

Tax treatment of the enterprises internationalization forms: a view from Costa Rica, a system in transition¹

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1. The two international trends in the tax treatment of multinational groups

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The phenomenon of economic and financial integration of multinational groups has been addressed by the tax law of different countries. In general, we find concerns that come from different directions: on the one hand, to favor the concentration processes or business consolidation, so that the groups reach the "critical mass considered necessary to compete in the global marketplace"³, as well as to prevent phenomena of double international taxation; moreover, in reverse, the latest to prevent phenomena of cross-border derivation of profits to jurisdictions with low or no taxation in these processes, with the effect of erosion of tax bases in countries where it is generated the higher value added and economic activities are developed.

Certainly the first trend has found its natural home in the capital exporting countries, which does not mean it has not been extended to traditional importing countries, such as Latin America, which even have developed their own "multilatinas". In this regard, we can see the citation that we find in the update of the GIULIANI FONROUGE's work by ASOREY Y NAVARRINE⁴:

"Works widely available have revealed the concern of the peoples of Europe against the potential of US companies and the need to expand the dimensions of commercial organizations to address the danger of annihilation from an economic point of view. And indeed, this situation, which is already pressing on the continent and has contributed to the

3 UCKMAR, V., CORASANITI, G., and DE'CAPITANE DI VIMERCATE, P., "Principios y Reglas Generales", First part of UCKMAR, V., CORASANITI, G., DE'CAPITANE DI VIMERCATE, P., TORREALBA, *Manual de Derecho Tributario Internacional. Primera edición costarricense*, Editorial Jurídica Continental, San José, 2014, p. 113. The authors emphasize how this concern is in the basis of Directive 434/90/EEC that contains the tax discipline of corporate reorganization transactions involving companies resident in different Member States of the European Union.

4 GIULIANI FONROUGE, CM, *Derecho Financiero*, Tomo I, 10th ed., Updated by NAVARRINE, S.C. and ASOREY, R.O., La Ley, Buenos Aires, 2011, p. 435.

creation of the Common Market and the European Union (EU), will project from day to day, to Latin America”.

That is why the “companies unions” are regulated, in its various forms. This class of unions

“sometimes take place in the horizontal plane, so common among those doing the same production process and to organize the competition, with the designation of consortium, cartel and syndicate; sometimes they occur vertically and are characterized by the group or concerno (from German, Konzern) that don’t pursue essentially market dominance but industrial or commercial rationalization. In the legal aspect, can be appreciated different typological criteria, but in general it can be said that sometimes the concentration does not result in the loss of legal personality of its members, may consist of stable unions and temporary unions; while sometimes it causes loss of the personality and takes place by fusion of the entities in a new entity, or absorption of one or more of them by other subsisting”⁵.

This first trend is developed in typical legal regimes in the different national, international and supranational regulations, such as:

- The regulation of corporate reorganization regimes, both internally and supranational, as in the case of Directive 434/90/EEC, that contains the fiscal discipline of corporate reorganization transactions involving companies resident in different Member States of the European Union,

5 GIULIANI FONROUGE, CM, *Derecho Financiero*, Tomo I, 10th ed., Updated by NAVARRINE, S.C. and ASOREY, R.O., La Ley, Buenos Aires, 2011, p. 435-436.

including operations such as mergers, divisions, transfers of assets and exchanges of shares and transfer of the centre of management⁶.

- Associations of undertakings, both stable and temporary character, which the law gives them autonomous legal personality (case of associations and unions of corporations in the Spanish Law of 1963 or economic interest grouping of French Ordinance of 1967).
- Consolidated tax regimes in voluntary form, which usually means that the parent company of the group is erected in the single taxpayer⁷.
- The Double Taxation Conventions (DTC) and internal unilateral measures to avoid double taxation. It should be noted that the first also share some elements of the second trend, having among its objectives to prevent international tax evasion, which justifies the inclusion of the article on exchange of information.

The second trend has a recent history that starts in 1998 with the publication of the OECD report called "Fiscal harmful competition: An Emerging Global Issue", which put in the spotlight both member countries of the OECD and non-members, with the aim of developing a better understanding of how tax havens and harmful preferential tax regimes affect the location of financial activities and other services, eroding tax bases of other countries, distorting patterns of trade and investment and undermining fairness, neutrality and broad social acceptance of tax systems. That was how it characterized the "tax

6 Vide exposure from UCKMAR, V., CORASANITI, G., and DE'CAPITANE DI VIMERCATE, P., "Principios y Reglas Generales", *Primera parte...*, cit., pp. 114-115.

7 Tells ROZO-GUTIÉRREZ, C., "Tributación corporativa a la luz de las legislaciones de Estados Unidos, México, Perú y Holanda: Norma general antiabuso, normas específicas antiabuso, tributación consolidada de grupos empresariales y régimen de compañías holding", *Memorias 2013. 37 Jornadas Colombianas de Derecho Tributario*, T. I, Instituto Colombiano de Derecho Tributario, Cartagena de Indias, 2013, p. 241, that this type of regime, with different nuances, finds regulation in 17 countries of the European Union

havens” and other “harmful preferential regimes” around the absence of taxes or purely nominal taxes; lack of effective exchange of information; lack of transparency in the operation of the legislative or administrative provisions and the absence of substantial activities of investors attracted to the jurisdiction. Also, a process of lifting and modification of lists of tax havens began.

After the 1998 report, the OECD swerved to its original approach. Thus, already in the document *Toward Global Tax Cooperation, Progressing in Identifying and Eliminating Harmful Tax Practice*, elaborated in 2000, as stated G. MARINO⁸, OECD changes its focus, putting aside its focus on the substantive characteristics of the legal and tax systems, to focus on respect for international standard on transparency and exchange of information. In the same year 2000, to avoid negotiating one by one with the jurisdictions, the OECD developed a quick way to get away from the blacklist, in the form of a *Collective Memorandum of Understanding*, which countries could join through a public declaration and focused on transparency and exchange of information in tax criminal matters (31st December 2003) and then for all tax matters (for December 31st, 2005). Moreover, essentially leaving aside the standard of the requirement that the jurisdiction carry out substantial activities are carried out, to focus on the exchange of information⁹. And within this exchange, the issue of banking secrecy and information on partners and beneficiaries of partnerships, trusts, foundations and similar arrangements becomes central,

8 MARINO, G., “La Consideración de los Paraísos Fiscales y su Evolución”, in *Curso de Derecho Tributario Internacional* (coord. VICTOR UCKMAR), T. 2, Editorial Themis, SA, Bogotá, Colombia, 2003, p. 199.

9 OECD, *Framework for a Collective Memorandum of Understanding on Eliminating Harmful Tax Practices*, 2000. Cf. about what was said in the KUDRLE, R.T., “The OECD's Harmful Tax Competition Initiative and the Tax Havens: from Bombshell to Damp Squib”, *Global Economy Journal*, Vol. 8, Issue 1, The Berkeley Electronic Press, 2008, p. 9.

not merely complementary as in the case of Report 1998. An important achievement in this process is the publication of the Tax Information Exchange Agreement Model (TIEA, for its acronym in English Tax Information Exchange Agreements) in April 2002.

Now, as noted GARCÍA NOVOA¹⁰ as the failure of OECD policy against tax havens -relative would add on my part- as TIEA limitations by relying exclusively on exchange of information upon request, has led to two major turns in the international tax scene.

On the one hand, both through unilateral efforts (such as FATCA in the US) and, better yet, multilateral, such as the Convention on Mutual Administrative Assistance in Tax Matters, open to accession by non-OECD countries, the trend is clearly oriented towards automatic exchange of information.

On the other hand, the implementation of the Action Plan on Base Erosion and Profits Shifting (hereinafter BEPS Plan)¹¹, driven by the OECD. Its remote origins, as notes C. GARCÍA NOVOA¹², lies in the social and media pressure around the supposed reduced taxes payment by certain multinationals (Starbucks, Google, Microsoft, Facebook, Amazon) for the use of tax planning strategies that take advantage of the characteristics of different legislation to achieve goal of a low tax burden. This Plan, consisting of 15 actions in respect of which have already been issued final reports, tries to solve the problem. To do this, it is stated that "national and international tax rules should be modified to align in greater detail the fate of the profits with the economic activity

10 GARCÍA NOVOA, C., "La Influencia de las BEPS en el Poder Tributario Internacional", Tema 1, *Memoria de las XXVIII Jornadas Latinoamericanas de Derecho Tributario*, Instituto Latinoamericano de Derecho Tributario, 2015, pp. 486, 489 ss.

11 OECD, *Action Plan on Base Erosion and Profit Shifting*, 2013

12 GARCÍA NOVOA, C., "La Influencia de las BEPS en el Poder Tributario Internacional", Tema 1, *Memorias de las XXVIII Jornadas Latinoamericanas de Derecho Tributario*, cit., p. 486.

generated by that income”, and states are urged to “agree on specific changes international tax rules in the coming years”.

The actions deal with different key aspects in the relationship within multinational groups: digital economy (Action 1), hybrid instruments (Action 2), international fiscal transparency regimes (Action 3), interest deductions and other financial expenses (action 4) neutralization of the harmful effects of preferential arrangements through increased transparency and demand substance (action 5, which is simply an update of Report *Harmful Tax Competition: An Emerging Global Issue*, 1998); prevent abuse of DTC through general and specific anti-abuse rules that do prevail substance over form (action 6); permanent establishments (Action 7); transfer pricing (shares 8, 9 and 10); monitoring results BEPS (action 11); disclosure rules (action 12); transfer pricing documentation and country by country reporting (Action 13, Country by Country Reporting); dispute resolution more efficient mechanisms (action 14); development of a multilateral instrument to amend bilateral treaties (Action 15).

Is important to draw attention on regarding the transfer pricing regulations are located at an intermediate point between the first and second trend. To begin with, it derives that the OECD guidelines on the subject are nothing more than a development of Article 9 of the OECD DTC Model¹³, so the subject shares the dual objective of the DTC, avoiding double taxation, but also to combat tax evasion.

The transfer pricing approach certainly has its origin in the attempt to prevent erosion of tax bases as a result of these transactions type. The argument is simple: when negotiating two entities that are part of the same group, the game of competing interests that is typical in the negotiating parties in the

¹³ *Commentary to the OECD DTC Model article 9*, paragraph 1.

market is wont to be absent, given the presence of the unit will of the group. Thus, the pricing may be a function of the tax savings, shifting profits to countries or jurisdictions with lower taxation levels. In response to this problem, international consensus has been oriented around the idea that it should be required that related parties transactions are agreed on terms similar to those that adopt independent parties, that is, under the principle of free competition or free concurrency (arm's length).

Although it could be interpreted that legislation transfer pricing has purposes against elusion, it must say that the international development of this approach had not been characterized to establish this direct and radical relation with the objective of combating tax fraud. The OECD Guidelines explain that this principle of free competition is necessary to standardize the tax treatment between independent companies and related¹⁴, whereby the emphasis is more on an idea of tax neutrality than one of combat tax fraud. So, consider the guidelines that while those companies -the independents- when negotiate with each other, are usually conditioned by market forces in their commercial and financial relations, the latter cannot be conditioned by these forces external, although often they themselves intend to play in their operations such dynamic market forces. Hence, warns, "Tax administrations should not automatically consider that associated companies aim to manipulate their profits. There may be real difficulties in accurate determination of fair market value in the absence of market forces or because of the adaptation of a concrete business strategy". Similarly, "the analysis of transfer pricing should clearly disassociate themselves from consideration of the problems of fraud or tax avoidance, even if the decisions adopted on transfer pricing could be used for such purposes"¹⁵. In the 2010 guidelines, the OECD reaffirms the

14 1.8 2010 OECD Guidelines.

15 1.2. 2010 OECD Guidelines.

maintenance of international consensus on the principle of full competition, while recognizing the practical difficulties in its implementation in many situations¹⁶.

Notwithstanding the foregoing, it is to indicate that the BEPS Plan sets out specific actions (4, 8,9,10 and 13) related to transfer pricing as part of the fight against so-called aggressive tax planning. That is, under BEPS, the focus of transfer pricing in the treatment of transactions inside an economic group is clearly aligned to the second trend that we analyze, as evidence by recognizing in the final report on actions 8 to 10¹⁷ that currently existing standards for transfer pricing rules can be misapplied so that result in an allocation of utilities that is not aligned with economic activity that had them produced. Hence, this report is drawn up as amendments to various chapters and sections of the Transfer Pricing Guidelines 2010.

The delicate balance between the objective of promoting transnational investment and prevent tax evasion shows up when the Report addresses the issue of the option of disavowing the transaction, once it has come to the conviction that it lacks all economic rationality. The Report explains that this option should only be applied after making every effort to set a price of free competition after delineated accurately the characteristics of the transaction regarding the correspondence of actual behavior with the existing contract, its adjustment case of discrepancy, analysis and, where appropriate, correction of risk allocation to the entity that performs control and mitigation and has the financial capacity to support their implementation. Thus, it argues that because

16 1.10 to 1.14 2010 OECD Guidelines.

17 OECD, *Aligning Transfer Pricing Outcomes with Value Creation*, p. 9.

ignorance can be a litigious and a source of double taxation, its application should be absolutely exceptional¹⁸.

This OECD initiatives certainly mark an influence that determines, for better or worse, the tax sovereignty of all countries. As the final phase of the process has BEPS

"The addition of the expected results to internal systems of different countries, inasmuch as BEPS will condition the legislative power of states that adhere to the Plan. In some cases, the expected result is only for producing a report identifying problems. In others, they will make recommendations for the design of internal standards (notably in the development of general anti-abuse provisions or General Anti-Abuse Rules- GAAR). In such a case, these recommendations will be provisions that limit or influence the legislative power, eroding the centrality of law as an expression of sovereignty in the design of the tax system. And in other cases, the measures will condition the new version of the OECD's Double Taxation Convention Model"¹⁹.

This conditioning is also manifested by the side of the review actions on compliance with standards of transparency in information sharing, such as revisions Phase 1 and Phase 2 (the so-called Peer Review) in the context of the Global Forum on Transparency and Exchange Information for Tax Purposes, which emit highly persuasive "recommendations" and that, in fact, generate changes in domestic legislation and administrative practices of the countries.

Costa Rica is not an exception to respect these tensions and pressures to its sovereignty, thus having already incorporated legal instruments consistent with trends targeted as its ongoing process as a candidate to join the OECD as

18 OECD, *Aligning Transfer Pricing Outcomes with Value Creation*, pp. 38-39.

19 GARCIA NOVOA, C., "La Influencia de las BEPS en el Poder Tributario Internacional", Tema 1 *Memorias de las XXVIII Jornadas Latinoamericanas de Derecho Tributario*, cit., pp. 487-488.

a full member. It is in this context that we will discuss in the sections that follow the current status of the Costa Rican tax system in relation to the trends that we referred to, as well as proposals for tax reform in the process of legislative debate. In addition, with regard to the internal corporate group's tax responsibility, we introduce the analysis of the rules contained in the 2015 version of the Inter-American Center of Tax Administrations Tax Procedure Code Model (CIAT-TPCM).

2. The Costa Rica and CIAT Tax Procedure Code Model regulations of relevance in the tax treatment of international companies

2.1. Tax-law forms of multinational groups established in Costa Rica

2.1.1. Introductory Note

In the phase 2 Peer Review conducted in October 2015, it is affirmed that Costa Rica attracts one of the highest levels of foreign direct investment per capita in Latin America²⁰. Its generally reflects the character of capital importing country and therefore it affects the development of their tax legal institutions. To this should be added the dilated disability of the country to modernize its income tax, after two aborted processes and a current one with serious difficulties to thrive²¹.

20 Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer Review Report. Phase 2. Implementations of the Standard in Practice. COSTA RICA, OECD, October 2015, p. 30. It says that in 2014 US \$ 15.9 billions of dollars in direct foreign investment were received.

21 For a discussion of these projects and their vicissitudes, see TORREALBA, A., "Segunda Parte. La Normativa Costarricense de Derecho Tributario Internacional" in UCKMAR, V., CORASANITI, G., DE'CAPITANE DI VIMERCATE, P., TORREALBA, A. *Manual de Derecho Tributario Internacional. Primera edición costarricense*, Editorial Jurídica Continental, San José, 2014, pp. 161-162.

This does not mean that there are no Costa Rican companies to expand abroad, as well as the country, its territorial taxation system, is an attractive location for holding companies.

Foreign investment involves a substantial establishment of companies that conduct economic activity in Costa Rica. For this purpose, a multinational group that decides to invest and develop in Costa Rica substantive economic activity can do so through the establishment of a subsidiary, a branch or a permanent establishment, or can even move the headquarters of a foreign company to Costa Rica, in the exercise of freedom of contract and corporate under articles 28 and 46 of the Constitution, respectively. The tax treatment of these three options is essentially the same, as are taxed in the income tax, which, within the schedular system prevailing in the country, acts as a tax on corporate income and individuals with gainful activity. For this reason, no problem of unequal treatment are presented as those raised in the systems which the permanent establishment enters in regulation on non-residents tax or real tax-paying obligation²².

22 We think about correcting these problems of inequality, which damaged the freedom of establishment provided for in Articles 43 and 48 of the Treaty establishing the European Community (EC), today Maastricht Treaty, which had to resolve the judgment of the Court of justice of the European Union of 21st September 1999 in the famous case Saint Gobain, providing that such articles preclude a permanent establishment in Germany of a capital company established in another member State do not benefit, in the same way as capital companies established in Germany, the tax benefits of the exemption from corporation tax for dividends received from companies established in third countries under a tax treaty concluded with a third country to avoid double taxation; imputing the German corporation tax, corporation tax paid in other state different from the Federal Republic of Germany for the profits of a filial established that, under national legislation and the exemption from property tax for investments in companies established in third countries in the field of wealth tax, also under national law.

2.1.2. Subsidiaries and transfer of residence of a foreign company

They are considered domiciled in Costa Rica legal persons in both its constitution and registration have been made in accordance with the Costa Rican legal requirements. This implies that a subsidiary or affiliate owned by a company domiciled abroad is considered domiciled in Costa Rica under this criterion, no difference that makes the nationality of the members, being then a specific phenomenon of tax residence acquisition²³. The distribution of dividends by subsidiary abroad is taxed in the remittances abroad tax, which is basically a tax on income of non-residents ("non-domiciled" in the nomenclature of the Income Tax Law) at a rate of 15%.

Also the transfer of residence of foreign companies to Costa Rica and the incorporation of goods from abroad is allowed. In accordance with articles 5 and 227 of the Commercial Code, foreign companies and branches and agencies thereof, engaged in acts of commerce in the country, and only when they act as distributors of products manufactured by their company in Costa Rica, which are authorized under the laws of the country in which they were created to transfer their social venues with other countries, they may transfer to the territory of Costa Rica. To do this, you must present a set of requirements indicated in the aforementioned article 227 at the Commercial Register. This, for example, should be declared the capital of the company in its country of origin, but it has no purpose than to make known in the country its economic solvency and does not imply the obligation to pay registration fees based on the total amount of global capital.

In essence, the offices change involves subjection to income tax.

Moreover, the capital gain by the incorporation of assets that were assigned to an economic activity abroad and now be used by the re-domiciled company to

23 Cfr. TAVEIRA TORRES, H., "Relatoría General", Tema II, "Tributación de Intangibles", *Fiscalidad y Globalización*, SERRANO ANTÓN, F., SIMÓN ACOSTA, E., and TAVEIRA TORRES, H. (directors), Thompson Reuters Aranzadi, 1st edition. Navarra, Spain, 2012, p. 1164.

Costa Rica would not be taxable for two reasons: firstly, because there is no alienation of goods, being the same legal entity which would be incorporated; in addition, there would not be a Costa Rican source, coming earning from assets were assigned to an activity abroad. As discussed below, there is controversy as to between what limits the Costa Rican capital gains source obtained by a non-resident are taxable; however, this issue was not even raised in the situation that we look because the mentioned reasons.

Now, when depreciable tangible assets displaced the national territory, import taxes would be activated, including general sales tax at the level of customs. While it is true there is an inability to revalue assets for purposes of their share of depreciation, we consider the fact that these had previously been subject to foreign tax legal system, the base value for depreciation in the context of re-domiciled society it should be the customs value rather than book value in the re-domiciled company.

2.1.3. Permanent establishment

Stayed that Costa Rica has current three conventions for avoidance of double taxation, with Spain, Mexico and Germany, the concept of permanent establishment serves a dual function as it is used in the conventional field or domestically. In the first case, delimits the jurisdiction of the State of source regarding corporate profits, which in principle and if it were not for this concept, would be taxed exclusively in the State of residence. Thus, in the presence of a PE, corporate profits may be taxed in the State where this is established. To take the example of the DTC with Spain, although the DTC does not indicate to which domestic tax must be submitted corporate profits of the establishment, it is important to take into consideration the provisions of paragraph 3 of Article 7 to the effect that in order to the determination of the benefit of the permanent establishment is permitted the deduction of expenses incurred for the purposes of permanent establishment, including the costs of management and general management for the same purposes, whether in the

State in which is located the permanent establishment or elsewhere. This standard relates to the provisions of article 24, paragraph 2 of DTC force with Spain (article 24, paragraph 3 of the OECD Model), which is established as a rule of non-discrimination which the permanent establishment which an enterprise of a State Contracting in the other State have not be taxed in that State less favorably than enterprises of that other State carrying on the same activities²⁴.

These rules impose that the Costa Rican internal tax applicable should be the income tax, which allows the taxation on business profits treated as net income, and not the abroad remittances tax, which establishes a tax on gross income (30% in large part of business activities). We could remove here the consequence that, even if there is a discrepancy between the concept of conventional PE and internal (for example, by internal rules do not consider the existence of a PE and other by DTC), the presence the first requires the application of income tax, despite that discrepancy.

In Costa Rican domestic field, the concept makes a foreign company considered to be resident for tax purposes by the income produced in Costa Rica, implying that is subject to income tax and not the abroad remittances tax.

The Article 2 b) of the Income Tax Law includes among taxpayers in the tax:

"The branches, agencies and other permanent establishments operating in Costa Rica, of people not domiciled in the country, that there are in it. For these purposes, the term permanent establishment of persons not domiciled in the country means every office, factory, building or other real

24 As say *OECD Commentaries on the articles of the Model Tax Convention (CMTTC)*, article 24, paragraph 21, the "purpose of this provision is to eliminate all discrimination in the treatment of permanent establishments respects of resident companies belonging to the same sector in relation to the taxes imposed on business activities and professionals, especially taxes on corporate profits."

estate, plantation, mining, forestry, agricultural or other business or exploitation, warehouse or other fixed place of business - including temporary use of storage facilities - as well as the intended to sale of goods and products within the country, and any other company owned by non-resident persons performing gainful activities in Costa Rica”.

This is undoubtedly a concept whose terminology clearly separates from the conventional concept, forcing to do some work for approval of terms to find similarities or differences²⁵. Administrative jurisprudence has considered the comments to the OECD model are valid doctrinal source for interpreting domestic concept. We can see that this definition resembles or differs from the conventional concept in the following aspects:

a) While it seems at first glance that the terms “branch”, “agencies” and “permanent establishments” as different concepts actually, the use of the word “other” preceding the “permanent establishments” suggests that also branches and agencies are considered permanent establishments, such as in the conventional concept. It must be stated, however, that neither in the latter nor in the OECD commentary it is referred to a feature that does have a branch in the Costa Rican regulatory environment: it is a form of permanent establishment which carries a higher level of formalizing the establishment that could called “substantial” (namely then taken up from that says the law “means permanent establishment of a person not domiciled in the country...”). Indeed, the “branch” is regulated in article 226 of the Commercial Code figure,

25 In recent Thesis for the Degree of Bachelor of Law, Faculty of Law, University of Costa Rica, explains how this terminology is drawn from the of Income Tax Law of 1916 and 1946, criticizing precisely the total disregard of the existing international terminology in 1988, the year of adoption of the current Law. Cfr. RODRIGUEZ VASQUEZ, G., *La Evolución y Determinación Actual del Concepto de Establecimiento Permanente en el Derecho Tributario ante el Auge del Comercio Electrónico en Costa Rica*, Thesis for the academic grade of Bachelor of Law, Faculty of Law, University of Costa Rica, 2013, pp. 123 ss.

according to which opening is optional but once you decide to open must be appointed and keep a general proxy in Costa Rica, which shall be established by public deed, indicating the object of the branch, its capital, its representatives and a number of formal requirements, having even registered in the Commercial Registry. Although in most cases the material features of a branch coincide with those of substantial establishment we do not consider applicable to this internal concept indicated by the OECD Commentary²⁶ in that the "branch" expression is considered a permanent establishment if it satisfies the conditions set out in paragraph 1 of article 5 of the Model. Thus, should be considered taxpayer on the Income Tax a branch as such, regardless of whether they meet the substantial requirements (for example, though not develop a business but obtain only passive incomes, such as the rental of a real estate). Finally, the difference between the branch and agencies and other permanent establishments is that the branch is a legal concept of Commercial Law, so it should be understood that there is "branch" when its constitution and registration has been made in accordance with the requirements of Costa Rican Commercial Law, not as a separate legal entity, but as a **branch**. On the other hand, they are similar in that both the branch and the substantial form of permanent establishment participate in the legal status of the entity that they are part, but neither all means the entity is considered as domiciled nor taxpayer in the Income Tax²⁷.

b) In the same line as the conventional concept, the term "agents or other permanent establishments" allows to detach the two modes: the based on a subjective and personal concept or the based on an objective concept.

26 Vide "Comentarios al artículo 5", Section 2, 12.

27 About these figures, vide the trade DGT 73-2002 (permanent establishment) and failures of Administrative Tax Court: 463-2002, 245-99 and 104-99 (branch).

c) The “subjective” concept, while the term “agents” is brief, it can be understood, as indeed it has been doing the administrative law, in the sense of the conventional concept described in the first part of this work (dependent and independent agents acting outside the scope of normal or ordinary activity). While a related company does not necessarily become dependent agent of its parent, as we have seen, conditions of local society as being a dependent commission agent, where the risks are borne by the parent company, because that is subject to its instructions²⁸. Interesting how the ongoing review of the Commentary on Article 5 is included as a case of PE for non-resident who hires personnel performing work at home or the presence of a non-resident staff subject in the source country²⁹.

28 Interesting reference to the call “Case Roche” in Spain, settled by the Administrative Chamber of Spanish Supreme Court, by judgment 1626/2008 of 12th January 2012, it was considered that Roche Vitamins SA (Spain) by contract he pledged to represent, protect and promote the interests of Roche Vitamins Europe Ltd (later renamed DSM Nutritional Products Ltd) based in Switzerland (Roche Switzerland). Thus, by applying the conventional concept of DTC Switzerland-Spain, it was determined that even though the contracts it was stipulated the lack of power that would Roche Spain to act on behalf of Roche Switzerland, it was a dependent agent. “Definitely –said the Supreme Court- dependent agent clause acts not only when the agent has authority to contract on behalf of foreign client, but also when, by the nature of its activity, will involve activities of business in the domestic market”. From there a analysis based on the risks of the operation that were assumed by Roche Switzerland, who imposed the price and turned instructions was determined that it was acting through a permanent establishment in Spain analysis (according to indicated by paragraph 38 of the Commentary to article 5 of OECD-DTC Model: “the independence of a person in connection with the represented company depends on the extent of its obligations to the company. If the business activities that the person done to the company are subject to detailed instructions or global control, this person cannot be considered independent of the company. Another important criterion is to determine whether the business risk should be borne by the person or company it represents”. It can be an extensive review of this case in CALDERON Carrero JM,” Beneficios Empresariales (y de navegación) “Cap. III.2, Convenios Fiscales Internacionales y Fiscalidad de la Unión Europea, Wolters Kluwer, España, Valencia, 2012, pp. 176 ss.

29 Vide OECD, *Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, OECD, October 19th, 2012 to January 31st, 2013, paragraphs 22-27, pp. 9-11 Cfr. PASARELLA, LM, “Las rentas derivadas del trabajo autónomo y dependiente. Pensiones. Honorarios de directores”. *Tratado de Derecho*

d) As for the “objective” concept, it is clear that the definition of Article 2 b) Income Tax Law contains the general conventional concept of “fixed place or fixed base of business through which the enterprise is wholly or partly carried exercised”. As noted, “Legislator chips indicated above preamble and enters once the specific cases”³⁰. So incorporates a “positive list” with declarative character consistent in pointing out various business locations that in principle are permanent establishments. However, could result from the closing expression “or other fixed place of business” the equivalent, as indeed has admitted administrative jurisprudence. Hence must apply conventional comments that the place of business should be geographically linked to the source country; that must be a fixed place that is in a precise, certain and locatable place with some degree of permanence, not merely temporary³¹; it required to demonstrate the existence of linkage to Costa Rican soil by the physical presence of the taxpayer (subjective principle) and the use of fixed place of business, being enough the simple use and not the right on which basis it occurs (use test).

e) While the wording is not a paragon of clarity, from the definition can be extracted the connection should have all the positive list of examples of

Internacional Tributario, T. II, ASOREY, R.O., GARCÍA, F.D., Directores; BILARDI, C.J., Coordinador, Ediciones La Ley, Buenos Aires, p. 535, note 29.

30 RODRÍGUEZ VÁSQUEZ, G., Ob. cit., p. 134.

31 The CMTC 6 to 6.3, develop this concept of permanence. So it is said that a place of business may constitute a permanent establishment even if, in practice there only for a short period of time, because the very nature of the business makes only be carried out for a limited period. They add that experience has shown to be normal a stay of at least six months, with some exceptions: recurring activities, to take into account each of the time periods during which the place of business deals, along with the number of times it is used (and may be extended activities for several years); framed in a business activity that takes place exclusively in the country in question, albeit short-lived. It warns that temporary interruptions do not imply that no longer exist the permanent establishment.

permanent establishments to the developing a business activity, as derived from the conventional concept. Thus, a building or real estate, and finally, after a controversy to which we refer in the next section, constitute a permanent establishment only if it constitutes an asset relating to business. This interpretation derives from the phrase "or other fixed place of **business**" and expression of closing "and **any other company** owned by persons not domiciled perform gainful activities in Costa Rica." Certainly this expression is misleading if to be given a sense the word "enterprise" equivalent to "legal entity" as this would amount to considered "permanent establishment" a owned subsidiary 100% by a person or entity not domiciled, which has brought some confusion in the administrative jurisprudence³², as we'll see. But if we understand "enterprise" in its goal of company or set of assets assigned to a business sense, we see that the expression makes sense: when we speak of "enterprise" alluded to this objective aspect; when talking of "gainful activities" alluded to the functional aspect of business, that is, as "activity". Hence we would have a closing clause that tells us that the existence of a set of affected assets to a business generates a permanent establishment.

f) While the above conclusion leads us to link the internal concept to the requirement of business from the conventional concept, it is also true that confronts us with the possibility of a significant expansion of conventional trend, especially in e-commerce. Indeed, an asset subject to a business activity may probably be a website, which is an intangible asset. This could allow an interpretation as to which the Central Administrative Economic Court

32 Confusion to that aid the definition of "enterprise" from article 1b) of the Development Regulation to the Income Tax Law: "Enterprise: any economic unit with one or more permanent establishments in the country, dedicated to conducting activities or business for profit". This definition takes RODRIGUEZ VASQUEZ, Ob. cit. , P. 163 to rule out that this part of the article open the possibility of considering a permanent establishment to a server or, much less, as we suggest, to a web page.

of Spain has reached in its judgment 00/2017/2007 of 15th March 2012 on the so-called "Case Dell":

"... E-commerce is developed through the pages web, which consist primarily of software and electronic data, through which the trader (e-trailer) discloses its products, whether goods or services, or digitized materials (which can be downloaded directly from the network), such as books, computer programs, games, music, movies, photos, etc. That is, the customer delivery can be done from the computer, "on line" or itself through physical referral to the client "off line" address, so that fits the marketing of traditional products and in digitized format and the provision of services across the network. The page "web" is hosted on a server (computer) that may be owned by the operator, or disposes it of him through any legal title. From the above it follows that, while a "website" has no physical manifestation which can be attributed some presence, this does not mean that there is no fixed place of business or a business organization located in a particular place, then through the same commercial operations can be performed"³³.

This position may be exaggerated case of standardized websites that operate to any country without updates and adaptations to the peculiarities of the local market, as this would lead to the absurdity that the company would have permanent establishments in all jurisdictions from which you have access. It is therefore important to note that a peculiarity of the case Dell exposed was

33 Noted that in this case the TEAC found that also existed in Spain staff creating, designing and maintaining websites, which implied the involvement of human resources activity, in addition to the electronic intangible resource. However, the TEAC warns that this is an additional reason, because "it is no human intervention required to cause permanent establishment is". But, it seems, is also no requirement that human resources are concentrated in some way a physical place to form a permanent establishment, as the thread of reasoning of this judgment.

precisely the existence of business analysts to support maintenance of the home page, with translations and review of content, as well as an administrator of the local web shop company in Spain that “deals with updates, and therefore, supervision and accommodation to the peculiarities of the Spanish local market. According with the above, the entity claimant has in Spain dedicated staff to the website for the Spanish market, and this determines the existence of a permanent establishment, the presence in Spain of a directly operated by the company server is not necessary”.

g) The internal concept lacks a negative list, as has the conventional, that is, it does not constitute a permanent establishment. Moreover, we find a contradiction with exceptions a) and d) of paragraph 4 of Article 5 of the OECD Model cited, once includes assumption as permanent establishment of temporary use of storage facilities. Thus, the Costa Rican legislature expressly included as elements of the definition of permanent excepted establishment assumptions by the OECD Model, approaching this to UN Model³⁴. This shows the inappropriateness of using such concepts literal and mechanically. Moreover, by using our lawgiver the word “including” it makes clear that is not intended to provide an exhaustive list, but only exemplify on the extent of the used concept. Thus, minimal grammatical interpretation leads us to understand that the concept of permanent establishment in our Income Tax Law does not have to include no more exceptions to paragraph 4 of Article 5 of the OECD Model. We could even say that this is a broader sense of the OECD Model concept.

34 Vide UCKMAR, V., CORASANITI, G., DE' CAPITANE DI VIMERCATE, P., ASOREY, R.O y BILLIARDI, C., *Manual de Derecho Tributario Internacional*. Primera Edición Argentina, La Ley, Buenos Aires, p. 260. These authors state how the concept of permanent establishment of the UN Model “is wider by including storage activities...”.

In respect of the aspiration of Action 7 of BEPS³⁵ on permanent establishments, aimed at preventing the use of schemes of commission rather than distributors to avoid total taxation of the profit generated in the country, it can be said that the separation of the current wording with the OECD Model presents some flexibility to avoid interpretatively what aims such Action 7 with a modification of the wording of article 5 of the Model. Indeed, remember that, for purposes of BEPS, "Theme comes from the expression of the Convention art. 5, par. 5, according to which for there to be personal establishment, it is necessary that the agent carries out activities not only on Behalf, that is, on behalf of the foreign company, but also conclude contracts in the name, that is, his name"³⁶. Is this wording what has allowed contracts commission be established, in which the broker acts on its own behalf but on behalf of the agent. So even if the alleged commission agent is closely linked to the non-resident company, the wording of Article allows circumvent the existence of a permanent establishment for the company. Thus, the source taxation to the commission is reduced and not all sales dealer to charge against the eventual PE.

How not exist in the current internal drafting of PE that literalism, but refers only to the term "agency" could solve the problem posed by BEPS by applying the general anti-abuse clause provided for in article 8 of the Standards and Tax Procedures Code.

Paradoxically, the draft amendment to the Income Tax Law which is currently being discussed in the Legislative Assembly has proposed a drafting change to

35 OECD. *Action Plan on Base Erosion and Profit Shifting*, 2013, p. 19.

36 CORRADO OLIVA, C., "BEPS y Establecimiento Permanente. Algunas Consideraciones Acerca del Método de Intervención y sobre la Eficiencia de las Propuestas de Modificación en Función de los Objetivos".

the internal concept of permanent establishment, aligning itself with the wording of the OECD Model precisely requires reform by action 7 BEPS:

When a person acting in Costa Rica on behalf of a non-resident company, unless if this person were an independent agent shall be deemed that the company has a permanent establishment in Costa Rica regarding the activities which that person undertakes for the enterprise, if that person:

- a) Display and habitually exercises in Costa Rica an authority to conclude contracts **on behalf of the company**; or*
- b) Does not hold such powers, but habitually maintains in Costa Rica a deposit of goods or merchandise from which conducts regular deliveries of goods or merchandise on behalf of the company.*

It would be desirable that in the legislative process of Bill was introduced a wording more along the lines of the proposed Final Report Action 7³⁷, according to which (reform paragraph 5 of article 5) the agent must act on behalf of the company and in doing so, usually concludes contracts or usually plays the main role oriented conclusion of contracts are routinely terminated without material change by the company and these contracts are either the company name or the transfer of ownership or to ensure the right to use property of the company or that it is entitled to use, or the provision of services by the company.

The proposed amendment to paragraph 6 of the article adds that the exclusion of independent agent of this rule does not operate when the person acts exclusively or almost exclusively on behalf of one or more companies to which it is closely linked. In this regard, it understands that there is close connection to a company if, based on the relevant facts and circumstances, a company

37 OECD/G20 Base Erosion and Profit Shifting Project, Artificial Preventing the Avoidance of Permanent Establishment Status. Action 7-2015 Final Report.

has control of the other or both are under the control of the same person or company. In any case, such close links exist if the person or company owns directly or indirectly over 50 percent stake in the other (or, in the case of a company, more than 50 percent of the vote added and the value of company shares or equity of the company) or another person directly or indirectly owns more than 50 percent share (or, in the case of a company, more than 50 percent of aggregate vote and value of company shares or equity of the company) in the person and the company.

Another issue that has raised Action 7 BEPS is that not all activities that exclude or exempt from the presence of PE by article 5 are qualified in the sense that they must be auxiliaries or preparatory. Indeed, as he explained CORRADO OLIVA³⁸,

"formulation of the OECD Model specified for any of the activities listed these should be preparatory or auxiliary, while for others does not come equally. Thus, the list also includes activities according to the modality as executed, may be more significant than a mere auxiliary or preparatory activity and, as such, can take substantial characteristics of permanent establishment; but how are you on the list of excluded and these activities are not expected to be textually preparatory or auxiliary, the question is ending -even improperly- ensuring non configuration of a permanent establishment and therefore non-taxation in the State of source".

Proposal from the Action 7 is, then, adding a final paragraph in which it is clarified that the condition of preparatory or auxiliary is essential for exclusions paragraph 4 of article 5. This problem is present in existing DTCs. Regarding the domestic concept, as we have seen, the current wording does not provide

38 CORRADO OLIVA, C., "BEPS y Establecimiento Permanente...", cit., p. 590.

for exceptions to exclude the status of permanent establishment related preparatory or auxiliary character of the activity; on the contrary, it considered as permanent establishment the use of storage facilities. In the proposed amendment to the Income Tax Law all references to exemptions or exceptions based on preparatory or auxiliary character are omitted. Thus, the proposed rule does not conform to the wording of the OECD Model, even with the reform of Action 7. This shows an imbalance between finding balance between the objective of promoting and facilitating the development of multinational companies and their attraction as foreign investment and the objective of limiting unacceptable elusive practices, as introduces a concept of PE exceeding the legitimate claims of a source state, the cover also any auxiliary or preparatory activity.

The other issue that has been the subject of attention in BEPS has to do with the exemption provided by paragraph 3 of article 5 of the Model, in which a work or a construction project constitutes a permanent establishment only if it lasts more than 12 months. As noted CORRADO OLIVA³⁹ the "clause could be easily circumvented by subdividing contracts related to the project or construction, for example, two works of 6 months each, so as not individually exceed the duration of 12 months set the permanent establishment. This is called splitting up (separation) of contracts". This rule is not contained in the domestic concept of PE in Costa Rica and therefore could interpretatively overcome. Not so with the existing DTCs so far that if the reform proposed by the Action 7. In any case, the Bill of Reform Income Tax Law seeks to introduce a rule to solve this problem⁴⁰.

39 CORRADO OLIVA, C., "BEPS y Establecimiento Permanente...", cit., p. 590.

40 If the proposal states: "The term «permanent establishment» includes likewise:

- i. Works, construction or assembly or installation project or supervisory activities in connection with them, but only where such site, project or activities carry on for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned.

The immediate implication of the existence of a permanent establishment is the subject to Income Tax that levies the net income at general rate of 30%, but may be 20% or 10% depending on the level of gross income. Now, the Costa Rican system also subject to tax the distribution of "disposable income", which is defined by article 16 Income Tax Law as the remaining to be available and resulting from deducting from taxable income the levy on profits. That is, it is a tax on the dividend or income after taxes, which has an overall tax rate of 15%, and 5% for members of partnerships, partner's cooperative associations and solidarist or beneficiaries of certain collective entities without legal status as trusts. This leads to a situation of economic double taxation. This tax is certainly applicable to the partners or shareholders domiciled in Costa Rica from different associative entities; also it applies to non-domiciled counterparts, by the reference in article 59 Income Tax Law, inserted in the

ii. The provision of services by an enterprise, including consultancy services, through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same project or a connected project) for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned.

With the sole purpose of determining whether passed within 183 days indicated above will be considered the following:

a) When a company not domiciled provide services or perform activities in Costa Rica, a place where works or construction projects or installation are developing, and these services or activities are carried out for periods of time not exceeding the period of 183 days, and

b) One or more companies associated with the first company perform services to the same customer or activities in the same place where services are provided or works or construction projects are made or installation (in relation to the same project or with a related project) for additional periods of time.

These additional periods will be added to the period in which the first company served or carried out activities in that place where construction works or projects or installation are made".

rules of the tax on remittances abroad, the tax rules disposable income⁴¹. Arise then the question of whether the domestic double taxation regime applies to permanent establishments.

Respect to the article 19 c) ITL contains an explicit rule that says:

"in the case of branches, agencies and other permanent establishments of non-domiciled in the country to act on it, hundred percent (100%) of disposable income that is credited or remised to the parent company will be subject to payment of a tax fifteen percent of the indicated credit or consignment".

Cleared up above, there is another question to be specified: if the tax on disposable income is generated immediately once it has been settled profit for the period and paid the Income Tax.

In the case of a subsidiary that is, a company with its own legal personality that is owned high percentage of its share capital by a company not domiciled in Costa Rica, it is clear that while there is no agreement of distribution of dividends –explicit or implicit- neither tax disposable income nor tax remittances abroad are generated. In the case of a branch or permanent establishment, non-existence of a distinct legal personality between the matrix and the PE or branch raises the question of whether it should be considered that the distribution of income has been implicitly favor of the parent once paid income tax.

About the point to clarify, there was a position of the former Direct Taxation General Directorate, externalized through trades such as of 12th December 1988 and the resolution R-51/82, which had been understood that, in fact, income tax disposable income was generated immediately by closing the corresponding fiscal shape. Thus, in the aforementioned first office was established that "when the loan is made to an account payable to the parent

41 As will see later, there has been unwarranted controversy on this point.

company at the time the branch settles its annual operations". In the resolution indicated, it was said that, having no branches or permanent establishments own equity account, or to capitalize their profits, "the profits generated in its activities should be incorporated into the parent company, once closed the financial period".

This criterion, however, was varied in the office 1145 of 21st August 1990 of the Direct Taxation General Directorate, in which said clearly that:

"...this General Direction considers to under the terms of c) indent of Article 19 of the Income Tax Law, and subsection c) of article 18 of the Regulation, the 15% withholding is only appropriate where disposable income is credited or remitted, so that if it were decided to capitalize on the profits of the branch, such detention should not be effected, for surely the law does not give rise to interpret the operative event occurs on the termination of the subsidiary annual operations..."

Thus the treatment of PE is equated to resident legal entities.

2.2. Tax treatment of dividends received by non-residents

Also has been well raised the issue of whether there is any difference in the tax treatment of dividends received by residents versus those obtained by non-residents. The controversy, in my opinion, is unjustified, as in the case of dividends and shares there is a reference to the regulation of disposable income tax that levies on the dividends received by residents. Thus, article 59 expressly tells us that profits, dividends or social **referred in articles 18 and 19 of this law** are taxed. By going to article 18, we find a levy of the "disposable income," says and precisely defined in article 16 of the Law as the remnant, remains after paying the income tax, which has been previously calculated on net income⁴².

42 Concept of available rent is completed by the addition of other schedular rents subject to tax by the law and exempt income in the income tax.

Traditionally Tax Administration had been no doubt that the concept of disposable income also applies to tax remittances abroad⁴³.

However, in several cases in which it has sought to apply the remittances abroad tax assimilated to a dividend transactions distribution, it has held the thesis –in our opinion devoid of normative basis- for the concept of disposable income is not applicable to this tax or at least comparable to such a dividend distribution transactions. They are situations in that the supposed benefit assimilable to dividends is made in the context in which disposable income, as we have defined it back, is not enough to cover the amount that is intended to tax, even as taxable income -calculated as Income Tax rules- is lower than the financial or accounting -calculated profit under IFRS-⁴⁴.

This interpretation does not withstand analysis of the clear letter of the law (interpretation according to the proper meaning of the words) and also from the point of view of interpretation for its purpose and spirit, as well as its constitutional context.

The essence of the interpretation we discussed is that the Income Tax Law, when defining the tax treatment of two members of the same society, is different depending on the partner residing or not in Costa Rica. Thus, if the partner resides in Costa Rica, applies a 15% only those dividends which

43 Vide oficio n.º 1200 of 25th august de 2006.

44 So, the resolution 000868-F-S1-2010 of the First Chamber of the Supreme Court, when hearing the case of a holding hotel company in Costa Rica to which it was charged that the payment of a debt the first by the latter was comparable to a dividend distribution, rejects the argument according to which the assimilation to dividends cannot be quantified over the own disposable income of the resident company transferring benefits implicitly to a non-resident partner. The ruling rejects these arguments almost without explaining why it considers that the concept of disposable income is not relevant to the configuration of the taxable event, despite the clear wording of the rules governing tax remittances abroad in the caption "distribution of dividends to a non-domiciled".

constitute distribution of disposable income, understood as the precise definitions of Articles 16, 15, 14 and 7 of the Income Tax Law. However, if the partner resides abroad, any transfer, directly or indirectly, receive from society, even though it does not constitute distribution of disposable income it is taxable at 15%.

This is undoubtedly a violation interpretation of the principles of constitutional law, in particular the principle of equality. Is illustrative respect to recall how the European Court of Justice has considered as a violation of the principle of non-discrimination -of undeniable relationship with the principle of equality- precisely dispenses a different tax treatment to non-residents in relation to residents. As reported V. UCKMAR⁴⁵:

"One case which later became the cardinal point of the Community case law is, without doubt, the Schumacker case where the Court applied the principle of non-discrimination, stating that a Member State cannot hold a taxpayer non-resident less favorable treatment there when the taxpayer is in analogous to the situation of its residents".

Are not perhaps two partners of the same company in a similar situation, although one resident and the other not? Are not all members of the various companies in similar condition regardless of where they reside? Therefore, the interpretation of the aforementioned judgment violates the principle of non-discrimination, classic corollary of the principle of equality.

Result paradoxical to some extent, and certainly encouraging for the correct interpretation of such clear rules as stated above, the Administrative Fiscal Court, in its ruling AFC N°. 304-2010, 14 hours of 20th September 2010, has

45 UCKMAR, V., "La actividad de la Corte Constitucional Italiana en materia tributaria y su relación con la corte de justicia europea", *Lecciones de Derecho Tributario Inspiradas por un Maestro. Tomo I. Liber Amicorum en Homenaje a Eusebio González García*, Lucy Cruz de Quiñones, Directora Académica, Instituto Colombiano de Derecho Tributario, Editorial Universidad del Rosario, Bogotá, 2010, p. 46.

revised the exposed position, arguing that the determination of tax remittances abroad in concept dividend distribution must comply with the provisions of article 16 ITL.

2.3. Corporate profits and dividends of residents in Costa Rica

By the criterion of territoriality, corporate profits earned abroad by a resident in Costa Rica are not taxable. This notwithstanding the above, the Costa Rican source can be maintained even in cases where the activity is materially out from geographically but in a context of closely related to economic structure. However, administrative and judicial practice related to the criterion of territoriality has been characterized in recent years for being too expansive to the point of denying it. In terms of these business benefits is not an exception. Article 6 paragraph ch) in harmonic ratification of article 1 establishes a didactic hypothesis of not subject related to the concept of Costa Rican source income tax. According to that paragraph, are excluded from taxation the "income generated under contracts, agreements or negotiations on goods or capital located abroad, although it has entered into wholly or partly in the country."

Interpretation of this article has oscillated between two trends: according to the first, if a company domiciled in Costa Rica only coordinates the sales of goods between subjects resident in third countries so that goods do not enter into Costa Rican territory, revenues from those sales are not Costa Rican source; according to the second trend, most recent and can be considered prevailing at least at the administrative level, although of questionable legality, the article in question is not applicable when such sale of goods between subjects resident in third countries is done through a economic or business carried on by the company domiciled in Costa Rica. Despite this, at least in one case the First Chamber of the Supreme Court of Justice confirmed in its judgment n°. 686 of 20th September 2006 that such income should be considered offshore.

By the criterion of territoriality exposed, neither the dividends received by residents in Costa Rica distributed by companies operating abroad are taxable. However, we must record the position, clearly illegal, supported by the National Large Taxpayers Directorate in respect of a company resident in Costa Rica, holding shares of an economic group with operational activities in several foreign countries such as Mexico, Nicaragua and Panama. Unusual way, the resolution DT10R-069-12, supported by the office DGT-821-2011, even claimed that all income earned by the company, regardless of its origin, was taxed at the corporate income tax⁴⁶.

The matter does not go beyond to be overturned this decision by the Administrative Tax Court in its ruling AFC-034-2013, but the reasons used by the AFC had to do with the concrete adjustment was made by exchange gains on shareholdings foreign currency, concluded the Court, as it had already done the Administrative Court in its judgment 289-2012-VI, that such foreign currency assets are not likely to generate taxable exchange gains.

46 Record the astonishing reasoning: "This office therefore is of the opinion that in making its represented, as usual, investments in the financial market both internally and externally, is developing a profitable activity in accordance with that defined in article 1 of the income tax law, so exchange differences **or any other income** are subject to tax on profits". (...) "Hence, its revenues result of financial activity from these investments are part of the income statement and the shares acquired by the company are classified as financial instruments. Consequently, both dividends and other income -coupons accrued interests- from funding granted to investee companies and the profits from the sale of investments, or whether **all income earned fruit of their financial activity** - they will form part of the concept of income or profits of the profit and loss account. Accounts in accordance with the rules contained in article 81 of on Income Tax Law and 8 of its Regulations, to be considered for the purpose of determining the taxable income to be bound by the taxpayer to value all its transactions in foreign currency at the closing exchange, because in the opinion of this direction, investments in the financial market, both internally and externally, made by the claimant in accordance with the provisions of Article 1 d Income Tax Law, **would form the performing a lucrative activity, so exchange differences or any other income are subject to Income Tax...**".

By other hand, the Tax Administration has understood⁴⁷ coherently that a holding company of shares of companies operating abroad, living in Costa Rica by the criterion of "registration" in the country, should not even register in the Registry of Taxpayers and filing. This thesis, consistent with domestic law, collides with the requirements of the Global Forum on Transparency; as such companies are outside the radar of the Tax Administration for the purpose of exchanging information on shareholders and ultimate beneficiaries.

2.4. Exchange of information about the owners of companies

In the recent Peer Review Report Phase 2⁴⁸, based on compliance with the standard exchange of information upon request, it has qualified to Costa Rica as "partial compliance". Weak points essentially revolve around the fact that while partnerships, limited liability and limited partnership must register their changes of ownership in the Public Registry, it does not perform any function of control. Meanwhile, the legislation does not sanction the failure to provide this information to the tax authorities. Similarly, with respect to corporations, the problem lies in the large number of dormant companies from the point of view of income taxes, causing even required to be registered with the tax authorities, so it is not have access to information on shareholders.

This issue should also be analyzed in the light of the trend towards the introduction of automatic exchanges of information, an issue that is not central to the Peer Review related to the Standard of Transparency and Information Exchange Model OECD 2002. In this regard, the Bill on Combat to Tax Fraud, currently discussed in the Legislature, proposes the creation of a "register of shareholders and beneficial owners." Important to analyze the content of this

47 Oficio DGT-909-2014.

48 *Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer Review Report. Phase 2...* cit.

proposal, taking into account the current situation on the obligations of provide information on shareholders of a company.

According to articles 105 and 106, the Tax Administration may, by order, establish an obligation to provide information on shareholders for "supply"

Article 105. - Third party information.

Any individual or legal entity, public or private, is obliged to provide to the tax authorities, relevant information for tax purposes, deducted from their economic, financial and professional relationships with other people. It will provide it as the administration indicates it through regulation or individualized requirements.

Article 106. - Specific duties of third parties (*).

Duties stipulated in this article will be met without prejudice to the general obligation established in the preceding article, as follows:

a) *Retainers will be required to submit information documents for amounts paid to others in respect of earned income, capital gains and professional activities.*

b) ***Societies, associations, foundations and professional associations must provide information stating tax significance in their records about their partners, associates, members and collegiate.***

It has been discussed whether Costa Rica is required to have a register of shareholders by international provisions basic regarding to OECD. In that sense, it must be remembered that the country ratified by Law 9118/2013 of the Convention on Mutual Administrative Assistance in Tax Matters, which provides 3 modes of information exchange:

- a) Upon request
- b) Spontaneous

c) Automatic

In order to comply with the procedures b. and c., the register of shareholders is required. While this Convention does not contain the anti-blocking statutes clause- it cannot be argued that domestic law does not allow such exchanges of information-the truth is that today the domestic law does not prevent this information from supply.

The reform proposal requires the legal representative provide information on all shareholders and the **ultimate beneficiary**. The inclusion of the latter information is novelty. Actually, this corresponds to an international trend. In this regard it should be noted that in June 2013, the **G8** countries recognized the importance of developing mechanisms **to reveal the identity of the ultimate beneficiaries of enterprises** as a step to tackle tax evasion. The creation of public records on people, who ultimately control a company and therefore benefit from it, is also one of the measures the European Union is considered as strategic in the fight against money laundering and tax evasion. Former Secretary General of United Nations Kofi Annan, after meeting the progress some countries have made for the implementation of these records declare that "Such action could end the extensive network of secret corporate structures that help hide illegal and unjust profits. But it can only work properly if there is a critical mass of countries acting in unison"⁴⁹.

Central Bank would be the repository of information under the assumption that there is safer. However, it must share it with the Tax Administration. It is included a sanctions regime to officials who misuse information.

Sanctions regime established in the style of "2% gross revenue" with minimum (3 basic salary) and maximum (100 basic salaries)

49 Inspiration y Global Witness, "Beneficiario último: ¿Qué lugares son los más transparentes? ¿Y los menos?", 14th January 2014.

<https://www.inspiration.org/publicaciones/informes/beneficiario-ultimo-que-lugares-son-los-mas-transparentesy-los-menos-2013/>

Central problem of rules is the lack of defining what is considered the “last beneficiary”. Generally speaking, it should be said that is who has the cash and clear majority control of a certain society or a certain trust and concentrating the benefits of the figure. This means that the last beneficiary is not necessarily an individual, for the case of a multinational group publicly traded each shareholder has not control on matrix group. Therefore, it would be inappropriate exacted in such cases the indication of all shareholders of the parent company, let alone individuals. Trading on the stock market, constantly changing ownership, which would rule out materially impossible to keep the current information.

In general, should be envisaged solution for cases where it is physically impossible to obtain information for the legal representative, he should be explicitly exempt from criminal prosecution.

2.5. The tax treatment of the economic group

2.5.1. Consolidation, transfer pricing and economic reality

As we saw earlier, there are two types of rules aimed at the tax treatment of corporate groups: the regime of transfer pricing and tax consolidation regime. The first type of treatment involves consideration of the various members of an economic group as separate companies, rather than view them as inseparable parts of a single unified enterprise (“separate entity approach”)⁵⁰. Indeed, the “legislator is presented with the following option in the tax treatment of relations between related companies: either regard these as an economic unit,

50 TRAPÉ VILADOMAT, M., “Empresas Asociadas”, Cap. III.3, in *Convenios Fiscales Internacionales y Fiscalidad de la Unión Europea*, Wolters Kluwer España, Valencia, 2012, p.p. 275-276.

regardless of the legal personality distinct from each [...] or attending this last fact, subjecting each of the companies to independent taxation⁵¹.

Thus, the transfer pricing approach is opposed to that of consolidated taxation, also called system of "society organ" (Organschaft its origin in the German Tax Ordinance, Article 114), which involves the taxation of profits from the companies dominated at the parent company, after they have eliminated the benefits that reveal the balances of independent entities from contracts between companies grouped and after they have been offset losses. This type of taxation is often used when the relations of direct or indirect participation, reaching a magnitude greater than is strictly necessary for the domain. This situation highly skilled participation by its intensity is what justifies the joint determination of the tax base. When the tax system provides different tax rates which encourage the artificial fragmentation of income, a consolidation

51 COMBARROS, *Régimen tributario de las operaciones entre sociedades vinculadas en el Impuesto sobre sociedades*, Editorial Tecnos, Madrid, 1998, p. 43 . How this dilemma was presented in the Argentine system is exposed by GOLDEMBERG, CE and DISKENSTEIN, MG, "Precios de transferencia" in ASOREY, RO and Garcia, FD (Directors), *Tratado de Derecho Internacional Tributario* T. II, ob. cit., p. 304: "The alignment of the Argentine provisions with the arm's length principle in accordance with the wording of art. 14 has its starting point in 1977, with the legal change that overcame the current interpretive issued by the Supreme Court from the case "Parke Davis" and those who followed him, "Mellor Goodwin" and "Ford Motor Argentina". In those cases the Court had adopted the theory of organ (disregard of legal entity) for the treatment of transactions between local companies with foreign capital (subsidiaries) with entities or outsiders who controlled them, under which not admitted deduction of royalties paid for the use of formulas, to be subject to treatment and the utility supply. This position meant rejecting the legal independence of the companies trading with each other, to argue that when a society was dominated by another so that was incorporated into the second, economic, financial and organically, that constitute a organ component of the parent company and, therefore, the tax consequences of their activity can be attributed to the parent company. As Balbi said, this theory involved a virtual identification of tax treatments applied to subsidiaries and permanent establishments. At present, the situation is completely reversed since the LIG, as we have noted, with the modifications incorporated from the law 25,063, consecrate the application of arm's length for both subsidiaries and permanent establishments".

system may have anti-elusive purposes; when it not, is usually optional and seeks to tax the taxpaying capacity of all societies⁵².

It is usual in consolidation schemes that the parent or parent company becomes the only taxpayer of the group. It is often discuss whether a new subject to tax capacity on the tax consolidation regime, "the group". Thus, for example in Case Saint Gobain stated regarding the German system of tax integration in this "a group of companies becomes the single taxpayer on the overall result of the group".

This question has to do with a general theme of tax law, which is the peculiarities of the existence of the concept of "ability to act" in taxation in relation to the rest of the legal system. Thus, the natural or legal persons have a general legal capacity in all sectors of the system, and the tax is no exception. Now the doctrinal controversy of the issue has to do with "certain discrepancies between capacity under private law, primarily civil law, and the ability for the purposes of tax obligations..." Thus we can speak of a tax legal capacity (others call subjectivity tax) of particular characteristics that distinguish it from the private legal capacity, as in some cases who have civil capacity is not subject to tax liabilities and, conversely, it may be that lack that capacity⁵³.

In the case of groups of companies under consolidation does not appear that a new taxpayer, despite what is stated in the judgment in Saint Gobain is established, but one of the group companies assume the representation of others and calculates a group tax base by eliminating internal transactions

52 A variant of the approach of consolidation is the overall benefit-sharing, opposed by the OECD Guidelines See C.1, 1.16 ss OECD Guidelines Model 2010.

53 GIULIANI FONROUGE, C.M., *Derecho Financiero*, Volume I, 10th ed., Updated by NAVARRINE, S.C. and ASOREY, RO, cit., p. 427.

group. In any case, the issue is controversial, as reported FONROUGE⁵⁴ respect for controversy in the German doctrine around the Organschaft: being the basis of this figure financial, organizational and economic dependence on the parent company, a part of the doctrine (Becker and Faller, seconded by Antonini) believes that figure only has an effect on the operative event of the obligation but does not affect the legal capacity, that is, subjectivity or personality dominated company is not affected, but only constitutes a technical means to solve tax problems arising between companies complete cycle and subcycle companies and in some cases, give a special case of joint and several liability; the other stream (Buhler, Wilser), understand that disappears personality and legal capacity of the company dominated because of their total subordination to the dominant, as a kind of "fusion of autonomous subjects". Must distinguish the existence of this type of tax subjects without legal personality of private law of those cases related to situations where members of a set or economic group are held responsible. Thus, the overall economic CIAT-TPCM article 35 ,of whom later we'll speak- is not a subject capable of acting tax, but what sets are rules responsibility, that recognizing the subjectivity of different entities of the group members, attributes them the status of jointly liable with each other⁵⁵. The same can be said of subsidiary liability of article 39 of the Company for the tax liability of the partners: although this figure has an origin in the doctrine of piercing the veil does not reach the end of eliminating tax purposes the different subjectivity natural and legal persons involved to create a single specific tax subject. It is rather

54 GIULIANI FONROUGE, CM, *Derecho Financiero*, Volume I, 10th ed., Updated by NAVARRINE, S.C. and ASOREY, RO, cit., p. 438.

55 An interesting analysis of figures of economic group in which it concludes that are not subject to tax obligations can be seen in GIULIANI FONROUGE, CM, *Derecho Financiero*, Volume I, 10th ed., updated by NAVARRINE, SC and ASOREY, RO, cit., p. 427.

attribution of responsibility, with respect for tax subjectivity, independent of partner and of society.

Costa Rica, at the legal level, has not recognized in its Income Tax Law neither a regulation of transfer pricing nor a fiscal consolidation regime, except the special scheme of multinational companies of transport and communications, which we will refer. Nevertheless, by applying the so-called criterion of economic reality Article 8 of the Tax Code, which is a general anti abusive clause, paradoxically has led both the basis for an administrative regulations on transfer pricing as the basis for the contrary, namely, the disregard of the corporate veil or ignorance of transactions between related parties, which has common elements with a consolidation regime.

In matter transfer pricing, the Costa Rican national law is very peculiar because without a specifically rule that establishes in the legislation on income tax a regulation on transfer pricing, we have a Regulation on Transfer Pricing structured according to the Guidelines OECD and a constitutional jurisprudence (case 4940-2012 and 8739-2012, who reported the constitutionality of an internal Guideline, DGT-20-03). This guideline had come to the general anti-elusive clause from article 8 of the Tax Code, to support the implementation of the approach to transfer pricing. The cited constitutional rulings have given the OECD Guidelines character of technical regulations, indispensable application to avoid a violation of the limits to the discretion of the administrative act under articles 15 and 16 of the Public Administration General Law. Particularly in the latter, which sends that administrative acts respect the univocal rules of science and technology.

The Bills that have attempted to introduce this legislation were halfway. It is currently in the legislative process the Bill to Reform the Income Tax Law, which includes a summary-rule of the principle of free competition, referring regulation to regulatory foresight (already existing!) The recent publication of a Regulation on Transfer Pricing follows a path full of uncertainties and legal uncertainties, recognized by the preamble to that regulation. But what is clear

is that, unlike what is normal, namely pass a law, develop in a regulation and then apply in specific cases, the Costa Rican experience has been just the opposite: the Tax Administration has conducted specific cases it has been tried, with different and contradictory approaches, related party transactions, even in some of them trying to directly apply the approach to transfer pricing, with undeniable technical shortcomings parts; then he adopted a regulation; finally, maybe someday we will have a transfer pricing law⁵⁶.

The new regulation includes⁵⁷:

- Rules for identifying related parties.
- Introduction OECD methods and the sixth method (international price assets).
- The need to value related transactions based on an analysis of comparable parts.
- Documentation obligations (transfer pricing studies), which must be specified and developed by General Resolution. This resolution has not been issued yet and could be used to collect the recommendations of the Action 13 BEPS re-examine the documentation requirements as well as those proposed by the Final Report of Shares 8 to 10 in relation to the content changes should be Studies Transfer Pricing.
- Previous agreements Transfer Pricing can subscribe to companies with tax authorities, to ensure legal certainty.

56 Volume borrowed this approach Costa Rican colleague Rafael Luna.

57 Vide for a comprehensive analysis of this Regulation in the light of the OECD Guidelines, TORREALBA, A., "La Normativa Costarricense de Derecho Internacional", en UCKMAR, V., CORASANITI, G, DE'CAPITANE DI VIMERCATE, P. y TORREALBA, A, *Manual de Derecho Tributario Internacional. Primera Edición Costarricense*, Editorial Jurídica Continental, San José, 2014, Cap. X.

The lack of specific regulations on transfer pricing between economic groups in the Income Tax Law has caused much uncertainty and confusion as to the rules based on which should be treated the tax transactions between related parties.

Before Guideline DGT-20-03, the Tax Administration and Fiscal Administrative Court handled the argument that the mere fact of linking parts of a transaction was reason enough to ignore it. Indeed, the administration, in the presence of related party transactions, opted for a classic application of the criterion of economic reality contained in article 8 TRPC (in conjunction with article 12 of the Code)⁵⁸. Historically based on an attitude of rejection of the existence of transactions under a difficult rebut presumption of simulation by the only fact of the link. Guideline DGT-20-03 attempted to overcome this archaic and unjust approach generating potential situations of double taxation. However, the practical history of this guideline has been so inapplicability as erratic application, if we abide to all concepts on which implies the correct application of the approach to transfer pricing.

58 "This agreements concerning tax matters between individuals are not which can be given against the State" in its previous wording of the Law 9068 of 2012. While the Costa Rican jurisprudence administrative and judicial have had trouble recognizing him, the fact that Article 12 of the Tax Code provides for an entirely different hypothesis that can only confined to agreements aimed to "redistribute" the tax liability between individuals, as is evident if we look back the Explanatory Memorandum to the Latin America Tax Code Model, article 19 is exactly equal to our 12. The preamble says: "The arrangement is common in the tax legislation and is explained by the fact that the tax obligation is an obligation ex lege and therefore the state's relations with individuals can only come from the law and not private conventions. It will be liable to pay such tribute whoever is legally mandated, without agreements between individuals to alter their provisions. The rule does not deprive of value to such agreements but only, has its unenforceability the State". The new wording of the article should dispel any doubt about it: **the elements of the tax liability, such as the definition of the taxpayer, the fact generator and others** may not be altered by acts or agreements of individuals, which not become effective before the Administration, without prejudice to its legal and private consequences.

Curiously in the Costa Rican legal system, the possibility of “consolidation” can be achieved through the same article 8 of the Tax Rules and Procedures Code, which gives basis to approach separate entity, without having traditionally been at all clear when to apply either approach.

A variant approach to consolidation is the overall benefit-sharing, opposed by the OECD Guidelines⁵⁹ and, as we saw earlier, it has been used in Costa Rica under Articles 11 ITL and 14 of its Regulations for transport companies and communications prevailing on Transfer Pricing Regulation, which implies that there is an exception to the principle of free competition. Indeed, article 11 of the Income Tax Law says:

“The transport companies in general and those of communications, whose owners are persons not domiciled in the country, who carry out operations with foreign countries and hindering the determination of income attributable to Costa Rica, in accordance with the provisions established in the regulations of this law, may request the Tax Administration a special system for calculating their net income. The Tax Administration is empowered to authorize its use, provided that the general rules for determining contained in the law are not contravened”.

It is the case of transport companies in general and communications, whose owners are not domiciled in the country, who carry out transactions with foreign countries and hindering the determination of income attributable to Costa Rica. In such hypothesis, which also includes the possibility of operating through an PE, it is available from the Tax Administration a special system for calculating net income, allowing make one presumptive (or objective) attribution of global enterprise income generated in Costa Rica. This system is

59 Vide C.I.,1.16 ss. 2010 OECD Model Guidelines.

implemented through “agreements” between the company and the Tax Administration. Application is common, for example, international airlines.

In application of this system, which is governed by article 14 of the Regulation of the law until now has been used a method based on the so-called “unitary principle” or consolidation, which is essentially a global benefit distribution system as a prescribed formula for distributing the overall results consolidated a multinational group, as opposed to the approach of “transfer pricing”⁶⁰: tax the entire multinational group, applying a proportionate or indirect distribution method according to a formula by which are apportioned among the states affected by trade and financial relations of the company or multinational group based on economic activities conducted under its jurisdiction; either pursuant to a predetermined formula based on a combination of cost, assets, sales and wages, either through a formula to determine in light of the facts and circumstances of the case. Thus, based on annual reporting of profit and loss and the disaggregation of activities presented to the tax authorities of residence of the parent, sets a relationship between gross receipts and total net profit before tax and profit sharing dividing the amount of profits between gross income. The factor thus established is multiplied by the amount of sales in Costa Rica.

It is clear that this method of allocation of profit is incompatible with the Transfer Pricing Regulation and the OECD Model 2010. Although it could be argued that the TPR is later, the fact that article 11 has legal status and, speaking a “special system for calculating net income” is not clearly referring to the approach to transfer pricing. So, for existing special legal rule expressed in the Income Tax Law, developed by an equally special regulation, it takes

60 In Section C of Chapter 1 of OECD Guidelines applicable to transfer pricing for multinational enterprises and tax administrations, June 22nd, 2010, OECD-Institutos de Estudios Fiscales, 2010, (hereinafter “Guidelines OECD 2010”) is it stands and attacks the contrast of this method with the principle of full competition or defending these guidelines.

precedence over the Transfer Pricing Regulation that while refers to the Income Tax Law, it is based on a rule such as article 8 of the Tax Rules and Procedures Code.

In any case, we said, the common origin of both the approach of respect for the separate entity such as the piercing the veil or ignorance of transactions is that article 8 of the Tax Code. It will be understood that it is problematic to accept that two opposing approaches can have the same legal rule of origin. In that regard, the Guidelines themselves OECD transfer pricing, and even after the reforms proposed by the Final Report of Actions 8, 9 and 10 BEPS can provide the integrative answer to this apparent contradiction. Indeed, one of the issues that traditionally often ignored when discussing transfer pricing is whether, before to the adjustment of transfer price by the Tax Administration (primary adjustment) or even before to the adjustment to its accounts when declared by the taxpayer (compensatory adjustment), that or it may reclassify the legal forms and accounting support the legal form that corresponds to the reality of the transaction.

Is worth noting that the Costa Rican regulation does not contain a rule such as that found in the Nicaraguan Concertation Tax Law, whose article 98 says:

***"Principle of economic reality.** The tax authorities will respect the operations carried out by the taxpayer; however it is empowered to requalify the operation according to their true nature if prove that the economic reality of operation differs from the legal form adopted by the taxpayer or agreements relating to a transaction, valued globally differ materially from those they have adopted independent companies, and / or structure that, as presented prevents the tax authorities determine the appropriate transfer price".*

Neither was included article 7 of the Transfer Pricing Law Model issued by the Council of Secretaries of Finance and Ministers of Central America, Panama and the Dominican Republic:

"1. The tax administration will respect the operations carried out by the taxpayer. However, the Administration is empowered to re-qualify the operation according to their true nature if prove that the economic reality of the transaction differs from its legal form, or agreements concerning a transaction valued globally, differ substantially from those they had adopted separate companies and the structure of it, as presented, prevents the tax authorities determine the appropriate transfer price".

This absence, however, should not pose problems seen that the TPR basis is precisely the economic reality criterion laid down in article 8 TRPC. In that sense, it is to remember, as it has well summarized the First Chamber of the Supreme Court in its judgment 1181-2009, the criterion of reality not only plays a role in the interpretation of the tax rules but also in qualifying and legal requalification of the facts, which means that you can dispense with the legal forms used by the taxpayer when they are manifestly inappropriate and whose sole purpose is the tax savings. That is, when there is an abuse of legal forms. This means that if there are business reasons that explain the use of legal form, this provision would not apply. Also, it can dispense of the legal forms in the case of simulation, absolute or relative⁶¹. Additionally, we can say that it is already a concept repeatedly confirmed by the contentious courts and the First Chamber of the Court that the principle should be of neutral application, regardless of whether benefits or hurts the taxpayer or administration⁶², which has by implication that with occasion of his self-assessment of the tax, the

61 About this issue we refer to TORREALBA, A., *Derecho Tributario. Parte General. T. I. Principios Generales y Derecho Tributario Material*, Editorial Jurídica Continental, San José, 2009, p. p. 221 ss. Recently "Claúsulas Antiabuso en el Derecho Tributario Costarricense", *Revista Tributaria de Faycatax*, en www.Impositus.com

62 Cfr. First Chamber, SJC, 1181-2009 y 1270-F-S1-2011; TCA 3076-2010-VI y TCA 148-2010-VI.

taxpayer can re-qualify his own legal forms as preliminary step to compensatory adjustment.

This approach allows us to demarcate the areas of application of Article 8 of the Tax Code: in its traditional version, can dispense with manifestly inappropriate legal forms; in its basis version of the TPR, undertakes to respect the separate entity, is the opposite to disregard the corporate legal forms. Well, in cases where an entity has no real economic function, understood under the terms of comparability analysis to which we refer in the next section, then the next step is to apply the traditional version; however, if there is such a function, the Administration should implement mandatory "transfer pricing" version.

Changes to the Guidelines Transfer Pricing proposed by the Final Report of Actions 8, 9 and 10 BEPS consolidate this integrated approach between what is respect for the separate entity and setting a price competition and the possibilities of requalification and, even, ignorance of transactions within the economic group, that is, between related parties. Thus, revisions to Section D of Chapter 1 of the Guidelines seek to ensure that transactions incurred by associated companies are identified, so that adjustments to transfer prices are not made based on contractual agreements that do not reflect the economic reality⁶³. Thus self "Comparability analysis" must distinguish two key aspects: the first is to identify the commercial and financial relations between partner companies and the economically relevant conditions and circumstances related to those relationships, so that the controlled transaction is delineated with precision; the second aspect is to compare the relevant economic conditions and circumstances of the controlled transaction and the economically relevant circumstances of comparable transactions between independent enterprises.

63 OECD, *Aligning Transfer Pricing Outcomes with Value Creation*, p. 13.

So, before making comparisons with uncontrolled transactions it is vital to identify the economically relevant characteristics of the underlying transaction controlled commercial or financial relations⁶⁴.

This process of identifying and delineating transactions through the analysis of the contractual terms of the transaction and its correspondence with the real conduct of the parties; analysis of the functions performed by each part of the transaction, taking into account the assets used, the risks assumed, the circumstances surrounding the transaction and practices of the industry; the characteristics of the property transferred or services provided; the economic circumstances of the parties and the market in which the parties operate; and business strategies pursued by the parties. Already at this level of analysis can be re-qualifications or re-characterizations of the ratings given by the parties: this happens when the behavior is different from what the contract says, in which case the former prevails; it also happens when the risks assumed by one party are not accompanied with the power to control and mitigate risks, nor the financial capacity to assume their consequences should they materialize.

In such situations, it is necessary to align risks with who actually decide on taking and manage them, and who financially supports its materialization. The report gives the example (Example 3) of a group company (A) acquires ownership of a tangible asset for lease to third parties. However, another company of the group (B) is the one that decides the investment and designs the asset based on existing market opportunities and decide that is the company (A) that will purchase the asset. Meanwhile, the Company C decides how to use the assets, negotiates contracts with customers, ensures that the active is delivered to independent third parties and installed properly. In this case, even if Company A is the owner of the asset, does not exercise control over the investment risk, lacking any ability to decide to invest in a particular

64 OECD, *Aligning Transfer Pricing Outcomes with Value Creation*, p. 15.

asset and investment protection or dispose of the asset. In this case, having taken a risk that does not control, it must reallocate the risk to place on who controls and manages and who is financially able to bear it. This done, the last step would be to price favor of the company A that limits to the return of an investment without risk⁶⁵.

It is only after having made every effort to characterize and, where appropriate, re-characterize transactions, the new guidelines allow for the possibility of complete ignorance of the transaction, what will happen when it lacks economic rationality that would require reasonably parts independent. The report insists warn that ignorance of a transaction that has economic rationality of an agreement of free competition does not constitute a proper application of the principle of free competition. In such a case the restructuring of legitimate business transactions would be a completely arbitrary exercise, whose inequity entail double taxation also created there when the other tax authorities do not share the same view on how the transaction was structured. The possibility of ignorance can reach the lack of corporate juridical figure, which substantially involves a way to consolidate into a single taxable base, the bases of two or more entities, which is feasible in principle of economic reality. This will happen in cases where there is mixing of assets or of resources, or a society is purely formal, without substantial economic activity whatsoever.

2.5.2. Limitations on the deductibility of interest

A usual situation between related companies or concerns related to financing made by the parent company domiciled abroad its branch or local subsidiary. It then arises to what extent this funding can have full or partial loan component,

65 Vide OECD, *Aligning Transfer Pricing Outcomes with Value Creation*, pp. 30-35

generating interest instead of dividends, with the resulting tax savings: while the dividend payment does not generate deductible expense, it does pay load financial, including the deduction of negative exchange rate differences if any.

There is no rule in Costa Rica through which it is made derive, by the mere fact of membership of the lender, the assimilation of the loan to contribute, with the consequences of non-deductibility of the financial burden. That is, in Costa Rica would apply the decision in the judgment of the Court of Justice of the European Union in the Thin Cap Group Litigation case (Case C-524-04), in that

"The mere fact that a resident company is granted a loan by a related company which is established in another Member State cannot be the basis of a general presumption of abusive practices and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty. In order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory".

In effect, the rule of article 8 d) of the Income Tax Law establishes a provision to that effect which refers exclusively to loans made by partners of Limited Liability Corporations (LLC). In the Interpretative guideline n^o. 23-03, 30th June 2003 (repealed by Interpretative Guideline n^o. 26-03, 2nd September, 2003) it had recognized that automatic assimilation of loan to a partner contribution is **only** produced in the case of Limited Liability Company.

Being clear that the mere fact of the membership status of the lender does not involve the assimilation of the loan to a contribution, except in the case of Limited Liability Companies, it should be remembered that one of the classics corollaries of the called principle of free competition in transfer pricing -the ability to adjust transactions between related companies at normal market

conditions between independents parts-, as derived from the OECD CMTC to article 9:

This not only corrects interest rates applied on a financial relationship between related parties when they do not respond to market, but also qualify if what is presented as a loan it can be considered as such or should be considered as a set-up available funds of another nature and in particular, as an equity interest⁶⁶.

This is what is known as the application of rules of "thin capitalization", which is "to deal with the provision of financial resources to a company by loan when the linkage and the ratio of equity and borrowed capital *it can be deduced that the loan covers up a real capital contribution*"⁶⁷.

In principle, we can say that the Tax Administration, based on Article 8 of the Tax Rules and Procedures Code can ignore operations classified as loans between related companies, assuming that, in reality, they are capital contributions.

To try to clarify that "reality" in the experience of different countries have chosen to adopt a flexible approach that seeks to examine the circumstances of each case. So says J.M. DE LA VILLA GIL⁶⁸ which is usually examined for effects factors such as the existence of an unconditional written promise to pay a certain amount within a certain period; the fact that the loan is subordinated to the rights of other creditors; the ratio of borrowed funds and equity of the company; if the debentures are convertible into shares of the issuing company; the fact that the alleged debt securities are distributed among

66 SANZ GADEA, E, "Medidas antielusión fiscal", *Documentos del Instituto de Estudios Fiscales*, n.º 22, p. 19.

67 GARCÍA NOVOA, C., "La Influencia de las BEPS en el Poder Tributario Internacional", cit., p. 497.

68 *Precios de transferencia y empresas multinacionales*, Instituto de Planificación Contable-Ministerio de Hacienda, Madrid, 1986, pp. 88-90.

shareholders in proportion to the shares they hold; the rights of holders in the event of non-payment of interest; or if the parties had no intention of creating a debtor / creditor relationship.

OECD CMTC article 10 (paragraph 25) which can be used as an interpretive source in his condition as soft law indicates typical in which the interests of loans could be treated as dividends:

- the loan exceeds, largely, the remaining contributions to the capital of the company (or has been arranged to replace a significant portion of capital has been lost) and the amount bears no reasonable relation to depreciable assets;
- the creditor participates in the profits of the corporation;
- the repayment of the loan is subordinated to repayment of debts for other creditors or the payment of dividends;
- the amount or interest payments depends on the profits of the company;
- the loan agreement contains no clause providing for repayment within a specified period.

Costa Rica's Tax Administration has adopted an approach of this kind, giving relevance to whether interests have been agreed or not, or if, having agreed, haphazardly paid or not paid at all⁶⁹, or if only interest and no amortizations are paid, remaining outstanding debt for long periods, showing that does not

69 In this regard vide DT-10-R-168-01 of December 27th, 2001, confirmed by the ruling of the Administrative Tax Court, the 11 hours of Aug. 5th, 2004: "to analyze the movement of these liability accounts , it appears that they have been growing year after year, and depreciation reflecting mostly due to reclassifications of accounts to other liabilities". In this case take into account the fact that a liability comes from some accounts by paying some services between companies that were not paid in due course. Thus, considering services as non-existent, inter alia never paid, even more so considering the financial expenses generated accounts payable as non-deductible.

face a typical creditor-debtor relationship, or whether there was actual delivery of the borrowed money⁷⁰. Also has considered not acceptable that the interest is capitalized, as is the case finally resolved with the decision n°. 71-2006.

In Bill of Reform of the Income Tax Law is proposed the introduction of a rule on thin capitalization. It is incorporated a rule to limit excessive deduction of interest and financial expenses. It is a **rule of thin capitalization**, oriented to it can deduct interest while the relationship between the equity of a company and its liabilities do not exceed certain proportions⁷¹. This limitation does not apply to entities subject to the supervision of the Superintendent of Financial Institutions (SUGEF) nor the proportion of transactions with such entities by taxpayers. Not apply to interest paid to unrelated suppliers, provided that the interest does not exceed average annual interest rates on loans in local currency. As a critic, it noted the lack of a "clause" of equity for those cases where an entity requires a higher level of debt and it remains within market conditions⁷².

70 Vide the judgment of the Administrative Tax Court n°. 400-P-2006, 12 hours on 12th September 2006.

71 Shall not be deductible excess value resulting from multiplying the total amount of interest accrued during the tax period (I) twice the relationship between the average annual balance of stockholders' equity (C) and the annual average balance of all debts taxpayer interest bearing (D): $I \times (2 C / D)$.

72 This was resolved in the Solidarity Tax Project through a flexibility rule that could apply the tax authorities. Solidarity Tax Bill proposed a 1 to 3 proportion, which is typical internationally. A 1 to 2 proportion is excessively restrictive, particularly when funding is obtained through modern figures such as leasing or factoring, which can be developed by entities not subject to the supervision of SUGEF.

Clearly the Bill does not advance to a proposal as contained in the Final Report Action 4 of BEPS⁷³, based on the establishment of a fixed limit, between 10% and 30%, which may represent the interest and related payments earnings before interest, taxes, depreciation and amortization (EBITIDA). This is complemented by the possibility of accepting a ratio of multinational group, which would allow an entity to net interest expense (difference between interest received and interest paid) above the fixed limit of the country deduct interest to the level of the ratio interest net/EBITIDA its multinational group.

2.5.3. Treatment groups societies at the collection phase: jointly and subsidiary responsibilities

Although Costa Rica lacks control systems joint or subsidiary responsibility of member entities of a group of companies, it is interesting to bring up the figures included in version 2015 Inter-American Center of Tax Administrations Tax Code Model (CIAT-TPCM).

In Article 34 CIAT-TPCM the assumption of "Joint and several liability of partners for taxes of society" appears:

"The partners, participants, associates, cooperative members, joint property owners and co-proprietors of a condominium, shall be held jointly liable for taxes and interest of the legal entity or collective entity without legal personality in which they are members, partners, participants, associates, cooperative members, joint property owners and co-proprietors of a condominium, proportionately to the full value of their contributions or equity ownership, on the assumption of limited liability of their stakeholders, and to the term relevant thereto in the applicable tax period".

73 OECD/620 Base Erosion and Profit Shifting Project. Interest Involving Limiting Base Erosion Deductions and Other Financial Payments, action 4: 2014 Final Report.

Comment 1 clarifies that it is an assumption of liability. Liability is limited to the contributions and the period held, whenever we are to entities with limited liability. Conversely, there is no limit in the case of legal persons or entities without legal personality that do not limit the liability of its members, such as Comment 2 says.

This is actually a deviation from one of the classic features of the building of the legal person, namely, the separation of the assets of the partners. As is known, this features, in cases that the legal system so recognizes, it implies that responsibility should circumscribe the amount contributed, that is, its own assets, excluding the unlimited liability of the partners⁷⁴. In this particular case, this feature breaks in the sense that the Administration can demand responsibility in partner's heritage, not only in society, apportioning the tax debt not covered depending on the contributions or shares.

Can be say that this is a case of "direct responsibility" of partner as anti-elusory measure, which is intended to act on the stage of recovery of the tax liability, notwithstanding also the settlement or determination is carried out with participation of the liable. However, it seems to be missing a very important element, namely, the lack of ownership unbundling should only occur in cases of abuse of legal personality, which happens to use societies without economic activity than simply hold assets to withdraw them from the collection of the tax debt. As C. GARCÍA NOVOA says⁷⁵,

"One thing is that the evidence of simulation in a society are much greater when it becomes an equity holder of a mass on which there is

74 Vide GARCÍA NOVOA, C., "La Responsabilidad de los socios y el abuso societario", Comunicación Técnica en *Memorias de las XVII Jornadas Latinoamericanas de Derecho Tributaria*, Tomo I, Instituto Peruano de Derecho Tributario, Lima, 2015., p. 701.

75 GARCÍA NOVOA, C., "La Responsabilidad de los socios y el abuso societario", Comunicación Técnica en *Memorias de las XVII Jornadas Latinoamericanas de Derecho Tributario*, cit., p. 713.

a risk of an embargo by the Treasury for debt of partner individuals. In such cases, society has no economic activity and becomes a simple structure holder goods, which seems lawful to ignore the fictional ownership of society and understand that these assets belong to the shareholders.

But one thing is this and a very different one to pretend tumble an essential rule, linked to the fundamentals of the general theory of law, as is the partner-corporation separation, which must be respected in phase of responsibility.”

It should be noted, moreover, that responsibility does not reach surcharges or penalties, or obligations on account, because it is limited to “taxes and interest”.

In Colombian system find a similar scenario, with the particularity that excludes stock corporations and similar. Regarding this, in a comment that applies to the rule in question, highlights F. LONDOÑO⁷⁶ the curious of this typicality,

“even although the responsibility is enshrined as solidarity, when applied individually to each partner or partners it becomes jointly, each responds only to the percentage of its share during the time that had owned shares or equity stakes. That is, it is not possible to pursue all jointly and severally liable for the total amount owed, but only by what percentage that corresponds. Therefore, the responsibility is integral for procedural purposes sue everyone as joint debtors, but the material obligation of each is severally”.

76 LONDOÑO, F., “La Responsabilidad Tributaria”, *Memorias de las XXVII Jornadas Latinoamericanas de Derecho Tributario*, cit., p. 264.

The same author⁷⁷ shows the gap regarding to the responsibility of managing partner in a limited partnership that does not have capital contributions in the same, about whom the rule does not establish rule of an association or quantification of responsibility, a problem that also has the rule we discuss.

Also is criticized the exclusion of capital companies, especially when corporations are used in family businesses, on account of the direct interest that assists them in their business⁷⁸. Text CIAT-TPCM rid of this review even partially, since on the other hand it is no longer reasonable allocation of liability in cases of open capital companies, such as publicly traded.

In Spanish law, a related standard is the letter b) of Article 42.1 TGL, which establishes joint and several liability, in proportion to their respective shares of the holders or joint holders of the entities referred to in paragraph 4 of article 35 LGT, that is, the collective entities without legal personality. In this case the problem of denial of ownership unbundling feature of partner-society is not presented, precisely because we are dealing with entities without legal personality.

By other hand, article 35 CIAT-TPCM introduces an alleged joint liability of all persons, companies or entities that make up an economic unit, for the tax debts generated by each (numeral 1). Numeral 2 provides a relative presumption of existence of an economic group whose basic fact is participation directly or indirectly in the management, capital, control or administration of one or more other persons, companies or entities. Numeral 3 remit to Regulation the cases in which the economic group will be set.

77 Ibid., p. 264.

78 Vide LONDOÑO, F., "La Responsabilidad Tributaria", *Memorias de las XXVII Jornadas Latinoamericanas de Derecho Tributario*, cit., p. 264.

Comment 4 offers an alternative wording with more accuracy circumscription of the concept of economic group when it is desired, which is highlighted by these elements:

- It clarifies that the identification of an economic unit does not require the preparation of a consolidated balance sheet.
- It establishes a “presumption” -which now does not appear as relatively- of existence of an economic unit when:
 - a) There is a steering unit or a joint coordination of economic activity of various subjects, which may manifest itself in the identity of persons who hold powers of decision to orient or define the activities of each or the existence of links of relationship between owners or members of their decision-making organs.
 - b) There is a reciprocal equity between different subjects or mutual transfer of profits or losses.
 - c) The economic activity of diverse subjects is organized jointly, either because each one of them carries out a stage of the same productive chain or because their turn is similar or they use common capital or work or have a common commercial or industrial structure.

Comment 1 provides a detailed explanation of the figure:

"This is a specific rule of extension of liability, which seeks to obtain better assurance for the tax credit in case of splitting equity among different businesses, by virtue of the undeniable proliferation of independent business organizations operating under the umbrella of the same economic group, which are strongly related. It is common for some of these businesses to occasionally incur violations of their tax obligations and in such cases, according to the rules on liable parties, the only means to fulfill the payment of the liability is through the taxpaying business, since there is no legal relation among the members of the group (they are not accountable for the same taxable event). Notwithstanding, strong links exist among the businesses,

which if detected by tax regulations, would enable the expansion and strengthening of the financial guaranties of the Tax Administration, since it would be able to act against the assets of the other members of the group”.

This responsibility can be juxtaposed with the one of article 34, so it should be understood that if participation in the equity or in the direction exceeds certain levels, to define by regulations, apply the responsibility of this article that, unlike the previous, does have the connotations of full substantive solidarity: respond for the entire debt.

Is to be noted that so-called linking “presumptions” really are not such, because they lack the typical structure of a presumption: base fact, alleged fact, and a nexus of probability or normality between them. Indeed, the events indicated as basic facts lack alleged facts, because factors such as direct or indirect participation in the capital or management, or the unit of direction are themselves defining elements of what is an economic unit. Thus, despite the comments 2 and 3 highlight the value of the presumptive structure as a protection mechanism of legal certainty of taxpayers -through the possibility of evidence to the contrary- and as a mechanism to facilitate the administrative application of the figure, the truth is that it lacks in the development of the rule the “fact alleged” to be evidenced whit demonstration of the base fact or be made subject to prove otherwise. Thus, for example, participating directly or indirectly in the capital of an entity so not presented as evidence of another fact, it would be alleged.

The only way in which these factors take the form of a presumption would be that the regulation that would be made establishes more precise defining elements of the group, being enough to be proven as the latter the existence of the most generic base facts described in article 35. For example, if the regulation provides that direct equity must be at least 25%; mere participation in the capital could be the basis fact of the proven alleged fact (participation in at least 25% of capital). Only in this way would make sense “prove otherwise”,

which requires first know what is proven against: in the example, would be proved against the alleged fact that it has at least 25% of capital.

This technique to define when there is an economic unit looks somewhat convoluted when compared with the usual rules on transfer pricing or consolidated tax regimes, in which definition of linked relationship or of the existence of a group or economic group are not presented as facts basis of another fact –the alleged one–, but simply as defining elements of the same basis of relation or the existence of economic unit.

In general, this form of liability is subject to the same questions concerning the circumstances in which it is reasonable to pierce the social veil and disregard the principle of entities ownership unbundling, and not only against the assets of the partners but other entities related or related. As we saw, this type of solution looks good against cases of entities without economic activity, mere holders of assets, which represent an abuse of legal personality. However, looks as an excessive and indiscriminate rule, as occurs in the present case.

Further this form of joint and several liability indiscriminate at internal economic unit does not fit the usual rules in the countries for the treatment of transactions between related parties, as we saw respects the principle of separate entity. Being a mandatory regime also does not sit well with voluntary schemes of consolidation.

Certainly the rule of responsibility we analyze is not logically inconsistent with an approach to transfer pricing, nor, as the Commentary 4 Article 35 CIAT-TPCM states in the proposed alternative wording, requires the accounting or tax consolidation of companies, because while those operating in the stage of tax obligations determining, the liability regime operates with regard to the guarantee of collection (collection phase) of such obligations. However, it does represent a radical solution that erases, for tax purposes, the principle of ownership unbundling of the legal person.

Is additionally to note that the economic set of Article 35 is not a subject capable of acting tax, but what sets are rules of responsibility, that recognizing

the different subjectivity of the member entities of the group, they are attributed the status of responsible solidarity with each other⁷⁹.

Article 39 CIAT-TPCM establishes subsidiary responsibility of society for the debt of the partners, by providing that

respond subsidiary for the tax debt of the shareholders, associates, members or partners, legal persons constituted by those in that having the whole or in part, directly or indirectly, or in which concurs a common leadership will with them effective control, where it is established that legal persons have been incorporated or used improperly or fraudulently to evade liability against the Treasury.

It is a form of doctrine called "piercing the corporate veil" or "disregarding the separate legal personality", as highlighted by the Commentary 1. As explained SÁNCHEZ HUETE⁸⁰, the

"piercing of the veil is the metaphorical expression with which is designated the operation consistent in ignoring and disregarding the subjectivity that the legal system recognizes to the legal entity. It is a jurisprudence that is rooted in the common law...

It is intended to prevent the misuse of legal persons to circumvent the principle of universal liability or to hide ownership a real property; in short, it is used to prevent fraud...

Basic idea is that there is not viable the argument of the separation of assets of the legal person by reason of having legal personality, when such separation is actually a fiction that seeks to obtain an fraudulent

79 An interesting analysis of figures of economic unit in which it concludes that are not subject to tax obligations can be seen in GIULIANI FONROUGE, CM, *Derecho Financiero*, Volume I, 10th ed., updated by NAVARRINE, SC and ASOREY, RO, cit., p. 427.

80 SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, Marcial Pons, Madrid, Barcelona, Buenos Aires, 2008, p.p. 32-35.

objective, as violating an obligation, to shirk responsibility, appear insolvency and so on”.

Judicial origin figure has been developed under certain principles:

1. Casuistry application principle: each situation is assessed in particular. Intrinsic difficulty to establish general, objectivables and commonly graspable rules.
2. Judicial application principle: only at that level there are guarantees an adequate solution to the conflict between justice and legal certainty.
3. Exceptionality principle: piercing the veil is an exceptional situation, because affirm its existence as generality goes against the existence of the legal personality of companies.
4. Subsidiarity principle: it can be applied only when it is not possible to consider other correction techniques⁸¹.

Therefore, in the transfer of the doctrine of piercing the veil to the regulatory environment, as with the rule of review,

“there is a risk that the generalized application of subsidiary liability based on the pierce of the veil, together with the wide appreciation of the originating assumptions by administrative organs, will not ensure the exceptionality, nor the correctness and justice of its application. This leads to a profound questioning of the principle of security, the other parameter on which the justification for the existence of such doctrine is based, the basis of the institution of tax-sanction liability established normatively”⁸².

81 Cfr. SÁNCHEZ HUETE, M.A., “El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)”, en *La nueva LGT*, cit., p.p. 56 ss.

82 SÁNCHEZ HUETE, M.A., “El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)”, en *La nueva LGT*, cit., p. 49. Concern that shares GARCÍA NOVOA, C., “La Responsabilidad de los socios y el abuso societario”, *Memorias de las XVII Jornadas Latinoamericanas de Derecho Tributario*, cit., p. 714.

Commentary 2 highlights how sidesteps the recognition of society as separate and distinct from the individual partners. Commentary 3 highlights that this resource should be exceptional "due the risks to the legal traffic", so must be proved "the control by the corporate partner or shareholder and a situation of abuse or fraud with respect to the legal entity". It draws attention to the prevention of conditioning the figure to abuse or fraud of legal personality does not appear in those already seen cases of joint and several liability of partners for taxes of society (Article 34) -which is precisely opposite to that we are concerned partners responding by company versus company responding by partners- or members of an economic unit (Article 35), in which it happens exactly the same phenomenon of piercing the veil.

The rule in article 39 saves similarity to the case of subsidiary liability of article 43.1 h) of the Spanish General Tax Law,

h) Persons or entities that taxpayers have the full or partial control, or where there is common governing aim with those taxpayer, by tax debts of these, when it is established that such persons or entities have been created or used improperly or fraudulently as a means of circumventing the unlimited liability against the Treasury, provided that either a uniqueness of people or economic spheres, or confusion or patrimonial deviation. In these cases, the responsibility will also extend to sanctions.

In this literal is regulated the phenomenon called "refuge society", in the partner carries out the activity and assumes tax obligations, but the heritage (assets, in particular) is of society. Therefore, the responsibility is attributed to the dominated⁸³.

83 Vide SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, cit., p.p. 255 ss.

In the same article 43.1 of the GTL, also appears another case of subsidiary liability, which is the reverse phenomenon, the front company:

g) Persons or entities that have the whole or in part, directly or indirectly, effective control of legal persons or whom concurs a common governing aim will with them, when it is established that legal entities have been created or used in abusive or fraudulent form to evade personal liability against the Treasury and there uniqueness of individuals or economic spheres, or patrimonial confusion or deviation. The responsibility will extend to tax liabilities and penalties of such entities.

In this case, absent in Article 39 CIAT-TPCM, the acquired company carries out the activity and assumes tax liabilities; however, heritage belongs to the dominant partner, so that responsibility be attributed to the dominant partner⁸⁴.

The reason that the CIAT-TPCM not collects this second course it includes the Spanish GTL is the issue of accountability partner is regulated as joint and several liability in article 34, on which we have already expressed a reservation that does not come conditioned the responsibility to abuse of legal personality. Regarding the object of responsibility, article 39 uses the concept of "tax debt" which, as defined in Article 69 CIAT-TPCM covers financial penalties, which is justified by the abusive use of legal personality.

As notes SÁNCHEZ HUETE⁸⁵ in relation to paragraph h) of article 43.1 GTL, the requirements that enable the application of this tax liability are:

84 Vide SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, Marcial Pons, Madrid, Barcelona, Buenos Aires, 2008, p.p. 179 ss.

85 SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, cit., p.p. 258-259.

- There is a tax credit due and payable. The tax liability must be dated before the fraudulent business through which it aims to reduce the solvency of the debtor's assets.
- The subject, after the acquisition of a debtor, celebrates a business that benefits a third legal entity.
- The Administration prejudiced in its tax credit for such negotiations.
- That negotiation involves granting real benefit to front company, although it is not fictitiously, because it is hidden in a seemingly reciprocal and equivalent services context. It is essential the existence of assets concealment by the debtor, and the business constitutes a fraudulent means of circumventing the patrimonial liability of the debtor. Thus, the company has formal ownership of the assets of the dominant person. In this case it comes to shape the course involves active society, which has so apparent assets and rights attributable to the obligated (dominant subject).
- There is a knowledge and aim to harm the tax creditor.

In structure of this form of responsibility are, on the one hand, the dominant subject, which could be provided shareholder, associate, member or partner, depending on the type of entity in question, and on the other hand, the apparent legal person. It should to be noted that it not included collective entities without legal personality of article 26.2 CIAT-TPCM, unlike the Spanish case. Nor does it include individuals, as does the Spanish rule preventing the use of figurehead⁸⁶.

86 Cfr. SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, cit., p. 261 who describes the option of Spanish legislature as revolutionary from the philosophy that animates the doctrine of piercing the veil, because it applies only to legal persons. For the author, "say that the subjectivity of the individual may be, all of it, instrument, subject of another, against the Law, because this assertion is based on can ignore such subjectivity". Therefore, what is meant is that the rule applies when it is questioned that the transfer of assets to figurehead is true. Vide p. 268.

In this way,

there is a transfer of asset –assets and/or rights- of the taxpayer to the apparent entity. This transmission is generic, but also may consist of real and concrete assets or rights, individuals, with the aim of achieving insolvency. It is not the generality or uniqueness of the transmission what grounds the application of that legislation, but the patrimonial insolvency that produces⁸⁷.

About the degree of control, the rule states that it should effective, although, as noted C. GARCIA NOVOA⁸⁸ respect for the Spanish case, it is not specified “what criteria is followed to determine that there is such effective control, if it is limited to a majority of capital, which could be set at more than 50 percent or more than 33 percent, or if it will attend the equity, results or voting rights.”

Further, control may be direct or indirect -phrase absent in paragraph h) of article 43.1 GTL, not in paragraph g), which has brought interpretative difficulties-. So, they are understood immersed in the concept of indirect control the hypothesis on which it is exercised through another company in which it has participation.

This figure requires a common governing aim concur. The Spanish rule, unlike article 39 CIAT-TPCM adds that should be a uniqueness of individuals or economic spheres, or patrimonial confusion or deviation. While these characters are not included in the CIAT-TPCM rule, they may be useful to define cases where there is abuse of legal personality. As SÁNCHEZ HUETE highlights, those “ideas manifest two levels: the subjective, the requirement of

87 SÁNCHEZ HUETE, M.A., “El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)”, en *La nueva LGT*, cit., p. 282.

88 GARCÍA NOVOA, C., “La Responsabilidad de los socios y el abuso societario”, *Memorias de las XVII Jornadas Latinoamericanas de Derecho Tributario*, cit., p. 714.

uniqueness of people and the assets, by the uniqueness of economic spheres and the interrelatedness equity, usual of behaviors of confusion or deviation from it. Both uniqueness, as confusion or deviation behave a common understanding of loss of autonomy of the assets of the apparent entity⁸⁹.

The uniqueness "emphasizes the idea of heritage indistinguishability and identity. The opposite is the existence of otherness, inherent to the subjective and heritage diversity". In respect of the uniqueness of people, this means that the partner and society are, really, the same. If there not was the appearance of the entity, the interests that represents would be identical to those of the subject that supports it. There are no other partners within this appearance, which is an explicit reference to single-member companies. This requirement of subjective identity prevents its application to entities dominated by family interests. This identity can also be manifest in the identity of the managers of parent company and dominated⁹⁰.

The uniqueness economic spheres refers to the existence of a joint and closely interwoven functioning of economies of partner and dominated, of a cohesion and interdependence of heritages and interests⁹¹.

The patrimonial confusion denotes the idea that assets are indistinguishable and offset of the intended effects. Thus, the first manifested in the free availability of the assets transferred to the social heritage, in circumstantial elements such as the use of a single box for the various subjects, the sharing

89 SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, cit., p. 91.

90 SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, cit., p.p. 92-93.

91 SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, cit., p. 91.

of material and human resources without an economic consideration, one unitary direction, a common organizational operation, confusion template, the external appearance, of suppliers, of customers. So, it originates a lack of differentiation between the patrimonial social sphere and thus own or personal: the two entities share the facilities and means of production, suppliers, customers, employees, managers⁹².

In terms of equity deviation normally involves assets confusion. As explained SANCHEZ HUETE⁹³:

"equity deviation involves creating diversion or set up an entity to receive the equity assets of the obligated person. Such evasive purpose can be accomplished either through a bypass active, through a process of capitalization, can also be planned through an original configuration, without any such transfer, but a heritage confusion occurs. In the latter case various entities are created in a few assets and staffing -focus normal Social Security credits and tax.- and another entity are located, assets or final products of the activity they possess a higher added value. Ways of carrying out the process of disinvestment are varied, from the configuration of apparent credits to be paid to various subjects -for charges, allowance- creating the preferred credits to the public treasury them they became ineffective, until the transfer of assets and rights undervalued..."

It is, ultimately, equity split of alleged fraudulent purposes, behaviors that must be repressed by harmful. It starts from the existence of an entity with tax obligations not want assume; this aims to thwart the

92 Cfr. SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, cit., p.p. 94-95.

93 SÁNCHEZ HUETE, M.A., "El levantamiento del velo (La responsabilidad de la sociedad pantalla y refugio)", en *La nueva LGT*, cit., p.p. 288-289.

right to collect the Administration over the assets of the entity. For this purpose uses a legal entity to which transfer to the existing assets of the debtor entity first. This transfer is done by very different ways: creating preferential claims for preferential collection, establishing formal sales, feigning transfer of ownership, attributing salaries or higher salaries ... is, credits preconstitutes in favor of the shelter entity and against its assets, causing a false transfer of business asset”.

While this figure has an origin in the doctrine of piercing the veil does not reach the end of eliminating tax purposes the different subjectivity of individuals and legal entities involved to create a single specific tax subject. It is rather attribution of responsibility, with respect to the independent tax partner and subjectivity of society.

2.5.4. Corporate reorganization

Mergers and acquisitions, which sometimes are referred to the “M & A” acronym (from English, Mergers and Acquisitions), are an aspect of corporate strategy, corporate finance and business management, consisting buying, selling or combining of different companies that can help finance or grow a business developing without having to create a new business entity.

Given that most of the laws taxed capital gains when they produce, is often asked whether or not a special scheme for exemption or deferral of capital gains generated in reorganization operations business that implies business and partners continuity, as in that case it could be argued that it is unrealized capital gains, which would in itself the not taxation.

In effect, it is argued⁹⁴ whether a profit regime is necessary if according to economic and accounting principles and carrying out a transfer to the internal

94 Cfr. CAHN-SPEYER WELLS, P. “Relatoría General. Fusiones y Adquisiciones. Aspectos Internacionales”, *XXV Jornadas Latinoamericanas de Derecho Tributario*, T. I, Abeledo Perrot, Buenos Aires, 2010, pp. 32 ss.

of the same group, does not imply a real manifestation of economic capacity. Certainly this is clear in the case of mergers and divisions where there is universal succession rather than transmission. However, this is no longer so clear in cases like the split in changing the shareholding composition or the target companies.

To avoid such discussions, many countries have chosen to cut short the issue and have established explicit to ensure principle of fiscal neutrality in this type of transaction regulations.

So⁹⁵ the European Union, United States and Japan have developed specific regulations (development of Directive 90/434 / EEC of 23/6/1990).

In Latin America, although less developed, have specific regimes Argentina, Mexico, Peru and Brazil.

At Latin American countries it is usually condition the principle of permanence of activities and continuity of the partners (Argentina, Bolivia, Mexico), but not the principle adopted in the European Union, which is based on a exonerative or deferral regime.

Others countries such as Costa Rica, Chile, Venezuela and Nicaragua lack of regulation and therefore should be made to interpretations that often shed little legal certainty.

In any case, either by way of interpretation of the concept of implementation, or through explicit rules, it would be desirable prevalence of a principle of tax neutrality: taxes should not be a factor that affects the behavior of taxpayers, causing distortions in economic competition.

95 We take data from the excellent synthesis by CAHN-SPEYER WELLS, P., "Relatoría General...", ob. cit., p. 7. Vide in this work the national paper of different countries.

In the explicit regulatory schemes, the principle of fiscal or tax neutrality is implemented through a tax deferral mechanism: taxes shall not be required for capital gains (the difference between the normal market value transferred assets and the net book value) generated with the transfer of assets and rights during restructuring operations, as the assets retain the value they had in the transferor; the tax is deferred until the assets are sold. Obviously, to make sense, is required the previous rule that the transfer value of an asset is the market one.

It's important to say that these explicit schemes are more necessary in systems that have been introduced transfer pricing regulations, therefore clearly constitute an exception to the principle of arm's length between related parties.

The case of Costa Rica⁹⁶ is the absence of explicit legislation on the subject. Bill to Reform the Income Tax Law discussed in the legislature includes the figure in these terms:

"If corporate reorganization through various means, such as acquisition of shares, quotas or shares of interest, non-cash contributions in assets, mergers, purchase of business premises, total or partial purchase of assets and / or liabilities and others, the Regulation will set the conditions for not considering realized capital gains that may be generated, based on the principles of fiscal neutrality, business continuity and equity interests, and provided that the reorganization operation mediate a valid economic reason.

In any case they will keep the historical values of the assets and rights transmitted in different operations in order to

96 However, an effort enforcement of existing legislation and its consequences can be seen in TORREALBA, A., " La Normativa Costarricense de Derecho Tributario Internacional ", cit., pp. 393 ss.

determine the possible gains or capital losses that occur during a subsequent sale to be maintained those”.

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