

SEUL IFA CONGRESS

SUBJECT 1: ANTI-AVOIDANCE MEASURES OF GENERAL NATURE AND SCOPE-GAAR AND OTHER RULES

ARGENTINE REPORT

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SUMMARY AND CONCLUSIONS

Most countries have either judicial or statutory general anti-avoidance rules (GAAR); Argentina enrolls in the second group as GAAR are of statutory nature. Countries in both groups frequently combine GAAR with special anti-avoidance rules (SAAR).

GAAR are generally applied to interpret tax rules, to characterize taxpayers acts and transactions (*i.e.*, assessment of facts), or both, as it is the case in Argentina.

SAAR may be patterned after GAAR to emphasize their application in certain contexts, or may be specifically designed as mostly mechanical rules separate from the conceptual elements of GAAR. In both cases, the interaction between GAAR and SAAR is complex and frequently raises conflicts of application and overlap. The conflicts focus on whether SAAR exhaustively govern the tax avoidance issue in their context of application to the exclusion of other rules or whether GAAR also apply in that context as a residual rule. Similar conflicts arise between domestic GAAR and treaty GAAR. Both are still open issues under Argentine tax law.

GAAR may be comprehensive rules applicable to all taxes imposed at a certain level (*i.e.*, in a federal country like Argentina, at the national or sub-national level), or may be limited in scope (*e.g.*, only applicable to income tax or corporate income tax). Argentine GAAR discussed in this report apply to all taxes at the national level, though unless mentioned otherwise, comments will be limited to the income tax. Argentine statutory comprehensive GAAR may be construed against or even to the benefit of the taxpayer.

Domestic as well as across-the-border transactions within the same economically-controlled group have been particularly scrutinized against under Argentine GAAR. However, as precedents illustrate, the application of statutory conditions in certain areas (*e.g.*, tax free reorganizations within the same economically-controlled group) have been eased by application of the same standard. Judicial precedents have also applied GAAR in favor of taxpayers in other contexts.

The tax benefit, gain or advantage is an element inherent to the transactions subject to re-characterization under Argentine GAAR as well as an implied or express element under SAAR.

Although, under foreign tax law most GAAR require subjective purpose or intent, re-characterization under Argentine GAAR applies based on an objective statutory condition and regardless of an apparent intent of the taxpayer to avoid taxes, but for the case of acts in *fraus legis*.

A comparative analysis of other nation's approaches shows that re-characterization of a transaction for tax purposes under GAAR is made either: i) in accordance with fixed, pre-determined indicia interpreted judicially or fixed by statute, or ii) based on broad standards of application similarly construed or provided for by law, which require a case-by-case evaluation. Argentine GAAR fall in the second category, thus allowing the interpreter some flexibility, although within certain constitutional limits.

For instance, Argentine GAAR as applied to construe tax laws may not violate the constitutionally protected principle of reserve or legality. Similarly, for taxpayers' transactions, GAAR are also tempered with the well-settled principle that persons can organize their affairs choosing available alternatives that save taxes to the extent permitted by law.

Absent a double taxation agreement (DTA), Argentine GAAR and SAAR usually apply in an international context, even to assess the tax consequences to the foreign party in the host country. The same principle would apply under Argentine DTAs to the extent the agreement does not expressly prevent the application of domestic GAAR or SAAR, whether or not on a reciprocal basis. Absent such an express treaty clause, --as it has been the case of all DTAs under the Argentine network-- the application of GAAR has been deemed permissible and, in fact, the Argentine Competent Authority, AFIP, and the courts have consistently applied GAAR in a treaty context. Recent treaties (Spain, Chile, Mexico, UAE, and the Amending Protocol with Brazil) contain treaty-based GAAR and/or LoBs patterned after BEPS Action 6 and MLI's PPT.

In general terms, GAAR seek to prevent, deter or counteract the use of *unnatural* legal forms to arrange the affairs of a taxpayer that minimize or reduce the payable tax. This practice must not be confused with tax evasion, which usually involves the use of illegal means to the same end. Thus, while tax avoidance in Argentina does not necessarily lead to criminal prosecution --the usual remedy being re-characterization, the application of interest on unpaid taxes, and, unless certain excepting conditions are met, fines for tax omission--, tax evasion does lead to criminal prosecution in addition to interest and much higher fines for tax fraud.

When GAAR are based on broadly designed standards that give wide discretion on their application, as it is the case in Argentina, extensive interpretation of taxing rules to fact patterns clearly beyond the reach of the tax law proves appealing. Indeed, administrative precedents and precedents from lower courts reflect from time to time this temptation through the issuing of somehow zigzagging decisions. Nonetheless, this tendency is checked by constitutional principles, including the previously mentioned principle of reserve and the fundamental principle of legal certainty, which have been consistently upheld at the Argentine Supreme Court of Justice (the Supreme Court or CSJN) level.

The Supreme Court has played a significant role in providing certainty to the tax system through a line of decisions that has consistently: i) avoided exceeding the limits of judicial power, despite being called upon to close legal loopholes or correct legislative nearsightedness, ii) subordinated GAAR to the reserve principle; ii) balanced GAAR with other interpretation principles of the law; iii) limited GAAR's application to the assessment of facts to exceptional cases that clearly meet rule policies. Without the Court's tempering influence, an overly broad application of GAAR would have threatened businesses with uncertainty, yielding a tax system full of serious troubles for legitimate initiatives.

The strength of Argentine GAAR derives from their long application history which has given the judiciary ample time to define the rules' contours of application.

Reasonable taxpayers' safeguards against an arbitrary application of GAAR are provided under Argentine law and, with certain limitations, they are effective even at the tax agency's level.

PART I: GENERAL ANTI-AVOIDANCE RULES OR DOCTRINES

1.1 General overview

1.1.1. Description of GAAR and scope of application

Argentine GAAR are contained in sections 1 and 2 of the Tax Procedural Law (TPL)¹. Although in a different context, both sections describe the *economic reality principle*. Section 1, TPL, mandates the application of the economic reality principle to the construction of the tax law, while Section 2, TPL, provides for the application of the principle to the assessment of facts (i.e., the characterization of the acts and transactions of taxpayers).

Section 1, TPL, sets forth the principle that tax provisions must be construed in accordance with their purpose and economic meaning, adding that whenever it is not possible to ascertain the meaning or the scope of application of a tax rule based on its wording or intent, the interpretation may be made resorting to private law rules, concepts, and principles.

Section 2, TPL, in turn, directs consideration of the acts, situations, and economic relations performed, pursued or created by taxpayers to determine the true nature of the taxable event. Under this rule, whenever a taxpayer's chosen legal form does not coincide with a structure offered or authorized by law to properly shape actual economic objectives, the chosen forms may be discarded. In its stead, the law requires that the actual economic situation be considered within the structures provided by private law and the most natural forms applied consistently with the taxpayer's actual economic intention.

GAAR, as defined under section 1 and 2, TPL, apply to the construction of TPL itself and all other federal tax laws regulating taxes [*e.g.*, income tax, value added tax (VAT)] subject to TPL provisions,² their

¹ Law 11, 683, as amended.

² The content of TPL exceeds procedural matters to cover substantive tax law topics proper of a tax code.

implementing decrees and complementary regulations issued by the tax authorities (the Tax Agency or AFIP), as well as to the assessment of facts regarding the application of said federal taxes.³

The Argentine Constitution contemplates the reserve or legality principle (section 19 and, particularly, sections 4, 14, 17, 18, 28 and 33). Pursuant to this principle, a legislative enactment by Congress is required to, *inter alia*, create and impose taxes and other contributions in the exercise of taxing powers (sections 4 and 17, Argentine Constitution).⁴ Courts have repeatedly and consistently relied on the reserve principle to declare tax rules unconstitutional,⁵ and particularly counter balancing GAAR whenever their application result in the levying of taxes beyond the scope of the law (e.g., in cases of analogical extension of the taxable event).

1.1.2. The Economic reality principle as applied to the construction of the tax law

The nature of the legal rule as an abstract formulation requires that, in its application, be construed or interpreted, *i.e.*, its actual sense and scope of application be determined. This is a complex task often aggravated by the imprecision of the language used in the rule.⁶ Interpreting written laws (including tax laws) involves the need to answer two basic questions: What does the law say? What does the law intend to say?

The first question is answered by reference to the *textual or grammatical interpretation*, which is limited to assessing the plain meaning of the words used in the law.⁷ This is the primary method used by the interpreter to determine the meaning and scope of the tax rule.

The second question (what does the law intend to say?) is answered by the *logical or teleological interpretation* which consists of finding the *ratio legis* or lawmaker's intention as reflected in the law. A strict interpretation follows from a conclusion that the legislator's expression and intent coincide precisely. A restrictive interpretation results if the words used by the legislator exceed the deduced intent, and an expansive interpretation applies whenever the language does not reflect the legislator's intent and is expressed in overly narrow terms.⁸

In addition, the Supreme Court has repeatedly applied the so-called *systematic interpretation* of the law, stating that rules must be construed to prevent assigning to them a meaning contradictory with other

³ Unless otherwise noted, GAAR and SAAR will be discussed in the context of the income tax law (ITL).

⁴ Accord. Linares Quintana, *Tratado de la Ciencia del Derecho Constitucional*, vol. IV, p. 245 ff.

⁵ For an analysis of the reserve principle in the tax area see, e.g., Giuliani Fonrouge, *Derecho Financiero*, Depalma, vol. I, p. 361; Jarach, *Curso Superior de Derecho Tributario*, CIMA, vol. I, p. 93 ff; Linares Quintana, *El Poder Impositivo y la Libertad Individual*, Alfa, p. 177; Martín, *Derecho Tributario Argentino*, Depalma, p. 207; García Belsunce, *Temas de Derecho Tributario*, Abeledo-Perrot, p. 78, and *El Principio de Legalidad en el Derecho Tributario*, DF XLII, p. 1; Valdez Costa, *Instituciones de Derecho Tributario*, Depalma, p. 121; Spisso, *Derecho Constitucional Tributario*, Depalma, p. 253 ff; Teijeiro, *El Principio de Legalidad, la Seguridad Jurídica y el Ejercicio de la Función Judicial en Materia Tributaria*, La Ley 1994-C, p. 897 ff, in *Impuestos, Doctrinas Fundamentales 1942-2002*, La Ley p. 428 ff; Casás, *Derechos y Garantías Constitucionales del Contribuyente*, Ad-hoc, chapter VI, p. 507 ff. Casás, *Principios Jurídicos de la Tributación*, in *Tratado de Tributación* (García Belsunce – Díaz Eds.) Astrea, 2004, I, 1, p. 258 ff.

⁶ Carrió, *Notas sobre el Derecho y el Lenguaje*, Abeledo-Perrot, 1968; Krause Murguiondo, *El Método Dogmático y la Interpretación de las Normas Jurídicas*, LL 1979-D, p. 823, and *La Interpretación de la Ley y el Derecho Tributario*, La Ley, p. 33 ff.

⁷ García Belsunce, *Temas de Derecho Tributario*, Abeledo-Perrot, p. 139.

⁸ Chouhy, *Irretroactividad de la Nueva Interpretación de la Ley Impositiva*, DF X, p. 521-522.

provisions which also govern, directly or indirectly, the subject matter, and favoring the interpretation that harmonize the conflicting provisions.⁹

All general interpretative methods apply to the construction of tax statutes within the framework of constitutional rights and other fundamental guarantees.¹⁰ Because of the controlling principle of reserve or legality, the language used in tax statutes is particularly significant, and, hence, taxes may only be imposed by a written provision of law passed by Congress to the exclusion of analogy.¹¹

The exclusion of analogy, however, does not preclude arriving at an extensive application of the rule by logical interpretation. While analogy involves extension of a rule to cases beyond the scope of the rule based on a likeness of circumstances that assumes the legislator's intent to cause the same consequences,¹² extensive application merely cures the insufficient formulation of the interpreted law. Thus, analogy supplements a rule to apply it beyond its scope and intent, while extensive interpretation deals with shortcomings of the statutory language to give full meaning to the legislator's intent.¹³

The economic reality principle as an additional construction criterion of the tax law, reflects two fundamental principles: The economic content of the taxable event, and the disregard of legal formalities in search of an economic relationship's true nature.¹⁴ This criterion does not represent a revolution in legal interpretation theory, since the interpreter must always focus on the characteristics that determine the special nature of the relations ruled by the law.¹⁵

It is within this context that economic reality principle provided for by section 1, TPL, must be understood and applied. Its potentially excessive and arbitrary use, based on political considerations or the State's constant need for increased revenues, would violate the constitutional principle of reserve and cause uncertainty, whose effects on the economy and business development are apparent.¹⁶ Thus, it is well settled that Argentine constitutional law requires tax laws' interpretation under the economic reality principle to be based on the law, prohibiting the interpreter from exceeding the express rule to replace its spirit and give it a meaning that violates its express content.¹⁷

Section 1, TPL, also sets forth the supremacy of tax rules, concepts and principles over private law; only when interpretation cannot be based on the former, *i.e.*, because the tax law language is clearly predicated on private law, may the interpreter resort to it to resolve an interpretation issue. Nonetheless, it is worth mentioning that tax law usually uses terms of art that do not correspond to private law concepts.¹⁸

⁹ Argentine Supreme Court Official Collection, Fallos at 307:2053; *id.*, *inter alia*, Fallos 244:129; 255:360; 258:74; 271:7; 278:62; 297:143; 303:248; 1041; 307:993, 2071; 311:193; 316:2499.

¹⁰ Accord. Giuliani Fonrouge, *id.* note 5, p. 97.

¹¹ Sanz de Urquiza, *La Interpretación de las Leyes Tributarias*, Abeledo-Perrot, p. 64-65.

¹² García Belsunce, *id.* note 7, p. 141.

¹³ "... it is not possible to accept the analogy in the interpretation of substantive tax rules to extend the law beyond what was foreseen by the legislator nor to impose an obligation ... considering reiterated doctrine in the sense that, as regards tax obligations, the principle of reserve or legality controls ..." Fallos 312:912; accord, *inter alia*, Fallos 103:155; 180:384; 209:87; 310:290; 316:2329.

¹⁴ García Belsunce, *id.* note 7, p. 153.

¹⁵ García Belsunce, *id.* note 7, p. 154.

¹⁶ In this sense, see the wise reflections of Le Pera and Lessa (Argentine reporters) in *The Disregard of the Legal Entity for Tax Purposes*, LXXIV Cahiers de Droit Fiscal International, p. 157 ff., at p. 164/166.

¹⁷ Accord. Sanz de Urquiza, *id.* note 11, p. 30, 35.

¹⁸ Examples of this include the concept of permanent establishment in domestic and treaty law, terms used in the context of tax-free reorganizations such as mergers or divisions, or the concept of business enterprise, which includes unincorporated associations as well. In

1.1.3. GAAR as applied to the assessment of facts

The application of GAAR to the assessment of facts has generated significant academic debate and judicial controversy in Argentina. A series of circumstances has fueled the discussion on their scope and limits of application:

First, GAAR's own definition, which is based on broadly designed standards, leaving room for potential uncertainty and legitimate differences in interpretation.

Second, there has been a marked tendency to resort to GAAR to decide complex issues. This situation is particularly aggravated because of the frequent lack of adequate quality and precision of the tax legislation which have forced the Tax Agency to resort to GAAR to solve cases more often than expected. Besides, in many instances, the legislator has not reacted promptly to the dynamic of business transactions; in that context, to prevent revenue erosion, the Tax Agency has been faced with the need of enlarging the reach of the statutory definition of the taxable event by re-characterizing new forms of business transactions to match the statutory wording; this has been also made by resorting to the economic reality approach contained in Section 2, TPL, interpreted in a way which goes far beyond its language and purpose, and purportedly transforming legitimate tax planning into tax avoidance. The tax agency's reasoning underlying this position may be summarized as follows: Whenever more than one form or set forms may be used to characterize the taxpayer's economic goal –although all of them may be equally consistent with the economic intent– the one that would subject it to the heaviest tax burden should be applied. In other words, regardless of which legal transaction is performed, taxes are due as if the taxpayer has chosen the most unfavorable, in tax terms, legal forms.

Since inception in 1943, GAAR's application to the assessment of facts has been at times heavily influenced by political or ideological biases against targeted sectors, as demonstrated by Supreme Court's precedents dealing with foreign-controlled domestic corporate taxpayers during the seventies of the last century.¹⁹

The principle of *maximum taxation* has garnered theoretical support from some well reputed scholars who have sustained that section 2, TPL, allows complete freedom to discard the taxpayer's legal characterization of its business transactions.²⁰ This is not, however, the prevailing opinion today.

Maximum taxation policy ignores that legitimate tax planning efforts to save taxes within the text and meaning of the law are indeed permitted by the Argentine constitutional and legal system. Section 19 of the Argentine Constitution states: "*No resident of the Nation shall be obliged to perform anything not ordered by law, nor deprived of anything not prohibited by it...*" Coincidentally, *in re I.C.A. Argentina S.R.L.*, the Supreme Court held that "*...an honest effort by the taxpayer to keep its taxes as low as legally possible*

many instances the tax law also incorporates concepts from accounting rules and principles. In all these instances private law concepts are immaterial in connection with the interpretation of tax statutes.

¹⁹ Accord. Le Pera and Lessa, *id.* note 16, p. 166. This was particularly so during the 70's of the last century.

²⁰ See, *inter alia*, Jarach, *El Hecho Imponible*, Abeledo Perrot, p. 131 ff.

deserves no reproach."²¹ This principle might be deeply undermined if the *maximum taxation* approach to section 2, TPL, ever prevails.

Lastly, unless in defining the taxable event or other essential elements of the tax obligation the statutory language authorizes otherwise, the *maximum taxation* approach violates the reserve or legality principle, taxing or subjecting to a higher burden (by use of analogy) legal transactions not expressly contemplated in the law. This practice is unacceptable on constitutional grounds as repeatedly and consistently held by the Supreme Court.

1.1.4. GAAR and SAAR related to domestic and international transactions

GAAR apply to the construction of ITL international rules and to the assessment of facts relating to international transactions, only subject to international law limitations on the exercise of tax jurisdiction. GAAR, in this context, are to be applied with the same meaning and subject to the same limitations discussed when analyzing application in the domestic context.

Section 2, TPL, allow to re-characterize international transactions for tax purposes when such transactions are entered by: i) resident individuals and Argentine-domiciled companies, whether generating Argentine or foreign source income/expenses; and ii) nonresident individuals and foreign-domiciled companies as long as they generate Argentine source income subject to income tax withholdings at source.

The tax agency and the courts have applied GAAR as extensively in the international context as in the domestic context. Until 1992, however, application of GAAR to international transactions was mostly addressed to Argentine source generating transactions by foreigners since, until then, Argentine taxpayers were taxed on a territorial basis only. Within that context, intercompany dealings between foreign-controlled domestic companies and their foreign parent or other foreign affiliated companies, were closely monitored by the tax agency and originated significant judicial decisions.

Domestic SAAR are aimed at specific situations that, for different reasons, the legislator has considered inadequately covered by GAAR. SAAR may either take the form of mechanical rules that apply to all transactions meeting the statutory definition, thus describing in detail the targeted transactions, or rules whose application depends on a general standard patterned after that of GAAR. In the latter case, the law often presumes a specific intent, unless the taxpayer proves to the contrary.

SAAR are not defined or grouped as such in ITL, so that a functional approach has been followed to encompass them. Thus, all ITL rules regardless of whether designed as tax avoidance rules, and irrespectively of their nature or characteristics, are deemed SAAR if they function as such, *i.e.*, they help ITL taxing or other substantive rules to be applied to their true extent, as intended by the lawmaker.²²

SAAR applicable to international transactions are ITL rules that have developed over time to close legislative loopholes. Prior to 1992, most international SAAR were geared to reinforcing Argentine tax

²¹ Fallos 241:210.

²² See, Teijeiro, *Las Normas Anti-elusión en el Derecho Tributario Argentino: su Aplicación y Alcances en el Contexto Internacional*, en Interpretación Economics de las Normas Tributarias, Casás ed. p. 505 ff., at 541; Editorial Abaco de Rodolfo Depalma, 2004.

jurisdiction at source, avoiding the erosion of the Argentine income tax basis and assuring proper tax characterization of targeted cross-border inbound transactions by foreigners.

SAAR addressed to foreign source income/expenses obtained or incurred by resident individuals and domestic entities, as well as to transactions with tax haven jurisdictions were additionally included in ITL upon adoption of the worldwide income taxation for Argentine residents.

1.2. The tax avoidance scheme, arrangement or transaction

Section 2, TPL, allows deviation from the legal characterization of a transaction when the taxpayer has used legal forms that are *manifestly* inadequate to shape the effective economic intent. This means that Argentine GAAR only allow re-characterization when the legal forms utilized are distorted, *i.e.*, they do not conform because of their nature or characteristics to the actual economic intention of taxpayers. In other words, a radical or manifest discrepancy between the legal forms chosen by the taxpayer and the economic essence of the business pursued must exist for section 2, TPL, to apply.²³ Similarly, it has been said that Argentine GAAR only allow discard of the taxpayer's legal characterization of a transaction in the case of simulated (sham), indirect, or fiduciary transactions.²⁴

As a single, all-embracing rule designed as a general standard, Argentine GAAR leave a lot of room for the Tax Agency and the courts to determine whether and how they apply to a case, and, in fact, they have been extensively used in several contexts for several reasons. Moreover, the negative formulation of the statutory language (GAAR do not positively define the *most appropriate legal form*) does not help much on which legal form would have been appropriate in a given case to instrument the economic intention of the taxpayer, and this aspect is an issue by itself since, in essence, re-characterization is a twofold process where the interpreter must first disqualify the legal form utilized as alien to the economic intention pursued but, then, on the basis of facts and circumstances, must identify those other deemed connatural to said intention in order to apply the tax treatment afforded to them by the law.

GAAR long history of existence has given the courts ample time to demarcate the contours of their application despite their general formulation, making it possible to predict with reasonable certainty how the courts would decide a case if a similar one has come up before.

The Tax Agency has been traditionally aggressive in the application of GAAR to the assessment of facts, challenging even legitimate tax planning practices that save taxes. However, the Supreme Court has balanced those attempts, limiting the scope of GAAR to its statutory language and intent, and harmonizing the legal provision with the taxpayers' constitutional rights and guarantees.

²³ Accord. González de Rechter, Argentine Report, *Tax Avoidance/Tax Evasion*, LXVIIIa Cahiers de Droit Fiscal International, p. 211, at p. 212/213; Díaz Sieiro, Argentine Report, *Form and Substance in Tax Law*, LXXXVIIa Cahiers de Droit Fiscal International, p. 71, at p. 83; Teijeiro, *Argentine Anti-Avoidance Rules: Application under Domestic and International Conventional Law*, Tax Notes International, October 2003, p. 89; Teijeiro, *id.* Note 23, p. 505 ff. See also Tarsitano, *Argentine Report, Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions*, LIXVa Cahiers de Droit Fiscal International, p. 59 ff.

²⁴ Martínez, *El Criterio Económico y la Importancia que para el Derecho Fiscal tiene la Divergencia en el Negocio Jurídico entre la Intención Empírica (Intentio facti) y la Intención Jurídica (intentio juris)*, DF XX, p. 849. See also Tarsitano, *El Principio de Realidad Económica y el Exceso de la Potestad Calificatoria del Fisco*, in Protección Constitucional de los Contribuyentes (R.O. Asorey, ed.),

A significant area of GAAR's application is that of sham transactions. Sham transactions arise when the legal form used by the taxpayer contradicts the legal reality of the transaction under private law. As a result, the tax should be imposed on the transaction's real terms and not those simulated by the taxpayer.

While in strict terms the sham concept relates to *legal reality* rather than to *economic reality*, sham transactions are challenged through the use of GAAR.²⁵ Sham transactions may also imply fraudulent conduct leading to tax penalties and criminal persecution, as when the taxpayer has intentionally concealed the true nature of the legal transaction to avoid detection of the actual tax amount owed,²⁶ or when, with the same purpose, items of income and/or deductible expenses have been artificially shifted to an interposed person or entity.²⁷

Other pathologies under GAAR's scrutiny include taxpayers' acts in *fraus legis* (of which the indirect transaction is a species), and the fraudulent use of a legal entity.²⁸

The *fraus legis* doctrine prevents taxpayers from exploiting of the literal language of the statute for tax avoidance purposes. A transaction is deemed in *fraus legis* when, although valid for private law purposes, its legal form is used to avoid rules that correspond to the economic goal pursued. In other words, the legal act or transaction is carried on under the umbrella of rules applicable to a different goal or objective to avoid the tax. An indirect transaction implies fostering an objective through an oblique or circular means.²⁹ Finally, in particularly extreme contexts, GAAR have been applied to pierce the corporate veil in the tax field to deter abuses of the legal (separate) corporate personality.

1.3. The tax benefit, gain of advantage

The definition of GAAR pursuant to section 2, TPL, does not make an express reference to a benefit, gain or tax advantage derived by a taxpayer who uses legal forms which are manifestly inadequate to shape the economic intent pursued.

The tax advantage rather functions as a pre-condition for the tax agency to seek re-characterization or reallocation of income to its true beneficiary in an occurring case.

As regard SAAR, the benefit or advantage either functions similarly (*i.e.*, as a pre-condition of their application), or it is built into the SAAR formulation, particularly when they take an objective, mechanical form of application.

1.4. The taxpayer's purpose or intent

Marcial Pons, p. 265 ff., and *La Realidad Económica y la Calificación Jurídica en la Interpretación de la Ley Tributaria*, ED 198, p. 691 ff.

²⁵ Accord. Díaz Sieiro, *id.* note 23, at. p. 87/88; Tarsitano, *id.* note 24, ED 198, p. 691 ff., at p. 700.

²⁶ Accord. Díaz Sieiro, *id.* note 23, p. 88/89 and accompanying footnotes where applicable fines and criminal penalties are detailed described.

²⁷ Accord. Tarsitano, *id.* note 23, ED 198, p. 691 ff., at p. 701.

²⁸ *Id.* p. 696-701.

²⁹ See Díaz Sieiro, *id.* note 23, at p. 80 (n. 26).

If the legal forms chosen are manifestly inadequate to achieve the economic goal strived for, GAAR would apply to reconcile form and intent (substance), even if the taxpayer evidences that lack of experience or of legal knowledge led him to choose the inappropriate form.

On the contrary, evidence of the taxpayer's intent to save taxes does not *per se* cause re-characterization under GAAR if the chosen form is deemed adequate to shape the economic goal pursued; in other words, except in the case of an act in *fraus legis*, where by its sole definition the taxpayer's intent matters, use of the most tax-effective legally available type of transaction is beyond the reach of Argentine GAAR, regardless of the taxpayer's intent to save taxes.³⁰

1.5. Tax consequences of GAAR application to a given case

The principal consequences of GAAR's application in a case are re-characterization of a transaction or a series of transactions for tax purposes and/or the re-assignment of income (losses) to the actual beneficiary or beneficiaries following such re-characterization. Associated consequences are the application of interest on unpaid taxes, and unless certain excepting conditions are met, fines for tax omission. If the taxpayer's behavior is fraudulent, re-characterization may also lead to criminal prosecution in addition to interest and higher fines for tax fraud.

Tax re-characterization pursuant to GAAR, however, does not ordinarily project its effects on the legal characterization of the targeted transaction or transactions which remain unaffected from a strictly legal perspective.

There might be cases where, through separate and different procedures, transactions are challenged in their own nature under private law (for instance, by applying abuse of law principles), and tax law through GAAR, in which instances the result might be that the legal forms utilized be discarded for legal and tax purposes as well. That could be the case when a legal (paper) entity is artificially interposed in a business transaction and subsequently challenged by disregarding the corporate veil for corporate law and tax purposes. In this type of cases, however, there must be a separate legal challenge to the transaction so that it comes to confirm the principle that re-characterization for tax purposes under GAAR does not, *per se*, project its effects on the private law field.

1.6. Conflicts between domestic and treaty GAAR or between domestic GAAR and SAAR

1.6.1. Conflicts of GAAR with domestic SAAR

Most SAAR applicable in the domestic context take the form of mechanical rules that assume a potential risk of tax avoidance/abuse in an area to define their scope and consequences with practically no discussion if the taxpayers' acts or transactions come within the reach of the respective provisions. In some

cases, however, the law allows the taxpayer to prove to the contrary, thus escaping the adverse tax consequences described in the rule. That is, *inter alia*, the case of disbursements lacking proper documentation, whenever the payer can evidence that the undocumented payments are related to the earning or maintenance of taxable income, or that of the interest presumption unless such interest is originated in deferred-payment sales of real estate.

In some other cases, SAAR are more broadly designed (*e.g.*, re-characterization of derivative instruments, or the presumption of interest on the disposition of funds or assets in favor of third persons, when such dispositions are not made in the interest of the business), thus leaving room for a conceptual discussion on whether the rule's applying conditions are met in the case.

When SAAR are provided by the law, the issue is whether GAAR may still be applied in the former's area of application.

It may be argued that if SAAR exist, the Tax Agency and the courts should be precluded from applying GAAR, as the sole existence of SAAR demonstrates that the legislator's intent was to refine GAAR in the area, at the risk that tax planners find a loophole not covered by the special rule. Since most Argentine SAAR developed after the introduction of GAAR in the tax law, this argument would be reinforced by the general principle pursuant to which special subsequent rules supersede prior general rules. Under a different line of reasoning, however, it could be argued that SAAR merely add another statutory tool to fight tax avoidance and do not prevent the Tax Agency and the courts from applying GAAR if needed under the facts and circumstances of the case.

A difference could be made between mechanical and broadly-designed SAAR patterned after GAAR's design elements. The latter appears not to generate actual conflicts because the legislator merely provides for a specific application of the same principle, either based on the significance of the abuse or for other reasons. In any case, the argument may be made, the same conclusions could be arrived at by resorting to GAAR in the absence of SAAR.

Among mechanical SAAR, two sub-groups could still be analyzed differently. Those permitting the taxpayer to submit evidence to the contrary to escape their application appear to allow the Tax Agency to resort to GAAR to sustain its own position. For example, a corporate taxpayer may bring evidence trying to prove that a loan was, in fact, intended to be interest free, thus escaping the application of the interest presumption under the corresponding SAAR; however, the tax agency might still insist and, based on GAAR, sustain that unless such evidence is conclusive, an interest-free loan between companies is inconceivable, since under private law all acts of businessmen are presumably made for consideration.

As to mechanical rules allowing no evidence to the contrary, an argument could be made that if the taxpayer's transaction does not fall within the scope of the respective rule, GAAR should not be supplementary applied. Thus, for example, if directors' fees do not exceed 25% of accounting profits for the year, it appears that the tax agency would not be able to discuss the reasonableness of the directors'

³⁰ Teijeiro, *id.* Note 22, p. 505 ff., at 528-529.

compensation based on GAAR, nor require the company to prove that such compensation was commensurate with the directors' activities performed during the year.

Based on the foregoing, it appears to be reasonable and in line with the legislator's policy decisions to sustain that, as a general guidance, the more objective and mechanical the SAAR, the lesser room for GAAR's subsidiary application.

1.6.2. Conflicts between GAAR and international SAAR

Since most international SAAR are based on objective parameters, and hence, mechanically applied, *i.e.*, of unavoidable application to the taxpayer if the objective application conditions are met, GAAR could not be supplementary applied to enlarge the former scope of application.

However, GAAR may, under certain circumstances, overlap with objective SAAR in the international scene; that would be the case wherever the taxpayer can challenge SAAR by contesting the factual basis for their application and proving against the Tax Agency's fact finding.

An example may be the following. Precise transfer pricing rules apply to intercompany cross-border dealings between related parties. Bearing that in mind, let's assume that an Argentine exporter i) sells goods (other than commodities to which the Sixth Transfer Pricing Method applies)³¹ to a related entity domiciled in a no or low-tax foreign jurisdiction for subsequent resale to final customers in third countries, ii) sales to the intermediate foreign entity are made at below-market prices, and iii) an excessive profit margin is left with the intermediate company because it subsequently resells the goods at market prices to final customers. Let's also assume that the intermediate foreign entity lacks substance, and, hence, the margin earned by it does not actually compensate risks and functions related to the purchase and resale business.

The Tax Agency might try to readjust the export price and income of the Argentine taxpayer by applying transfer pricing rules provided for in ITL. However, the Tax Agency might alternatively resort to GAAR, prove that the foreign intermediate entity lacks any substance, that the transaction is in fact a sham, and, on that base, take the position that the intermediate company should be disregarded for tax purposes and its income fully attributed to the Argentine exporter.

Provided that all relevant facts may be conclusively evidenced, this last approach might be appropriate, and there are no ordering rules under ITL preventing the agency to follow it instead of readjusting the export price.

Another example comes in connection with the application of ITL international transparency rules; although these rules are limited to the current attribution to Argentine shareholders of income from passive activities obtained by tax heaven stock corporations, GAAR might be applied with the same goal when passive income is obtained through a foreign different vehicle (*e.g.*, a foreign trust) which is not the actual

³¹ The Sixth Transfer Pricing Method applies to the exports of commodities by an Argentine exporter to a foreign related final purchaser, channeled through a foreign intermediary entity which is not the final addressee of the goods, in which case a non-rebuttable presumption which consists of a deemed transaction price applies: the price to be considered is the prevailing market price as of the date of loading or the actual agreed upon price at execution date, whichever the highest (accord. Section 15.6, ITL). This is a purely mechanical non-rebuttable SAAR which, as such, excludes any potential application and, hence, overlap with GAAR.

beneficiary; that would be the case if it is evidenced that no actual transfer of title to the income producing assets took place from the domestic settlor to the foreign trust, as in the case in which the settlor is also the beneficiary of the foreign trust.³²

1.6.3. Conflicts between domestic GAAR and treaties

Argentina's treaty network is rather limited; at present, Argentina has DTAs in force with Australia, Bolivia, Brazil, Belgium, Canada, Chile, Denmark, Germany, Finland, France, Italy, Mexico, The Netherlands, Norway, Russia, Spain, Sweden, Switzerland, and The United Kingdom. Additionally, there is a DTA signed (not yet in force) with UAE. All DTAs but for Bolivia are structured along the lines of the OECD MC, with variations coming from the United Nations Model Convention (UN MC). In its original text, the DTA with Brazil allowed both countries to apply their domestic legislation with complete freedom,³³

Before the 1994 constitutional amendment, foreign treaties had the same legal status as domestic laws, so that a treaty might supersede a prior law and a law might supersede a prior treaty.³⁴

In *re Ekmekdjian v. Sofovich* (1992),³⁵ and based on the application of section 27 of the Vienna Convention (ratified by Argentina in 1972), the Supreme Court stated that conventional international law takes precedence over internal law. This principle was given constitutional status in the 1994 constitutional amendment, so that now international treaties approved by Congress prevail over internal laws, making clear that a subsequent statute may not override the provisions of a pre-existing DTA.

There would be no domestic legal obstacles to apply GAAR in the interpretation of DTAs, or taxpayers' acts or situations subject to DTA provisions.³⁶

In addition to the domestic principles of interpretation of the tax law, those contained in sections 31 to 33 of the Vienna Convention also apply to the interpretation of Argentine DTAs;³⁷ in this sense, rules contemplated in section 31 of the Vienna Convention deserve attention.³⁸

Until very recently, Argentine DTAs have not contained express anti-treaty shopping rules, and have been silent on the possible application of domestic GAAR.³⁹ Latest DTAs, however, do contain treaty GAAR

³² See, accord. Ruling 23/00; Tax Court, May 29, 2002, *Julio César Moreno*.

³³ The DTA with Brazil has been substantially amended by an amending protocol signed on July 21, 2017.

³⁴ See, Vicchi, (Argentine Report), *Interpretation of Double Taxation Conventions*, LXXVIIIa Cahiers de Droit Fiscal International (1993), p. 161 ff., at p. 162-164. The Supreme Court applied these principles in *re S.A. Martin & Cía. Ltda.* (1963) and *S.A. Esso Petrolera Argentina* (1968); Fallos 257:99 and 271:7, respectively.

³⁵ Fallos 315:1492; accord. Fallos 315:1282.

³⁶ Accord. Vicchi, *id.* note 35, at p. 169, 174; cfr. Díaz Sieiro, *id.* note 23, at p. 89-90, and Bugallo, *Compatibilidad de las Cláusulas Antiabuso con los Tratados de Doble Imposición*, Bulletin Argentine Association of Fiscal Studies, March/02, p. 39 ff.

³⁷ See accord. Asorey, *Los tratados internacionales y el ejercicio del poder tributario en América Latina*, RDF 5/07, p.5 ff., Lexis Nexis, November/December 2.

³⁸ For a detailed discussion of the interpretation provisions of the Vienna Convention, see Vogel ³⁸ The DTA with Brazil has been substantially amended by an amending protocol signed on July 21, 2017.

³⁸ See, Vicchi, (Argentine Report), *Interpretation of Double Taxation Conventions*, LXXVIIIa Cahiers de Droit Fiscal International 007. As regard OECD's position on the issue and the Copernican twist towards allowance of GAAR's application in a treaty setting, see Teijeiro, *Abuso o uso impropio de tratados de doble imposición. Medidas unilaterales y bilaterales para prevenirlo. La experiencia en el derecho comparado y en la Argentina*, RDF 5/07, p. 205, ff, at 232/233, Lexis Nexis, November/December 2007. and Prokisch (General Report), *Interpretation of Double Taxation Conventions*, LXXVIIIa Cahiers de Droit Fiscal International, p. 55 ff, at p. 66-74.

³⁹ See Teijeiro, *id.* note 38, at p. 237-239; see also Teijeiro, *The Argentine Tax Treaty Network: A Safe Harbor for Foreign Taxpayers*, Tax Notes International, January 19, 1999, p. 287 ff. Teijeiro, *LoB Clauses, PPT standard and the Latin American Treaty Network*

and/or LoB provisions (notably the treaties with Spain, Chile, Mexico and the amending protocol with Brazil).

The case for the application of GAAR in a treaty setting, absence an express treaty permission or prohibition, has been construed on the following reasoning: i) GAAR are an interpretative device aimed at making other substantive tax rules to be applied to the true extent intended for by the legislator or in accordance with the shared expectations of the treaty-partners concerned; ii) as other states have a common interest in avoiding unintended application of treaty benefits, GAAR application in this setting would be legitimated by general customary principles of international law; and iii) to the extent a DTA recognizes to a contracting state the right to tax a particular item of income, general principles would allow the taxing state's domestic rules (including GAAR) to apply when it exercises its taxing rights under the DTA.

As to the issue of whether GAAR apply in a treaty setting is concerned, Argentine scholars' opinions have differed,⁴⁰ and contradicting opinions have also been expressed among foreign scholars⁴¹ before the amendment to the Commentaries to the OECD MC in 2003.

Following the premise that the rule *pacta sunt servanda* does not require solely a literal interpretation of a DTA, one may take the position that application of GAAR under a DTA does not conflict with the Vienna Convention because its clauses do allow to go beyond a strict textualism when the shared intent of the treaty-partners is not manifest in the text.

Moreover, the constitutional prevalence of DTAs over domestic legislation under Argentine law would not be a decisive feature against GAAR application in a treaty setting either, provided that such application --generally allowed under a broad construction of section 3, 2 of Argentine DTAs-- does not imply a violation of the treaty text and purpose, and/or obligations of the taxing country under the DTA.⁴²

Within this view, the residence state keeps full jurisdiction to take measures when one of its residents makes an abusive use of a DTA. That would be the case, for example, if an Argentine resident channeled back to Argentina foreign funds through an intermediate (shell) entity domiciled in a treaty-partner country, thus availing himself of treaty protected Argentine source income, only available to true residents of the other contracting state.⁴³

On the contrary, it appears that the source state should be allowed to apply domestic GAAR to deny treaty benefits to residents of the other contracting state in more limited circumstances. This is the Argentine

Choices, Kluwer International Tax Blog, June 5, 2015; Teijeiro, *Argentine Treaty Network: Will the schoppable treaty soon become an extinct species*, Kluwer International Tax Blog, February 29, 2016. As an exception, limited in scope LoB clauses existed previously under the DTAs with Spain (the old treaty), the U.K. and Sweden.

⁴⁰ In favor of GAAR's application see Vicchi, *id.* note 37, at p. 174; Tarsitano, *id.* note 23, at p. 68; Teijeiro, *id.* note 38, at p. 238; against GAARs application; Diaz Sieiro, *id.* note 23, at p. 89-90, and Bugallo, *id.* note 37. Diaz Sieiro appears to sustain his opinion on the constitutional prevalence of DTAs over domestic rules according to the 1994 Argentine constitutional amendment. From a different perspective, I might also be argued that GAAR's application conflicts with the Vienna Convention, to which Argentina is a party, at least under a strict interpretation of the Convention's textualism.

⁴¹ See, *inter alia*, Jeffery, *The Impact of State Sovereignty on Global Trade and International Taxation*, Kluwer, Chapter 4, p. 102-112; IFA Congress Seminar, *How domestic anti-avoidance rules affect double taxation conventions*, Seminar Series 19 c, 1994 Congress, p. 6-9 (Dr. Lowe's opinion), p. 9-10 (Prof. Laule's opinion), and p. 10-11 (Mr. Gustasson's opinion) --who express the opinion that a DTA does not affect the application of domestic anti-avoidance rules--, p. 11-15 (Mr. Katz's opinion, who shares that view within certain limitations). Dr. Lowe also opines that application of domestic anti-avoidance provisions does not conflict with the Vienna Convention (*id.* p. 23).

⁴² Accord. see OECD MC, Commentary on Article 1, specially paragraphs 23 to 26.

⁴³ Teijeiro, *id.* note 38, at p. 238-239.

position, as reflected in the regulations issued by the Tax Agency, which rely on the other contracting state's competent authority declaration of residence to recognize treaty benefits afforded under a DTA to the residents of the treaty-partner country.⁴⁴ However, no similar limitations should apply on the source country to re-characterize a transaction under domestic GAAR, unless such re-characterization is contrary to the DTA's definitions or the parties' shared intent (as reflected in the DTA).

In line with the above referred position, there has been just a couple of isolated administrative precedents dealing with inbound transactions; both concerned the re-characterization of income at source and there is none challenging the residency of the treaty-partner beneficiary.

One of the inbound precedents⁴⁵ addressed the re-characterization of Argentine source insurance premiums paid by a local borrower to foreign insurers, relating to loans made by foreign banks located in Spain and Italy, as additional interest. In the agency's view, the economic reality showed that through the premiums paid the borrower was in fact assuming a higher financial cost.

The remainder was a precedent from the Argentine Competent authority (Dirección Nacional de Impuestos or DNI) dealing with the reallocation of interest income from DEG to other participants under a participated loan agreement governed by the DTA with Germany.⁴⁶

On the contrary, precedents on GAAR application in outbound situations, *i.e.*, affecting Argentine residents round tripping investments outside Argentina through DTAs, abound.⁴⁷

In Memorandum DNI 64/09 the fact pattern concerned an Argentine resident holding a 99% equity participation in an Austrian holding company which, in turn, held a 100% participation in a second-tier BVI corporation.

According to the then-existing Austrian DTA, the Argentine resident's holding in the Austrian intermediary and dividends received from that company were no taxable in Argentina by personal assets tax (PAT) and income tax, and Argentine international transparency rules were circumvented by the DTA, so that tax benefits to which the Argentine taxpayer avails itself by routing the investments through the Austrian holding were apparent.

DNI found that the Austrian holding was a phantom (shell) company without economic substance, and its decision qualified the situation as an abuse of the treaty; by applying GAAR, the interposed Austrian company was disregarded, and the holding of the shares in and income obtained by the BVI Corporation treated as if the interposed company have not existed.

In Memorandum 799/10, DNI dealt with a DTA structured after the Andean Pack Model Treaty (old Chilean DTA) and the interposition of a holding company (Platform Company) by an Argentine ultimate shareholder of a Latin American group of operating subsidiaries. The Argentine parent company held equity in second-tier operating subsidiaries domiciled in Peru and Uruguay, Latin American countries having no

⁴⁴ Id.

⁴⁵ Ruling 57/96.

⁴⁶ DNI Memorandum 3/06.

⁴⁷ See, *inter alia*, DNI Memorandum 64/09; and DNI Memorandum 799/10. Similarly, Tax Court, *in re Molinos Río de la Plata*, August 14, 2013, affirmed Federal Court of Claims, Court Room I, May 19, 2016. For an analysis of these precedents see Rey, Argentine rapporteur, Main Subject 2, *Planificación transnacional agresiva y abuso de tratados: herramientas de derecho interno y derecho internacional para contrarrestarlos en la era BEPS*, IX Latin American IFA Congress, Buenos Aires, May 31-June 2, 2017.

DTA with Argentina, through a wholly-owned Chilean Platform company which enjoyed a special (no-tax) holding regime in Chile; by interposing the Chilean holding, and routing its investments through it, the Argentine parent corporation avoided taxation on dividends made up with profits coming from the second-tier operating subsidiaries, which would have been fully taxable in Argentina if paid directly by the operating subsidiaries to the parent Argentine corporation.

DNI sustained that: i) DTAs should not be utilized to ameliorate or eliminate the tax burden through legal forms that would not be adopted but for the tax advantages deriving therefrom; ii) domestic GAAR might and should be applied to avoid abusive schemes in a treaty setting; iii) the main reason to interpose the holding was to deviate dividend income coming from Uruguay and Peru, which would have otherwise been taxed in Argentina, with the end result of benefiting from a double non-taxation; iv) double non-taxation contradicted the DTA and implied an abusive conduct challengeable under domestic GAAR; v) the Platform company regime was beyond the scope of the Chilean DTA, as it was a promotional regime which did not fall under Article 1 (taxes covered) of the DTA.

The Competent Authority's opinion in DNI Memorandum 799/10 gave rise to the Molinos Río de la Plata case, first decided by the Tax Court on August 14, 2013. The Tax Court upheld AFIP's tax claim against the Argentine parent company arguing, *inter alia*, that: i) there was an abuse of the treaty, so that AFIP's administrative tax assessment taxing dividends received by *Molinos* in Argentina had to be confirmed; ii) to find the existence of an abuse, the Tax Court applied domestic GAAR and considered that the Platform Corporation was not the effective beneficiary of the dividends paid out by the operating subsidiaries; iii) though the effective beneficiary concept was alien to the text and spirit of the DTA (since patterned after the Andean Pack Model which does not contemplate the concept), the court found that a deemed "effective beneficiary" concept was built into the applicable GAAR; and, finally, iv) as a *dictum*, the court sustained that DTAs might be used to mitigate or reduce the tax burden but not to eliminate that tax burden altogether (double non-taxation).

Critics against the Tax Court's decision were widespread. Criticism focused, *inter alia*, on the following: i) consideration of the effective beneficiary as an implied concept within GAAR; ii) the application of GAAR itself: Since a manifest discrepancy did not exist between the legal forms utilized by the taxpayer and the economic substance of the transaction, the latter might have not been challenged thereunder even if the taxpayer's intention was to obtain a tax benefit, unless it was evidenced that it acted in *fraud legis*; iii) tax advantage: pursuing a tax advantage or benefit under the DTA (*e.g.*, even a double non-taxation) was not, *per se*, enough to ignore the intermediate holding under GAAR. iv) Substance: To legitimately challenge the structure under GAAR, the Tax Court should have either evidence that the Chilean holding was not the actual owner of the dividends received from the Peruvian and Uruguayan subsidiaries, and/or that it lacked economic substance (*i.e.*, it exercised no effective management or administration of the holdings). Although the description of facts is somehow meager in the case, none of that resulted undoubtedly evidenced, but the mere fact that dividends received had been immediately repaid by the Chilean holding to the Argentine Parent Company; and v) *fraud legis* doctrine: If the Chilean Platform company used and enjoyed the dividend income without being constrained to pass the dividends on to the

Argentine parent, and managed the equity participations held, it might not be deemed to have been interposed in *fraus legis* nor would have failed meeting the substance test.

The Court of Appeals affirmed the Tax Court decision adding that: i) the Chilean holding has not been created with the purpose of carrying on the international expansion of the economic group led by the Argentine parent, but with the sole objective of obtaining tax benefits under the Chilean DTA, thus permitting to label it as a mere conduit; ii) the taxpayer's construction of the DTA contravenes the principle of good faith contemplated in the Vienna Convention; and iii) the lack of anti-abuse clauses in the DTA allows to apply GAAR.⁴⁸ A final decision on the *Molinos* case is currently pending before the Supreme Court.

1.6.4. Treaty GAAR and LoB

Starting in June 2008, Argentina terminated unilaterally a number DTAs including the treaties with Austria, Spain, Switzerland and Chile. Reasons for termination vary, but allegedly perceived misuses of the DTAs by Argentine residents through round-trip schemes were at the basis of the DTA terminations with Austria, Spain and Chile.⁴⁹ Today Argentina has new DTAs in force with Spain, Switzerland, Chile, and Mexico. A new DTA with UAE as well as an Amending Protocol with Brazil have also been signed.

The new Spanish DTA keeps applying to residents of one or both treaty-partner countries without being conditioned upon the beneficiary's effective taxation in its country of residency; thus, Spanish holding companies (ETVEs) were not subjectively excluded from the its scope of application. However, two new clauses in the accompanying Memorandum of Understanding (MoU) are worth mentioning: Clause A, which allows a treaty partner to apply domestic GAAR to prevent tax avoidance or evasion, and Clause B, which provides for the application of the beneficial ownership requirement regarding income of any nature received by a treaty-partner beneficiary. The most relevant innovation arising from the new Spanish DTA is a first-time-ever express treaty reference to the application of domestic GAAR.

Section D of the MoU further provides that sections 10, 11, 12 and 13 (dividends, interest, royalties and capital gain provisions) will not apply whenever the primary purpose or one of the primary purposes of a person related to the origination or assignment of shares or other dividend-generating rights, an interest-bearing credit, or a royalty-generating right, is to obtain the benefits of such sections. This rule might well be viewed as an early predecessor of BEPS Action 6 and MLI's PPT (principal purpose test) within the Argentine treaty network.⁵⁰

⁴⁸ Rey, *id.* note 49, at p. 27.

⁴⁹ See Teijeiro, *La Terminación Unilateral de los Convenios Internacionales de Doble Imposición: Cuestiones Jurídicas bajo el Derecho Internacional Convencional y el Ordenamiento Constitucional Argentino*, RDF Abeledo Perrot, Nov/Dec 2008. In the case of Switzerland, the main reason for termination was a clause in the Additional Protocol to the DTA which, by equaling the treatment of royalties to that afforded under Swiss law, in practice implied that Argentine-source royalties went fully untaxed. Argentina also wished to correct the treatment afforded to insurance businesses, and to introduce a wider exchange of information clause.

⁵⁰ See Teijeiro, *LoB Clauses, PPT Standard, and the Latin American Treaty Network Choices*, Kluwer International Tax Blog, June 5, 2015.

Although perhaps less ambitiously the new Swiss DTA sets forth an anti-abuse provision aimed at avoiding that residents of third countries may take advantage of the benefits of the DTA by structuring abusive tax planning that lead to double non-taxation.⁵¹

The new DTA with Chile follows the OECD MC structure, and sets forth strict rules to avoid round trip treaty shopping schemes. To that end, it⁵² provides (for a first time within the Argentine treaty network) a LoB clause, coupled with a PPT rule patterned after Action 6, BEPS.⁵³

Similarly, the treaty with Mexico provides express rules to avoid treaty shopping,⁵⁴ consisting of a LoB clause and a PPT standard patterned after Section 6, BEPS. Moreover, paragraph 6 of Section 28 provides that: *The provision of this agreement shall not prevent any contracting state from applying ... any anti-abuse rule in force in the domestic legislation of the contracting states.* This express reference to the application of domestic GAAR, without further qualifications, leaves open the issue of treaty rules' prevalence and potential overlap with GAAR.

Section 16 of the new Amending Protocol with Brazil contemplates a PPT rule⁵⁵ and a simplified LoB applicable to legal entities based on equity ownership (50%); this rule does not apply where the entity carries out business activities different from the mere holding of securities or other assets.⁵⁶

Finally, Section 26 of the UAE DTA (not yet in force) contain an express LoB, and a PPT (par. 2) which functions as an escape from LoB's application.

1.6.5. MLI and conflicts between domestic and treaty GAAR

The Multilateral Convention to Implement Tax Treaty Related measures to prevent BEPS (the Multilateral BEPS Convention or MLI) rounded up the implementation of the treaty-based final BEPS outcomes in one single document. MLI is aimed at providing a framework that could allow amending pre-existing bilateral treaties at once, bringing them in line with BEPS treaty-related minimum standards and recommendations. Argentina signed MLI in the ceremony hosted by OECD on June 7, 2017, where 76 countries and jurisdictions signed or expressed their intention to sign.⁵⁷

Regarding Actions 6, MLI provides a minimum agreed-upon standard, consisting of (i) the inclusion of an express statement in the Preamble stating the common intention to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements, and (ii) at least a PPT or Principal Purpose Test rule, which is the only approach deemed to satisfy the minimum standard by its own. Options include (i) supplementing the PPT

⁵¹ Section 4, 1, Swiss DTA: When defining resident, that provision adds "...*This term, however, does not include any person who is liable to tax in that state in respect only of income from sources in that state or capital situated therein.*"

⁵² DAT with Chile, Section 24, par. 1 to 5 (LoB); par. 6 (PPT); par. 7 to 9 (complementary rules).

⁵³ Teijeiro, id. note 41, *Argentine Treaty Network*...

⁵⁴ DTA with Mexico, Section 28.

⁵⁵ Brazil Amending Protocol dated July 21, 2017, Section 16 introducing new section XXVII to the DTA (par. 1 and 2).

⁵⁶ Amending Protocol, new section XXVII, par. 3. Par. 4 additionally contemplates a rule specifically addressed to income attributable to a PE situated in a third country and exempt in the treaty partner country where the head office is situated which is aimed at avoiding a double non-taxation.

⁵⁷ Teijeiro, *MLI Minimum standard on treaty shopping and mutual agreement procedure. LATAM countries' position*, Kluwer International Tax Blog, July 3, 2017.

rule by the application of a simplified LoB provision (SLOB), or (ii) a standalone detailed LoB provision, used in conjunction with a mechanism dealing with conduit arrangements not already dealt with in tax treaties. MLI does not include a detailed LoB provision, so that parties that prefer to use it should opt out of the PPT and agree to reach a bilateral agreement that satisfy the minimum standard, or accept MLI's PPT as an interim rule.

Argentina committed itself to amend its Covered Tax Agreements⁵⁸ adopting the text of the Preamble provided for in MLI, and the minimum standard consisting of a combination of PPT and SLOB.

Once MLI be fully implemented the ordering rules will be clear and chances of overlap with GAAR will be almost nil. Treaty PPT will prevail over domestic GAAR as a tool to fight tax avoidance (including treaty shopping) under the Argentine treaty network, while domestic GAAR will remain available, within a treaty umbrella, wherever Argentine domestic rules might be circumvented. This position arises from MLI text itself and is also in line with the status of treaties and its prevalence over domestic legislation. In practice, however, there would be cases where defining if treaty or domestic rules are circumvented might be troublesome; similarly, cases may arise where both types of rules are involved, so that fine turning would be required to avoid overlapping and, hence, uncertainty.

Insofar as the application of MLI's SLOB there should be no additional complexities since the rule will replace bilaterally negotiated LoBs and there are no competing similar domestic rules.

PART II: CASE LAW

General overview: Noteworthy cases on the operation of the statutory GAAR

2.1 GAAR as applied to the interpretation of the law

The Supreme Court has repeatedly held, as a basic tenet of the Argentine legal system, that the social, political and economic organization of the country is based on the law.⁵⁹ Therefore, the courts' function must be performed faithfully under the valid laws that structure the country's institutions, and within the scope of the court's constitutional and legal competence.⁶⁰

Reaffirming the division of powers, in *re Cabaña*, the Supreme Court held that: "*When attributing to itself the power to amend a law (the lower court) infringed the division of powers, a fundamental principle of our republican system of government ...*"⁶¹ The Supreme Court has also held that the injustice or mistake of the law does not permit judges to set aside its application.⁶² In other words judges may not decide on the equity of the law; they are only allowed to apply the law equitably.

⁵⁸ Covered Tax Agreements for MLI purposes, as of the date of MLI execution, were all treaties in force plus Mexico and UAE, but for Brazil and Germany, both under active renegotiation at that time, and Bolivia. Brazil and Germany are most likely to be added before final MLI implementation is achieved.

⁵⁹ See, e.g., Fallos 234:82: 253:474.

⁶⁰ Fallos 155:248.

⁶¹ Fallos 234:310; see also Fallos 306:783, 1472.

⁶² Fallos 249:425.

Moreover, in accordance with Supreme Court's precedents, decisions based on dogmatic statements, without legal basis or contrary to the law, are to be deemed arbitrary.⁶³ "*An interpretation that ignores the rule which governs the issue being judged is inadmissible unless an actual declaration of unconstitutionality is made.*"⁶⁴ For the same reason, judgments based on provisions not applicable to the controversy by reason of their temporal validity are rendered invalid (*e.g.*, provisions repealed or not yet in force).⁶⁵

The Supreme Court's decisions upholding strict adherence to the division of powers and appropriately limiting the courts' function have special meaning in the tax law area, where the principle of reserve or legality controls statute interpretation.

In *re Doucel de Cook* the Court held that: "...*The most basic to its nature and purpose, among all the general principles prevailing in the republican form of government, is the power of the representatives of the people to contribute as necessary to the existence of the State. It is the best and most complete evidence of the exercise of full sovereignty, as free disposition of what is owned, either in the private or public domain, is the most outstanding characteristic of civil liberty.*"⁶⁶

In *re Saffores de Doumecq* the Supreme Court held that when the law is clear its language must be respected as the text reveals the legislator's intent.⁶⁷ Teleological interpretation may not then ignore the legal text, assigning to it a scope different from its textual meaning.⁶⁸

Faced with claims tending to distort the legal text supplementing the provisions through interpretation, the Court repeatedly ruled that lack of consistency or foresight of the legislator may not be presumed,⁶⁹ and the interpreter may not assume the legislator's lack of foresight.⁷⁰

In several precedents, ratifying the principle of reserve, the Supreme Court has sustained that legal certainty requires the State to clearly establish the scope of application of taxes and exemptions, so that the taxpayers may easily plan their conduct in tax matters.⁷¹

Finally, the Supreme Court has made clear that the economic interpretation contemplated in section 1, TPL, may not override the principle of reserve or legality. In *re Autolatina Argentina S.A.* the Court held that "...*without ignoring the significance of the economic reality principle in tax matters, its application may not lead to contradict what is specifically provided for in the law without affecting the principle of reserve or legality ... (moreover, that practice) ... seriously jeopardizes legal certainty.*"⁷²

The interpretation criterion comprised in section 1, TPL, should be used irrespective of its result (*i.e.*, whether it favors the Tax Agency or the taxpayers). Several administrative and judicial precedents reflect this view, and, hence, in many instances, the agency has ruled in favor of the taxpayer where it understood that the

⁶³ Accord., *inter alia*, Fallos 236:27; 294:131; 295:417; 298:317; 304:583; 304:629; 306:626.

⁶⁴ Fallos 281:170.

⁶⁵ For a detail of Supreme Court's decisions addressing this issue, see Sagües, *Derecho Procesal Constitucional, Recurso Extraordinario*, Astrea, vol 2, p. 252/257.

⁶⁶ Fallos 155:290 (at 297); accord. Fallos 178:226; 181:268; 182:248; 185:150; 195:65; 294:152; 303:245 and 1522.

⁶⁷ Fallos 184:5.

⁶⁸ Fallos 300:558 and 687; Fallos 301:595 and 958; 310:865; 314:458.

⁶⁹ Fallos 278:62.

⁷⁰ Fallos 289:200; 297:142; 301: 460; 308:283.

⁷¹ Fallos 253:332; 312:912; 319:3208, among others.

⁷² Fallos 319:3208, at p. 3220; see accord. CSJN, *YPF v. Tierra del Fuego*, April 15, 2004 (General Attorney Office's Opinion, VIII); CSJN, *San Buenaventura S.R.L.*, May 23, 2006 (whereas #4).

text of the tax statute fell short of encompassing the legislator's purpose. One significant area where AFIP has prioritized economic substance to justify an extensive application of the tax law in favor of taxpayers has been that of tax-free reorganization, particularly regarding the minimum shareholders' participation in the surviving entity and the continuity of business qualifying tests.⁷³

2.2 GAAR as applied to the assessment of facts

A variety of situations has been addressed by the Supreme Court applying GAAR to the assessment of facts and subsequent tax re-characterization of taxpayers' acts and transactions. The Court's approach to the issue, as reflected in its decisions, has been tailored to the facts and circumstances of each case, avoiding general pronouncements that could have led to precisely limiting the contours of application of section 2, TPL, beyond the occurring cases.

In re Atkinson Ltda. (1954),⁷⁴ the Supreme Court analyzed a claim for reimbursement of tax withheld at source on royalty payments due to Atkinson London originated in an agreed upon year-end reduction of the accrued royalties. The Supreme Court upheld the taxpayer's position arguing that the agreed upon royalty reduction required that the tax law be applied accordingly as authorized by Section 13, TPL (today, section 2).

In a contemporaneous case⁷⁵ dealing with the valuation of cattle for purposes of the then applicable tax on extraordinary benefits, the Supreme Court rejected a taxpayer's claim for reimbursement since a change in inventory valuation was subject by law to the agency's consent, such consent had not been obtained, and the application of the economic reality principle could not be used to cure the omission of a statutorily contemplated condition.

In re Huarte (1961),⁷⁶ the Supreme Court held that, absent a clear intent of a gift, the economic reality principle required that tips received by claimant (a casino employee) were deemed compensation for his personal activity subject to income tax.

In the same year, the Supreme Court decided *Cobo de Ramos Mejía*⁷⁷ to find that the creation of a limited liability company to which real property was contributed by a taxpayer, followed by the transfer of partnership interest to his heirs at a value not representing that of the real property contributed, was an artifice to avoid the inheritance tax on the actual value of the property. Based on the application of the economic

⁷³ For a description of tax-free reorganization rules see Atchabahian, 950 2nd Tax Management, *Business Operations in Argentina* (periodically updated), p. A-66; Teijeiro, Argentine Report, *Tax Consequences of International Acquisitions and Business Combinations*, LXXVIIb Cahiers de Droit Fiscal International, p. 127 ff; Marzoratti, Argentine Report, *National and International Tax Consequences of Demergers*, LXXIXb Cahiers de Droit Fiscal International, p. 21 ff; Krause Murguiondo, *Regimén Impositivo de las Reorganizaciones Empresariales*, Lexis-Nexis, 2005; Asorey-Asorey, *Reorganizaciones Empresariales Libres de Impuestos*, 2nd Edition, Thompson Reuters, 2013. For administrative precedents in the tax free reorganization area easing minimum shareholders' participation and the continuity of business qualifying tests, see, *inter alia*, Ruling 23/88; Ruling 37/97; Ruling 6/98; Ruling dated February 25, 1994, issued by the Technical Advisory Department –unpublished– (in the same sense, Rulings dated February 25, 1994 and October 21, 1994, issued by the Technical Advisory Department, and Ruling 4/97); Ruling 31/96 (in the same sense, Ruling 85/01, and on the same issue and upholding the same construction of the law, CSJN, *Frigorífico Paladini v AFIP*, March 2, 2011, and *AFIP-DGI request of reversal of administrative act (Bunge Argentina S.A.)*, December 17, 2013.

⁷⁴ Fallos 237:739.

⁷⁵ Fallos 237:246, *La Guasuncha*.

⁷⁶ Fallos 249:657.

⁷⁷ Fallos 251:379.

reality principle, the Court assigned to the partnership interests transferred to heirs a value equal to that which would have applied had the real property been transferred directly.

In re Refinerías de Maíz (1964),⁷⁸ the Court held that royalty payments made by plaintiff to Corn Products Refining Co. (foreign parent holding a 96.6% equity interest) should be re-characterized as a dividend, based on the economic reality principle which looks to substance over form.⁷⁹

In re Naarden Argentina SRL (1971), the Supreme Court decided a case⁸⁰ concerning the then in force net worth tax on companies; piercing the veil of a limited liability company (in principle, not subject to the tax), the Court upheld the tax since 99% of the company's capital belonged to a foreign stock corporation.

In *Lagazzio* (1972)⁸¹ the Supreme Court analyzed a partnership converted into a stock corporation in which the original two partners maintained more than 80% of the contributed capital. Two years later a capital increase subscribed and paid-in by a third shareholder reduced the interest of the original shareholders to a 79.59% interest. The issue was whether this circumstance triggered taxation on the appreciated value of the assets transferred to the corporation upon the partnership's conversion. The Court held that the then-existing reorganization rules did not require maintenance of an 80% interest in the surviving entity *sine die*, and that the facts increase in equity by a third shareholder's capital contribution rather than an effective disposition of equity interest by the original shareholders.

On July 31, 1973, The Supreme Court decided *Parke Davis y Cía. de Argentina S.A.I.C.*,⁸² perhaps the most far reaching application of GAAR in Argentine tax history. Plaintiff was a 99.95% subsidiary of Parke Davis & Co., the U.S parent. Based on the parent's ownership of nearly all the subsidiary stock and on the application of the economic reality principle, the Tax Agency had disallowed deduction of the royalty payments made to parent, treating both companies as an economic unit. The lower showed a subsequent courts confirmed the Tax Agency's position, and the Supreme Court upheld the lower courts' holdings based on the following reasoning: i) absence of an actual contractual relationship between the parties to the royalty contract: In substance, it was inconceivable that such a contract might have existed because of the community of interest between the companies; ii) true nature of the transaction: The royalty contract was in fact a capital contribution by parent to subsidiary; and iii) GAAR prevalence over private law: GAAR authorized piercing of the corporate veil in the tax field to avoid abuses and undue tax benefits.⁸³

The far-reaching and somehow extreme doctrine of *Parke Davis* did not project its effects on the construction of intra-group cross-border dealings for long, since a 1976 amendment to ITL set forth internationally accepted arm's length standards for such dealings to be recognized as such, regardless of the level of ownership of the foreign parent or another foreign affiliated company in the domestic subsidiary.⁸⁴

⁷⁸ Fallos 259:141.

⁷⁹ See also Fallos 267:393, *Argentine Land and Investment Co. Ltd.*

⁸⁰ Fallos 280:18.

⁸¹ Fallos 283:258.

⁸² Fallos 286:97.

⁸³ See Díaz Sieiro, *id.* note 23, at p. 81/82; Le Pera and Lessa, *id.* note 19, at p. 159-160.

⁸⁴ Section 14, ITL.

In *re Mellor Goodwin*,⁸⁵ also decided in 1973, the Supreme Court disregarded the corporate personage in favor of the taxpayer and against the tax agency's interest in a case concerning a request for reimbursement of sales tax paid by claimant. (Claimant had argued that both companies were the same single person for tax purposes.)

Another decision issued in 1973, in *re The Dunlop Pneumatic Tyre Co. Ltd.*,⁸⁶ upheld the taxpayer's position regarding the deduction of investments in fixed assets, a benefit allowed by law only to manufacturing and value-added industrial activities, in a case where claimant's investments in fixed assets were put at a third-party manufacturer's disposal (Goodyear) which carried out the manufacturing activities with Dunlop's fixed assets. The Supreme Court held that, based on economic reality, Dunlop's deduction might not be denied.

In *re Kellogg Co. Argentina* (1985),⁸⁷ the Supreme Court ratified the *Parke Davis* doctrine in a case concerning legislation in force in the 1970-1972 periods (i.e., before the introduction of the arm's-length principle into ITL). Recognizing that the disregard of the legal entity doctrine and the treatment of companies as an economic unit for tax purposes also worked in favor of taxpayers, the Supreme Court allowed income tax correlative adjustments in a three related-party organizational structure.

Regarding tax benefits afforded under special regimes to investors in tax promoted projects, the Supreme Court used the economic reality standard for and against the taxpayers concerned, based on the facts and circumstances of each case (*Helper*, 1990, and *Eurotur*, 1995).⁸⁸

In *Tejedor S.A.*,⁸⁹ the Supreme Court addressed the issue of whether contributions received from shareholders not yet capitalized, and other shareholders' credits reported in the company's net worth, should have been reported as debt for purposes of the then applicable tax adjustment for inflation. Based on an economic and legal substance approach, the Court mandated to re-characterize those items as debt for tax purposes.

In *re Barmit S.A.* (2001),⁹⁰ the Supreme Court analyzed whether claimant had a right to recover VAT related to exports, invoiced to it in the internal market by an economically related purveyor which enjoyed a special exempting regime on the difference between input VAT and output VAT. The VAT rule set forth that whenever economic reality showed that the exporter and the beneficiary of the special treatment were the same person, the exporter's VAT reimbursements were limited to the VAT's actual obligation. Subsequent implementing regulations set forth included cases of legal and economic affiliation.

Barmit argued that its case was not expressly contemplated at the time the exports were made, but by a subsequent regulation that might not be applied retrospectively. The Court held that the statutory language was broad enough to cover Barmit's situation and its purveyor within the economic reality approach, regardless of whether it was expressly contemplated by the regulations in the relevant period.

⁸⁵ Fallos 287:79; cfr. *Ford Motor Argentina* (1974), Fallos 288:333.

⁸⁶ Fallos 287:408.

⁸⁷ Fallos 307:118.

⁸⁸ Fallos 313:215 and 318:637.

⁸⁹ Fallos 315:2798

⁹⁰ Fallos 324:1833.

In a quite recent case, the Supreme Court applied GAAR to challenge a sham arrangement made of a two-segment real estate transaction aimed at avoiding tax at the level of the true seller. The arrangement consisted of i) the sale made at a below market price by a legal entity to an individual, ii) followed by a second sale by the individual at a fair market price to the final purchaser, another legal entity. Under these scheme, the income derived by the interposed individual (otherwise taxed in the hands of the original corporate seller) remained untaxed under ITL, while allows to provide a stepped-up basis in the property to the final corporate purchaser.⁹¹

PART III: GAAR AND TAXPAYER'S SAFEGUARDS

The principal safeguards against an arbitrary application of GAAR as applied to the construction of the tax law or to the assessment of facts are the constitutional principles of reserve or legality, and the well-settled principle according to which legitimate tax planning efforts to save taxes are not prohibited by the Argentine constitutional and legal system, respectively. These principles have been consistently applied by the Supreme Court's decisions to counteract GAAR application in a purely domestic as well as in the international context, including a treaty setting.

Regarding GAAR applied under a treaty umbrella, a strong safeguard also comes from the constitutional status of foreign treaties that prevail over domestic law generally, thus preventing an arbitrary application of GAAR that may contradict the text and/or the shared intention of the parties to a DTA. This principle is also reinforced by Section 27 of the Vienna Convention to which Argentina is a party since it provides that *a party may not invoke the provision of its internal law as justification for its failure to perform a treaty...* As explained, this principle is a particularly relevant limitation wherever Argentina is the source country and applies GAAR to treaty-partners' residents with the purpose of challenging their access to treaty benefits based on lack of personal nexus, and the counter party asserts the beneficiary's resident status.

GAAR are one among the tools available to construe the tax law and to assess the facts to apply substantial taxing rules; and this is so without detailed ordering rules beyond a few basic principles, such as that mandating tax rules and concepts to prevail over private law.

In a tax audit, GAAR are utilized by the Tax Agency to single out the taxable event or events. However, it is not the only available tool, the first nor the last resort to that end. Moreover, there is no special, separate procedure to apply GAAR, different from the standard audit and subsequent formal administrative procedures to assess the tax obligation of taxpayers and/or other responsible persons.

Although application of GAAR does not relieve AFIP's burden of proof, SAAR applicable in the domestic or international tax context may reverse the burden of proof and even create a legal fiction that admit no proof to the contrary; thus, certain SAAR function as presumptions *iuris et de iure*.

Section 2, TPL, does not expressly contemplated the need of making corresponding or correlative adjustments in the process of applying GAAR, but, the right to them is usually recognized whether at the

⁹¹ CSJN, *Miracle Mille S.A. v. DGI*, June 3, 2014

administrative or judicial level. A third party's corresponding adjustment should be usually sought separately and independently, unless the tax assessment procedure involved the taxpayer and the counter party potentially having the right to a corresponding adjustment, which is not usually the case.

A couple of comments are worthy regarding the respect to the taxpayers' rights in AFIP's administrative practice.

At the operational level (i.e., tax auditors and administrative judges deciding tax assessments), there is a tendency to apply GAAR to an extent that might even contradict constitutional and legal principles (*e.g.*, by applying the "maximum taxation" implied mandate, explained in Part One, 1.1.4., above), thus postponing constitutional and legal remedies to subsequent instances, *i.e.*, Tax Court, Court of Appeals, and Supreme Court.

However, it is fair to say that respect of the taxpayers' rights is usually achievable when consultative departments within the Tax Agency are called to intervene in an assessment procedure or in previous instances, whether at the request of taxpayers or AFIP own operational divisions (this might occur where doubts exist on the position to be taken in the case). In these cases, the legal and/or technical advisory board (DAL or DAT) are often inclined to balance the Tax Agency's position by applying GAAR within their constitutional and legal contours, thus avoiding excesses in their administrative application. Moreover, in exercising their interpretative competences they have shown even permeable to apply GAAR in favor of the taxpayers, as it has happened, *inter alia*, in the tax-free reorganization area (see Part Two, 2.2.2, particularly administrative precedents at note 82, above).