing regulations and tax code amendments to increase penalties for late filing and payment are pending, but may not be approved in 2011.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	25%, plus 10% social contribution tax on net income
Top individual income tax rate	25%
Standard value added tax rate	12%

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Key drivers

- ▶ Whether the tax consolidation regime enacted in 2010 will be made permanent or revoked through legislation or litigation.
- ▶ The Mexican Government has expressed a desire to provide stability to taxpayers, after recent major reforms that increased income tax and VAT rates.

Political landscape

Since 2009, the Partido Acción Nacional (PAN) has held 143 seats in the Chamber of Deputies, while the opposition holds 357 seats. The opposition leader is the Partido Revolucionario Institucional (PRI), which holds 243 seats.

The Senate (128 seats in total) is led by the PAN, which holds 50 seats, while the opposition holds 78 seats. The opposition leader is the PRI, which holds 33 seats; its close ally, the Partido Verde Ecologista de Mexico (PVEM), holds 6 seats. The Senate is elected every six years.

2011 is expected to be a rather tranquil election year because there will only be 6 (out of 32) elections for governors and local (municipal) governments. The most important of these elections will be in the State of Mexico, which is currently governed by Enrique Peña Nieto (PRI). Nieto leads in polls among potential presidential candidates within the PRI, and polls also show the PRI as the preferred party leading into the 2012 presidential election. As a result, the elections in the State of Mexico are regarded by some political analysts as representative of the 2012 general election. Because direct re-election is not allowed in Mexico, President Felipe Calderón (PAN) and every member of the Senate and Chamber of Deputies will stand down in 2012.

With the upcoming general elections in 2012, most budget discussions are about which party will control the budgets of state and municipal governments over

Outlook

- ▶ Taxpayers should monitor a new tax reform proposal, submitted to the Mexican Congress by a senator from the Partido Revolucionario Institucional political party (PRI). If enacted into law, the tax reform bill could simplify certain aspects of the tax system, but would increase the overall tax burden of businesses in Mexico.
- ▶ The new tax consolidation regime in force since January 2010 is being challenged in court. This litigation could diminish the tax authority's audit intensity and other enforcement actions.
- ▶ Tax treaties, both new and renegotiated, will provide opportunities for companies to structure their businesses', operations in Mexico.
- ▶ The Government will likely continue auditing large taxpayers with transactions that have been identified by the revenue service as aggressive. Companies should keep close track of any audit action.
- ▶ The requirement for large taxpayers to issue electronic invoices will give the tax authorities a new enforcement tool. Taxpayers will need to maintain or enhance their current efforts to implement the change. It remains to be seen how the tax authorities will use the electronic invoices to monitor and audit taxpayers.

the next year and a half. To gain as many votes as possible in the elections, the political parties will most likely attempt to put control over the budgets and allowances in the hands of the local authority.

Current tax policy leaders and tax administrators

- ▶ Felipe Calderón, President
- ▶ Ernesto Cordero, Secretary of Finance and Public Credit
- ▶ Alfredo Gutierrez Ortiz Mena, Head of the Internal Revenue Service (SAT)
- ▶ José Antonio Gonzalez Anaya, Under Secretary of Revenue
- ▶ Mario Becerra Pocosoroba, Chairman of the Finance Commission, Chamber of Deputies
- ▶ José Isabel Trejo, Chairman of the Finance Commission, Senate
- ▶ Juan Carlos Rizo, Head of the Large Taxpayers Division

Upcoming Tax policy and administration activities: President submits FY2012 budget proposal to Congress (September); Congress approves the Income Act for FY2012, and the Chamber of Deputies approves the 2012 budget (November); the Income Act and Budget Law for FY2012 enter into force (1 January 2012).

Key tax policy changes 2009-10

The 2009 budget included amendments to the law for a few minor tax incentives. The 2009 minor changes followed the budget of 2008, which introduced highly controversial changes, the main one being the new minimum tax, the flat rate business tax (IETU).

In contrast to 2009, the 2010 budget included major tax reform provisions, which became effective 1 January 2010. The provisions included a 2-percentage-point increase in the income tax rate, a highly controversial change to the tax consolidation regime that required taxpayers to recapture benefits obtained in the consolidated return, and increases in the rates for the VAT and the tax on cash deposits (IDE).

VAT increase. The VAT changes, though seemingly favorable to taxpayers, could complicate tax compliance substantially during the transition. When the VAT rates previously increased to 16% and 11% from 15% and 10%, taxpayers faced significant administrative complexities for business transactions that occurred close to the time the changes took effect. For transactions that were initiated under the previous rates but were completed/

paid at the time the new rates came into effect, taxpayers faced complexities in their accounting systems as well as in their compliance paper stream. Companies' tax departments spent a great deal of time resolving this issue.

IMMEX. On 24 December 2010, after many months of speculation, and almost a year after proposed draft modifications were originally made available for public comment, numerous modifications to the IMMEX (formerly Maquiladora) Decree were published in Mexico's *Official Gazette*. As part of the modifications, a revised version of Article 33 of the Decree redefines what qualifies as maquiladora activities for purposes of a number of existing taxes, such as income tax, flat rate business tax and transfer pricing incentives. The changes became effective on 1 January 2011.

Compared with the proposed draft IMMEX Decree that was published on 14 January 2010, the enacted Article 33 of the IMMEX Decree is less stringent. For example, it does not require a majority of raw materials be imported (rather than locally sourced) to qualify for the definition of maquiladora activities. However, the new Decree requires at least 30% of the machinery and equipment used in the maquiladora operations be owned by the foreign-resident principal. Companies that operated under a toll manufacturing model before 31 December 2009 and applied the IMMEX program, as well as the maquiladora transfer pricing methods, are grandfathered.

In an effort to provide stability to taxpayers, a budget proposal for FY2011 was recently approved by Congress with very limited changes to existing tax laws. It became law on 1 January 2011.

Pending tax proposals

Tax treaties. The Government is renegotiating most of its existing tax treaties to increase taxes and close identified loopholes (e.g., the exemption available for capital gains on non-residents selling Mexican shares under certain treaties). It is also looking to align the exchange of information and collection assistance clauses in Mexico's existing tax treaties with OECD guidelines. The Government will continue negotiating tax treaties with countries regarded as tax havens by the Mexican tax authorities – examples include recently completed treaties with Barbados, Panama and Uruguay.

Tax consolidation regime. Whether the tax consolidation regime should be made permanent or revoked is an issue that may be discussed in the legislature during 2011. The tax consolidation regime allows qualifying groups to consolidate the tax results of various entities in one holding company. One of the opposition parties, the Partido de la Revolución Democrática, wants the regime to be abolished, saying it allows the largest industrial groups to defer payment of tax to the detriment of the rest of taxpayers, who cannot defer payment of tax as a general rule. The 2010 budget proposal included significant changes to the consolidation regime in Mexico that were made effective 1 January 2010. These changes include an obligation for

taxpayers to recapture the benefits obtained under this regime at the end of a five-year period.

Before the 2010 reform, taxpayers filing a consolidated tax return were required to recapture losses at the end of 10 years if the entity that incurred the loss did not generate taxable income sufficient to cover the loss during that period. All other consolidation benefits were subject to recapture only in the event of a partial or full deconsolidation. The requirement to recapture losses after 10 years was introduced in 1999. Therefore, the changes introduced in 2010 triggered an obligation for many large groups to book a deferred tax for certain benefits obtained in prior years through the consolidation regime and to pay tax in 2010. Many taxpayers are challenging this reform in the courts, and thus far the courts appear to agree with the taxpayers' position that the 2010 reform was retroactive and, therefore, invalid. It remains to be seen how higher courts will rule, but their decisions will likely influence future reform proposals.

VAT changes. The PRI presented a proposal to reverse the VAT rate changes. This proposal was discussed only briefly in the Chamber of Deputies in 2010, but because of the political climate and the coming elections in 2012, taxpayers will need to monitor this proposal, as well as any other proposal on this topic submitted to Congress in 2011.

Tax reform. A comprehensive tax reform bill was submitted by a senator from the PRI to the Mexican Congress in March. To simplify the corporate tax, the proposed reform would eliminate the current flat rate business tax (IETU). However, the proposed reform would adopt certain of the characteristics of the IETU into the income tax by changing the basis for recognizing income and expenses to a cash basis as well as by making salary payment relief through a credit and denying deductions for royalty payments. Other key proposals include imposition of a 10% tax on dividend payments at the corporate level, a 5 percentage point reduction in the corporate income tax rate by 2015, and a broadening of the VAT base to include all but the most basic of food and medicine, with a provision allowing individuals to recover a portion of the tax paid on reported transactions. As currently drafted, the reform proposal would have an effective date of January 1, 2013. The bill is in the beginning stages of the Mexican legislative process. Congressional approval from both houses is needed before the bill could be submitted to President Calderon for approval.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	30%
Top individual income tax rate	30%
Standard value added tax rate	16%

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Key drivers

- ▶ Progress is being made in tax and customs administration. A work schedule has been initiated with the assistance of the Center of Regional Technical Assistance oriented toward (i) strengthening control procedures, (ii) improving the procedures to control and accelerate the refund payment process and (iii) centralizing the performance of the large taxpayers unit.
- ▶ The pension regulator issued a report showing alternatives to improve the financial position of the system and correct the deficit.

Political landscape

Elections are scheduled for 6 November 2011. Voters will elect the President and Vice President, national deputies and members of the Central American Parliament.

Current tax policy leaders and tax administrators

- ▶ Daniel Ortega Saavedra, President
- ▶ René Núñez, President of the National Assembly
- ▶ Antenor Rosales Bolaños, President of the Central Bank of Nicaragua
- ▶ Alberto José Guevara Obregón, Ministry of Finance
- ▶ Walter José Porras Amador, Revenue General Director
- ▶ Eddy Francisco Medrano Soto, Customs General Director
- ▶ Marlon Brenes Vivas, President of the Administrative Tax Court
- ▶ Walter José Porras Amador, Revenue General Director
- ▶ Eddy Francisco Medrano Soto, Customs General Director

Upcoming Tax policy and administration activities: Presidential candidates published (March).

Outlook

- ▶ The Government will continue its efforts to strengthen the pension and tax system, address the sustainability of the public finances and attend to the country's social and infrastructure needs.
- ▶ Pension investment regulation will be reviewed to ensure that the management is in accordance with the best international practice.
- ▶ Tax alternatives will be evaluated as part of the rationalization of tax exemptions.
- ▶ Transfer pricing regulations are expected.

Key tax policy changes 2009-10

The amendment to the Fiscal Equity Law approved by the Plenary Congress was published in the *The Gazette* on 21 December 2009. Subsequently, the regulations were published on 30 December 2009 and were effective beginning 1 January 2010. The amendment made income tax, VAT and excise tax changes.

Minimum tax. A Minimum Payment Tax (IPM) replaces the minimum tax equal to 1% on assets with a minimum tax equal to 1% on annual gross income (statutory exemptions were retained).

Withholding. A permanent withholding tax was established at a 10% rate for: (i) dividends and profit shares; (ii) interest earned, received or accredited by deposits placed in authorized financial institutions; and (iii) interest received from Nicaraguan sources by non-resident persons (outside the financial system). This is a final withholding tax that should be excluded from taxable income. Other withholding taxes created by the amendment include a 10% tax rate for stock transactions in financial instruments, a 1.5% tax rate for primary agricultural goods and a 2% tax rate for other goods traded in the agricultural sector. Transactions up to an annual amount of NIO60 million are subject to final withholding. Transactions in excess of NIO60 million are creditable against payments of annual income tax. If the withheld taxes are greater than the annual income tax, they will be considered final withholding.

A withholding tax of 1% also applies to the sale of goods and services that are paid with debit or credit card. This 1% should be withheld by the financial institution when payments are made to the local vendors (affiliated establishment).

Employment taxes. The employment income exempt base has increased to N175,000 (approximately US\$3,600).

Sale of property. Occasional income from the sale of property is subject to tax with a tax base equal to the value of the asset or the property valuation, whichever is greater. Transmission of movable or immovable property subject to registration (capital contributions in shares or temporary corporate contributions) is taxable on the surplus capital gains from property valuation over the cost of such asset. If it is not possible to determine the value of the property, then it shall be presumed that net income is 20% of property valuation. The amendment increases the withholding tax rate for the transmission of goods subject to registration as follows: 1% on goods valued up to US\$50,000, 2% for goods valued between US\$50,001 and US\$100,000 and 3% for goods valued at US\$100,001 and higher.

VAT changes. Large taxpayers are required to pay the VAT every 15 days. The first tax return, which includes day 1 to day 15 of the previous month, should be filed within the first 5 days of the following month. The second return, which includes days 16 to 30, should be filed within the next 5 days after the 15th of each month.

Excise tax. The credit for the selective consumption tax when goods are used to make exempt supplies was modified. The tax base for the transfer of oil and cigarettes was also modified.

Pending tax proposals

On 30 November 2010, Congress approved a 2011 budget of \$1.64 billion, an increase of 10.8%, with a fiscal deficit of \$268 million. The IMF extended its credit agreement with Nicaragua through December 2011, allowing the Government to follow through on the objectives established in its budget. Among the commitments assumed with the IMF, the Government must continue to apply cautious fiscal policy in 2011.

Because 2011 is an election year, issues such as tax reform are not included in the national agenda. After the elections, discussions on such topics may resume.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	30%
Top individual income tax rate	30%
Standard value added tax rate	15%

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Key drivers

- ▶ The new Government considers Panama's compliance with international tax standards to be a top priority.
- ▶ The new TIEA with the US may unblock ratification of their Bilateral Free Trade Agreement, which has been stalled since 2007. The agreement allows the exchange of tax information retroactive to 30 November 2007.
- ▶ The expansion of the Panama Canal, combined with the anticipated free trade agreement with the US, is expected to boost and extend economic expansion for some time.

Political landscape

Ricardo Martinelli, of the Democratic Change Party, who was elected President with more than 60% of the vote, took office on 1 July 2009. The next national election will be in May 2014, when the President and the Vice-President will be elected to five-year terms by direct popular vote. Re-election is not permitted in Panama.

The political scenario changed significantly with the May 2009 elections. The new Government includes many ministers who have business backgrounds. The Government has introduced a variety of amendments to Panama's fiscal code and has also created a Tax Administrative Tribunal, which began work in January 2011.

There have been major tax reforms that, according to the Government, are designed to simplify the tax code to increase efficiency and make the tax system friendlier to business. In certain situations, corporate taxes have been reduced.

Outlook

- ▶ The simplification and reduction of individual and corporate tax rates that started with a tax reform effort in 2010 will likely continue.
- ▶ Panama will continue to focus on taxing certain sectors to reduce perceived inequality.
- ▶ Transfer pricing rules may be extended to apply beyond treaty countries.
- ▶ Additional tax treaties containing exchange-of-information provisions are being pursued and could result in Panama being removed from the OECD's "gray list."
- ▶ Panama has completed income tax treaties with 14 countries and is looking to sign many new treaties in 2011.

The Panamanian economy has been among the fastest-growing in Latin America. Economic growth is likely to help Panama make further progress in reducing persistent poverty.

Current tax policy leaders and tax administrators

- ▶ Ricardo Martinelli, President
- ▶ Juan Carlos Varela, Vice President and Minister of Foreign Relations
- ▶ Demetrio Papadimitriou, Minister of the Presidency
- ▶ Alberto Vallarino Clement, Minister of Economy and Finance
- ▶ Dulcideo de la Guardia, Finance Vice-Minister
- ▶ Frank George de Lima, Economy Vice-Minister
- ▶ Roberto Henríquez, Minister of Commerce and Industries
- ▶ Luis Cucalon, Internal Revenue Service Director
- ▶ Alcibiades García/Marta Gomez, Treasury Director

Upcoming Tax policy and administration activities: presidential election (May 2014)

Key tax policy changes 2009-10

The tax reform law of 15 March 2010 contained comprehensive amendments to Panama's tax code, including a reduction in the corporate and individual income tax rates and an increase in the VAT rate from 5% to 7%. The 2010 tax reform, which generally took effect 1 July 2010, reduced the corporate and individual income tax rates retroactive to 1 January 2010.

This is the second in a set of tax reforms within six months, as the Government seeks to collect revenue to fulfill its education, health and social projects. Law No. 49 of 2009, which became effective in September 2009, introduced a preliminary reform of the taxation of dividends derived from foreign source income and from companies located in one of Panama's free zones.

Corporate income tax rate. The 2010 tax reform reduced the corporate income tax rate for many entities to 27.5% beginning 1 January 2010, and to 25% beginning 1 January 2011. The corporate income tax applies to corporations, limited liability companies, partnerships, branches of foreign corporations and any other entity considered a person under the law. These entities also are required to make an alternative calculation of taxable income for purposes of the Panamanian alternative minimum tax (CAIR).

The CAIR is calculated on a percentage of gross taxable revenue considering the income tax liability for the year. Taxpayers can request non-application of CAIR if they have net operating losses or if their effective tax rate is higher than the nominal tax rate. The CAIR calculation does not apply for companies with taxable income of less than US\$1.5 million.

A 30% income tax rate will remain in effect for two years for entities engaged in the insurance and reinsurance business, banking services, certain financial services, the generation and distribution of electricity, telecommunications services, gaming and casinos, mining and the production of cement. This rate will be reduced to 27.5% on 1 January 2012 and to 25% on 1 January 2014 for these entities. The same rates will apply to a subsidiary and/or affiliated company whose main activity is to provide services to one of the above entities. Companies in which the Government holds more than a 40% interest will remain subject to the 30% income tax rate.

Monthly advance income tax. Starting on 1 January 2011, legal entities must pay an advance income tax equivalent to 1% of their total taxable income for each month, which should be submitted within the first 15 calendar days following the previous month.

Personal income tax rate. The 2010 tax reform both simplified and reduced the tax rates for individuals to a range of 0% to 25%. The reform reduced the regime's four income bands to two. In addition, changes were made to the taxation of expatriates; previously, foreign individuals were subject to payment of income tax according to parameters established in the tax code when they stayed for at least 180 consecutive or alternating days within Panamanian territory. That period has now been extended to 183 days. In addition, deductions for foreign individuals were reduced, and some deductible expenses were repealed.

Dividend taxation. The 2010 tax reform clarified when a distribution of dividends is subject to tax and specifically indicates the situations that trigger the tax. As part of 2009 tax reform, all companies that have a "Notice of Operations" are required to withhold a 10% tax on dividends paid out of domestic profits and a 5% tax on dividends paid out of foreign-source profits. Companies located in a Panamanian free zone must pay a 5% dividend tax on the distribution of profits, regardless of the source of the profits (and also must pay the Notice of Operations Tax).

Under the 2010 amendments, dividend tax withholding will apply not only when an entity holds a Notice of Operations permit (which previously was the only condition under which this tax applied) but also if it generates taxable income in Panama or carries on operations in the Colon Free Trade Zone or a Petroleum Free Zone. Companies operating under the Multinational Headquarters Law (SEM), certain companies operating in the Panama Pacific Special Economic Area (Howard)

and Panamanian offshore companies (whose operations are completed, used or take place abroad) are exempt from the dividend tax. The new rules also provide that, when a tax treaty applies, the treaty provisions will prevail over domestic legislation.

VAT. The VAT, which is assessed on the provision of goods and services, increased from 5% to 7% beginning 1 July 2010.

Notice of operations tax. The 2009 tax reform increased the maximum amount payable for the Notice of Operations Tax from US\$40,000 to US\$60,000. It also sets a yearly rate of 1% on the capital of the corporation for legal entities established in the Colon Free Trade Zone or in any other free zone within the country, with a minimum of US\$100 and a maximum of US\$50,000.

Transfer pricing. Law No. 33 of 2010 established permanent establishment and transfer pricing rules.

Pending tax proposals

TIEAs. The US and Panama on 30 November 2010 signed a TIEA, a step that may unblock the ratification of their Bilateral Free Trade Agreement, which has been held up since 2007. The agreement will allow the exchange of tax information retroactive to 30 November 2007.

Information exchange. On 1 February 2011 in Law No. 2, modifications were made to Law No. 32 of 1927 related to corporations. The modifications require resident agents (Panamanian lawyers) to keep a record of who owns bearer shares. This legislation was necessary for the implementation of taxpayer information exchange under the 2010 TIEA with the United States and for the double taxation treaties Panama is in the process of negotiations (14 in total as of March 2011). A key objective of the Panamanian Government is to be removed from the OECD's "gray list" in 2011 and the new legislation is a key supporter of these efforts.

Transfer pricing. Transfer pricing rules, which are currently only applicable to treaty countries, may be extended to all taxpayers.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	25%*
Top individual income tax rate	25%
Standard value-added tax rate	7%

*Except for companies within sectors noted above

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Key drivers

- ▶ The Government is evaluating alternatives to make the Peruvian tax system more competitive.
- ▶ In light of a declining number of taxpayers, the Government is evaluating alternative ways to add more taxpayers to the tax register.

Political landscape

The October 2010 local elections led to major change, with 18 of the 25 regions, including the capital, Lima, won by independent parties, most of them leftist. The traditional parties won in only seven regions.

2011 is an election year in Peru, with the general election scheduled to take place on 10 April 2011. The presidential election will determine the successor to Alan García, as well as the members of Congress and of the Andean Parliament.

There are several right-wing, centrist and left-wing candidates running for office. Currently, two right-wing political parties and a centrist party lead the polls. The right-wing parties are Solidaridad Nacional (National Solidarity), led by former Lima Mayor Luis Castañeda Lossio, and Fuerza 2011 (2011 Force), led by former President Alberto Fujimori's daughter, Keiko Fujimori. The centrist party, Peru Posible (Possible Peru), is led by former President Alejandro Toledo, and Ollanta Humala leads the left-wing Partido Nacionalista Peruano (Peruvian Nationalist Party).

If the right-wing or centrist candidates win, tax policy probably will not change dramatically. If Ollanta Humala wins, increased taxes and/or fees on industries involved in mining operations or hydrocarbons can be expected.

Outlook

- ▶ The Government will continue its focus on increased enforcement of existing taxes.
- ▶ Temporary income tax exemption provisions are scheduled to expire at the end of the year. Considering it is an election year, it is unclear whether they will be extended.
- ▶ The mechanism to permit the payment of capital gains obtained by non-residents through a withholding agent will likely be simplified.
- ▶ The new Government is expected to analyze a possible VAT rate reduction.
- ▶ Negotiation of more tax treaties and foreign trade agreements are expected.
- ▶ Measures to reduce tax evasion are being undertaken.

Current tax policy leaders and tax administrators

- ▶ Alan García Pérez, President
- ▶ José Antonio Chang, Prime Minister
- ▶ Ismael Alberto Benavides Ferreyros, Economy Minister
- ▶ César Zumaeta, Chairman, Congress
- ▶ Rafael Gustavo Yamashiro Oré, Chairman, Economy, Banking, Finance and Financial Intelligence Commission
- ▶ Nahil Lilliana Hirsh Carrillo, Superintendent of the Superintendencia Nacional de Administración Tributaria (SUNAT)
- ▶ Ricardo Arturo Toma Oyama, Deputy Superintendent of SUNAT

Upcoming Tax policy and administration activities: presidential election (April); presidential swearing in and speech (July)

Key tax policy changes 2009-10

Significant tax legislation in 2010 included modifications of the tax treatment of capital gains and the coming into force of a double taxation treaty with Brazil.

Capital gains. For non-residents, capital gains will be subject to either a 5% or 30% capital gains tax (CGT), depending on where the transaction takes place. A tax basis step-up is applicable

for securities acquired before 1 January 2010. The rule is designed to subject only the capital gain resulting from the appreciation of securities from 1 January 2010 (the date when the exemption to capital gains derived from the transfer of securities was repealed) onward to the CGT. An exemption exists for individual shareholders, resident or non-resident, until 31 December 2011. Under the exemption, capital gains that do not exceed five taxable units (approximately US\$6,000) will not be subject to Peruvian CGT.

Gains derived from the direct and indirect disposal of securities that are part of or underlie an Exchange Traded Fund (ETF) and replicate the indexes that reference Peruvian securities will be exempted when the disposal is carried out to create "exchanging securities for ETF units," to redeem "exchanging ETF units for ETF securities" or to "manage the ETF investment portfolio." The subsequent transfer of ETF by a non-resident will not be subject to Peruvian taxation.

Capital gains and interest arising from bonds issued by the Peruvian Government will be permanently exempt from tax. For transactions within the Peruvian Stock Exchange, the CGT must be determined and paid directly by the non-resident seller.

Tax treaties. The Peru-Brazil tax treaty, signed 17 February 2006, became effective 1 January 2010 and basically follows the OECD model.

Pending tax proposals

There are several draft bills pending in Congress addressing the following topics.

Withholding tax. Under current law, interest arising in loans granted to Peruvian banks can be subject to a 1% withholding tax. Proposed legislation aims to increase this withholding rate to 4.99%.

Interest. Interest and gains arising from bonds issued by the Government and by the Peruvian Central Bank are permanently exempted from income tax under current law. One proposal would include an additional exemption (temporarily until 31 December 2011) for any kind of interest and gains resulting from loans granted by international lenders to the Peruvian Government.

CGT. For transactions on the Peruvian Stock Exchange, the CGT must be determined and paid directly by the non-resident seller. One bill proposes that in any transaction of Peruvian securities performed through the Lima Stock Exchange, Cavali, the settlement agent, would act as withholding agent so the non-resident would not have to pay the income tax liability directly.

Another bill proposes that capital gains resulting from the disposal of securities issued by foreign entities be subject to a 5% CGT. Capital gains resulting from the transfer of securities issued by foreign entities or foreign ETFs by Peruvian individuals would, directly or through a Peruvian mutual fund, be subject to a 5% CGT compared with the current progressive tax rate schedule of 15%, 21% or 30%.

Under current law, income derived from the indirect transfer of shares is considered foreign-source income, and, for non-residents, is not subject to CGT. A bill under consideration would make this income Peruvian-source income subject to the income tax. Capital gains would be derived from the indirect transfer of shares, provided certain conditions are met.

Tax treaties. Peru is negotiating new tax treaties with France, Italy, Switzerland, Sweden, Thailand and the UK.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	30%
Top individual income tax rate	30%
Standard value added tax rate	19%

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Key drivers

- ▶ Policymakers are focusing on increasing US competitiveness.
- ▶ The continued high unemployment rate will influence the timing of the shift from fiscal stimulus to deficit reduction.
- ▶ New “cut-as-you-go” (CUTGO) budget rules in the House of Representatives will discourage spending increases. Any legislation would still need to be passed by the Senate, which operates under “pay-as-you-go” (PAYGO) rules. This will mean any spending increases or tax reductions will need to be offset by spending reductions or tax increases.
- ▶ The President’s election pledge not to increase taxes on low-income and middle-income households will constrain options for deficit reduction.

Political landscape

Before the November 2010 elections, Democrats held the presidency and majorities in both the House of Representatives and the Senate. After the elections, the balance between Republicans and Democrats shifted in Congress, with the Republicans winning a significant majority in the House of Representatives, and the Democratic majority in the Senate declining from 59/41 to 53/47. These election results increase the likelihood that deficit reduction efforts will focus on spending reductions, and make it less likely that significant tax legislation will be enacted this year.

In the current Congress, there is increased discussion of the proper role and size of the Federal Government, as well as the projected unsustainable future deficits and debt levels. While there is concern about the high unemployment rate, and about whether additional fiscal or monetary stimulus is needed, Congress

Outlook

- ▶ Expiring tax provisions will be closely evaluated for cost effectiveness in light of budgetary constraints.
- ▶ Spending reductions will likely be used to pay for legislation.
- ▶ Base broadening may result from possible changes to the tax code to limit tax expenditures, reduce “spending through the code” and close business “loopholes”.
- ▶ Increased enforcement of existing taxes, with a focus on high net worth taxpayers and cross-border transactions, is expected to continue and intensify.
- ▶ Increased use of information reporting and withholding will continue.
- ▶ 2011 will be the start of a multiyear focus on deficit reduction and tax reform, similar to the 1981 to 1986 period. Corporate tax reform will likely be high on the agenda.

is likely to shift its focus to addressing medium-term (2015) and long-term (2030) deficit levels early in 2011.

Tax policy will also be shaped by new budget rules adopted in January in the House of Representatives. Under the new CUTGO rules, the House is prohibited from considering legislation that has a net effect of increasing mandatory spending within the one-year, five-year and ten-year budget windows. Legislation, including mandatory spending increases, must be offset by mandatory spending cuts. In the House, this policy replaces the previous PAYGO rules, which allowed spending increases to be offset by tax increases or spending cuts. These new budget rules apply only for purposes of moving legislation through the House. Any legislation would still need to be passed by the Senate, which operates under PAYGO rules. Although there are some important temporary exceptions to the PAYGO rules – and Congress can always override its own fiscal rules – PAYGO resulted in several 2010 tax changes in which tax increases were used to finance spending increases and tax cuts.

2011 is a non-election year at the Federal level in the US. The next national election will be in November 2012, when the President, all members of the House of Representatives and one-third of the Senate will be chosen.

In 2012, President Obama will be running for re-election.

Current tax policy leaders and tax administrators

- ▶ Barack Obama, President
- ▶ Timothy Geithner, Treasury Secretary
- ▶ Michael Mundaca, Treasury Assistant Secretary (Tax Policy)
- ▶ Rep. David Camp (R-MI), Chairman, House Ways and Means Committee
- ▶ Rep. Sander Levin (D-MI), Ranking Member, House Ways and Means Committee
- ▶ Senator Max Baucus (D-MT), Chairman, Senate Finance Committee
- ▶ Orrin Hatch (R-UT), Ranking Member, Senate Finance Committee
- ▶ Thomas Barthold, Chief of Staff, Congressional Joint Committee on Taxation
- ▶ Douglas Shulman, Internal Revenue Service Commissioner
- ▶ Heather Maloy, Large Business and International Commissioner

Upcoming Tax policy and administration activities: Congressional Budget Office analysis of President’s budget proposal (March); debate on debt limit likely to begin (March/April); Senate Finance Committee hearings on tax reform (March and thereafter)

Key tax policy changes 2009-10

During the past two years, significant tax legislation has included economic stimulus tax measures, tax increases to pay for part of the cost of health care reform and several tax cuts that were paid for with tax increases.

Stimulus legislation. Major stimulus legislation was passed in February 2009, including tax reductions such as temporary individual tax credits and bonus depreciation.

Health care reform. Health care reform legislation was enacted in March 2010. The law included \$450 billion in tax increases, including items such as a tax on high-value health insurance policies starting in 2019; selective excise taxes or fees on medical devices, pharmaceuticals and insurance; and corporate information reporting.

Information reporting. Legislation requiring information reporting on shareholder basis, credit card payments and contractor payments was enacted to reduce the tax gap.

Temporary tax reductions. Temporary tax reductions were enacted, including payroll tax credits for new hires and temporary accelerated depreciation. These tax cuts were paid for with an assortment of largely permanent tax increases.

Expiring tax provisions. At the end of 2010, legislation was passed to extend the 2001 and 2003 tax cuts for all individual taxpayers through 2012, extend the alternative minimum tax exemption adjustment through 2011, and extend most expiring provisions through 2011. As part of additional economic stimulus, the legislation reduced the employee payroll tax rate by 2 percentage points in 2011 and increased bonus depreciation to 100% for investments made through the end of 2011.

Pending tax proposals

Administration's budget proposals. The President's budget proposal sets forth the Administration's priorities, particularly with respect to promoting economic growth and creating new jobs, and creates a framework for legislative debate about tax and spending priorities for the rest of the year.

Last year's budget proposal included \$400 billion of proposed tax increases along with proposals for a permanent research and development tax credit and some temporary tax stimulus

proposals. Some of the budget proposals were enacted in 2010, but most remain on the table and were re-proposed by the President this year. Some of the larger revenue increase proposals that were re-proposed in the President's FY2012 budget blueprint include:

- ▶ Repeal of last-in first-out (LIFO) inventory accounting
- ▶ Foreign tax credit changes
- ▶ Taxing excess returns on transfers of intangibles
- ▶ Taxing carried interest at ordinary tax rates
- ▶ Energy tax increases

Tax reform. In December 2010, the President's National Commission for Fiscal Responsibility and Reform (Fiscal Commission) recommended significant reductions in the deficit through spending reductions and some tax increases. The Fiscal Commission also recommended significantly lower individual and corporate income tax rates paid for by base broadening achieved by eliminating or reducing "tax expenditures." The report garnered support of 11 of the 18 commissioners and called for a corporate tax rate ranging from 23% to 29%, repeal of business tax expenditures and a transition to a territorial tax system. The Fiscal Commission report also proposed a trigger that would impose across-the-board reductions in tax deductions, exemptions and credits if tax reform and deficit reduction are not enacted by Congress by 2013. While the report contains only recommendations and does not have the force of law in the US, elements of the Fiscal Commission's proposals are expected to be considered by the President and Congress in 2011. However, the prospects of significant tax reform being enacted in 2011 are slight.

2011 tax rates (as of 1 January 2011)

Top federal corporate income tax rate	35%*
Top federal individual income tax rate	35%**
Standard value added tax rate	0%***

*Plus state rates ranging from 0% to 12%

**Plus state rates ranging from 0% to 11%

***Many state and local governments have sales taxes.

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Key drivers

- ▶ The Government is expected to increase taxes to close the budget deficit if oil revenues are insufficient.

Political landscape

This year is likely to prove tumultuous, with the political landscape becoming increasingly polarized. The results of the September 2010 parliamentary elections reduced President Hugo Chávez's majority in the parliament and encouraged the opposition in its bid to defeat him in the 2012 presidential election.

In September 2010's parliamentary elections, President Chávez's United Socialist Party of Venezuela (PSUV) lost its two-thirds majority after failing to win the nationwide popular vote. The PSUV held on to 98 of 165 seats in the unicameral legislature, after a redrawing of electoral districts. The opposition coalition, the Democratic Unified Panel (DUP), won 65 seats, and Patria Para Todos (PPT) won two seats.

The new Parliament seated 5 January 2011 will likely become the scene of numerous and heated debates between the PSUV and the DUP. Several divisive and politically charged social and economic issues will likely be on the congressional agenda.

Prior to the September 2010 elections, Congress passed several laws aiming to deepen the socialist project led by President Chávez by increasing the state's control over traditionally privately handled sectors. In addition, the following legislation was passed and became effective 21 December 2010, before the newly elected representatives took their seats in January 2011. One of the new laws, the Communal Economic Promotion and Development Act, included a tax provision requiring certain organizations to pay a minimum percentage of their revenue to the Government for purposes of social reinvestment.

Outlook

- ▶ Indirect taxes are likely to be the focus of tax increases (VAT and selected excise taxes have been discussed).
- ▶ The Government will review taxpayer compliance.
- ▶ Tax authorities will increase enforcement efforts targeting high net worth individuals and business.
- ▶ The Government will continue to focus on the taxability/deductibility of foreign exchange adjustments.
- ▶ The Government will increase its audits of transfer pricing, particularly in technical assistance contracts, royalties and interest loans.
- ▶ In Venezuela's customs valuation, the trend to include license payments in the customs value of imported intellectual property goods will continue.

The minimum percentage is not specified in the law and is expected to be set by a presidential decree.

The 2011 budget bill, passed 14 December 2010, included an increase in the tax collection goal. The budget forecasts a greater non-oil tax share than in prior years. Non-oil tax revenue is projected to be 58% of total revenues in 2011, up from 53% in 2010.

Current tax policy leaders and tax administrators

- ▶ Hugo Rafael Chávez Frías, President
- ▶ Jorge Giordani, Planning and Finance Ministry
- ▶ Jose David Cabello Rondon, Superintendent of SENIAT

Upcoming Tax policy and administration activities: Parliament to enact Fiscal Stamp Law reform (first quarter 2011)

Key tax policy changes in 2009-10

Exchange controls. Last year began with a major change in exchange controls. The Government devalued the currency to VEF4.3 and VEF2.6 against the US dollar from a rate of VEF2.15 per US dollar, giving the better rate for "priority" goods. It further banned intermediation with foreign currency denominated bonds, as the Government considered the swap market to be the primary cause of

Venezuela's continuing runaway inflation. The Government also modified the Law on Exchange Violations, broadening the definition of foreign currency to include securities in foreign currency denominations or those susceptible to being paid in foreign currency.

These changes affected the tax position of Venezuelan taxpayers. The impact was especially evident in the evaluation of the taxability and deductibility of gains or losses associated with the corresponding foreign exchange adjustments.

On 30 December 2010, the Government issued an exchange agreement eliminating the application of the priority exchange rate of VEF2.6 as of 1 January 2011.

FONA. Tax-related changes were made to the contribution to the National Anti-drug Fund (FONA). The Master Law on Drugs, which replaced the Master Law Against the Illicit Traffic and Consumption of Psychotropic and Narcotic Substances, modified the basis of the contribution to the FONA to the equivalent of 1% of operating income obtained during the period. The law expressly establishes that net operating income is calculated by subtracting gross income of the financial period less any operating expenses, as determined in accordance with generally accepted accounting principles.

The contribution is imposed on private companies, consortia and public entities with business purposes that employ more than 50 workers. The funds obtained from the tax are distributed as follows: 40% for prevention projects in the taxpayer's labor environment that favor workers and their families; 25% for integral prevention programs aimed at children and adolescents; 25% for programs against illicit drug-trafficking; and 10% for operating costs of the National Anti-Drug Fund.

Fiscal Stamp Law. The partial reform of the Fiscal Stamp Law provided the District Capital authority to receive income from stamped paper. This reform will be implemented once enacted by Parliament, which is expected in the first quarter of 2011.

Tax reform. Government officials made informal announcements during the last quarter of 2010 urging the National Assembly to develop a major tax reform proposal. The scope of this proposal remains to be seen.

Pending tax proposals

President Chávez announced in early January that an expected increase in the VAT rate will not occur and that a possible resurrection of the tax on financial transactions (bank debit tax) will not be proposed.

Contributions to science and technology. Entities and permanent establishments with gross revenue exceeding 100,000 tax units (currently US\$1.5 million) are required to pay 0.5% of their gross annual income to the activities established in the Innovation, Technology & Science Act (Ley Orgánica de Ciencia, Tecnología e Innovación) (LOCTI), which are generally related to research and development in science, technology and innovation. Under current law, qualified entities may either make a contribution to certain private or public institutions previously approved by the Ministry of Science and Technology or internally invest in science, technology and innovation for the benefit of the company.

An amendment to the law was passed on 16 December 2010, restricting the ability of privately held entities to receive funds to develop science and technology projects or to invest in internal projects for their own benefit. Further regulation for the implementation of these changes is expected in 2011.

2011 tax rates (as of 1 January 2011)

Top corporate income tax rate	34%
Top individual income tax rate	34%
Standard value added tax rate	12%



Photo: Rio De Janeiro



Conclusion

As illustrated in the preceding pages, to keep pace with the global economy, countries in the Americas region are increasingly using tax policy and tax administration to achieve a variety of policy objectives. In the wake of recent economic recession and political shifts, many of these countries are emerging with strong fiscal outlooks and greater political stability. A number of them are trying to balance the goals of developing competitive tax regimes that promote economic growth with ensuring a sound fiscal future. This has led to a focus on fiscal austerity, but often with a reluctance to raise taxes.

As governments in the Americas increasingly use tax policy to promote their economic agendas and keep pace with globalization, there are both opportunities and risks for multinational companies with operations in the region. At this time of rapid change, companies need to think globally. Companies must also be equipped with specific knowledge about the countries in which they operate, so they will be prepared to act in accordance with national tax policies and practices. Forging relationships with tax administrations and being an active participant in tax policy development is essential for companies to remain competitive in this rapidly changing global economy.

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Ernst & Young's Tax Policy and Controversy services

The economic downturn and its impact on profits is increasing the pressure on tax directors. Rapid globalization has brought increasing interconnectivity among businesses, and permanent shifts in the flow of capital. Tax departments are bearing the responsibility of more corporate risk than ever. Tax now has a higher profile, not only with company management but also with shareholders, regulators, the media and other industry observers.

Developing a tax policy that resolves impediments to business needs a team that can work with government to explain issues, clarify objectives and achieve a successful outcome for everyone. Ernst & Young's global tax policy network has extensive experience of helping develop and implement policy initiatives, both as external advisers to governments and companies, and as advisers inside government. Our dedicated teams of tax policy professionals and business modelers help address your specific business environment and improve the chance of a successful outcome.

In addition, our global tax controversy network works with you to address your global tax controversy, enforcement and disclosure needs. We focus on pre-filing controversy management to help you properly and consistently file your returns and prepare the relevant back-up documentation. Our controversy professionals leverage the network's collective knowledge of how tax authorities operate, and increasingly work together, to help resolve difficult or sensitive tax disputes. It's how Ernst & Young makes a difference.

About the Ernst & Young Center for Tax Policy

The Ernst & Young Center for Tax Policy is a team of Ernst & Young LLP National Tax professionals who identify marketplace trends, analyze proposed tax legislation, and report on implications for various types of taxpayers. For more information, contact Mike Dell at michael.dell@ey.com, +1 202 327 8788 or Sean Ford at sean.ford@ey.com, +1 202 327 7113.

About Ernst & Young

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