16TH ANNUAL

U.S. AND LATIN AMERICA TAX PRACTICE TRENDS

MANDARIN ORIENTAL MIAMI

The Current State of M&A in Latin America and Beyond

June 2024

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     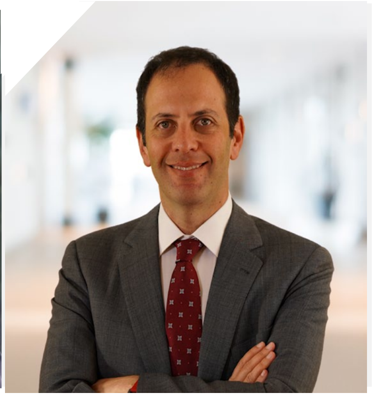 

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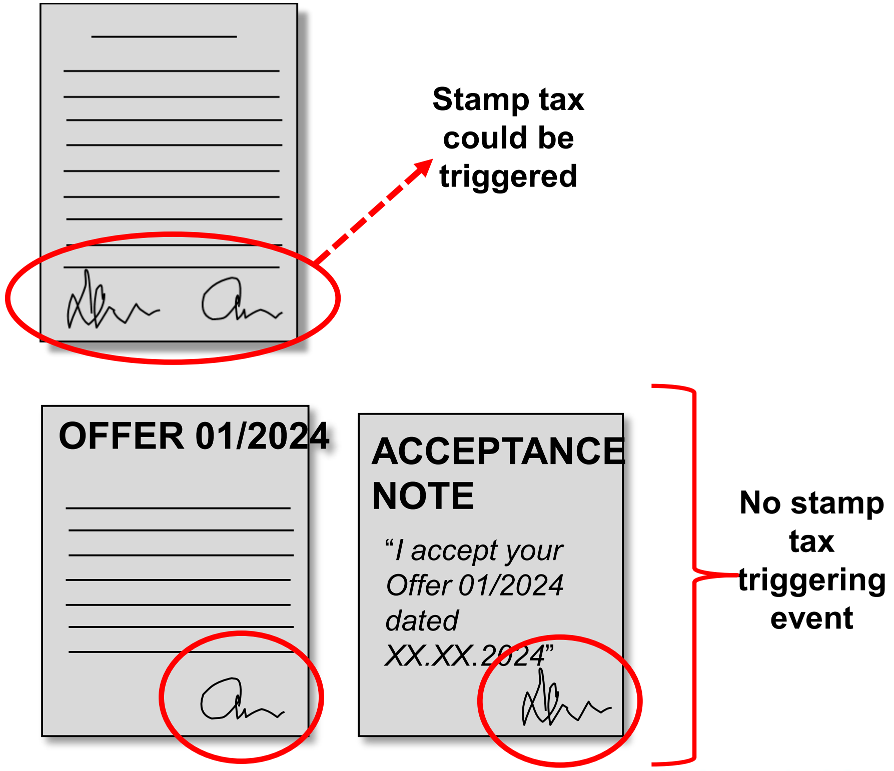
II. Indirect Taxes and M&A

II. Indirect Taxes and M&A (Argentina)

VAT

- Share deals do not give rise to VAT, as opposed to asset deals.
- VAT incidence in asset deals varies by asset type (*e.g.*, transfer of rights often exempt from VAT).
- No VAT applies if the transaction complies with all requirements for the application of tax-free regime for income tax purposes.



Stamp Tax

- Stamp tax applies on all acts, contracts, and onerous transactions that are formalized within the territory of an Argentine province / City of Buenos Aires.
- Stamp tax is triggered if the document is executed or has effects or assets located within the taxing jurisdiction.
- The stamp tax rate may vary depending on type of assets and the jurisdiction involved; it is generally applied on the economic value of the contract.
- Execution of agreements through offer letter and separate acceptance note is a widespread practice in Argentine used to neutralize stamp tax incidence (unless a public deed is statutorily required depending on the type of contract).

II. INDIRECT TAXES (BRAZIL)

“VAT” inspired tax (ICMS) and federal contributions (PIS and COFINS)

- PIS and COFINS generally not imposed on share deals, neither on asset deals.
  - Exception (1) : sale of shares by a holding company engaged in purchasing/selling equity stake – special regime to tax the spread (gain) at a reduced 4.65% rate
  - Exception (2): sale of current assets (such as inventory)
- ICMS is generally not imposed on share deals, as opposed to asset deals (depending on the nature of the asset – e.g. inventory)
- No VAT applies if the transaction complies with all requirements for the application of tax-free regime for income tax purposes.

Stamp tax

- No stamp tax in Brazil

Other taxes on transfer of assets

- ITBI (tax on transfer of real estate) is triggered whenever real estate is sold

Majority of cases in Brazil involve share deals. Whenever a group of assets/going concern, they are generally carved out via drop down so that the sale involves shares.

II. Indirect Taxes and M&A (Chile)

- No capital duties, no share transfer duties, no VAT
- Municipal Duty: Annual tax on tax adjusted net equity
- Stamp tax: Upfront cost on debt funded acquisitions

Legislative proposal: Specific antiavoidance rule:

- Recharacterization of share deal as a sale of capital assets, when:
  - Sale of 20% or more of shares considering all direct and indirect dispositions by the taxpayer and related persons over prior 12 months
  - At lest 50% of the value of the shares is derived from the value of capital assets,
  - Directly or indirectly owned, and
  - Share sale made with the principal purpose of avoiding VAT that would have applied if the assets where directly sold as an asset deal.

II. Indirect Taxes and M&A (Mexico)

VAT

- Transfers of shares are exempt, whereas sales of assets are generally subject to tax with exceptions
  - Transfers of land and accounts receivable are exempt
  - VAT paid by purchaser is generally creditable, which may lead to favorable balances
    - Getting a refund is challenging
- Mergers among Mexican resident companies may qualify for tax-free treatment subject to requirements (both form and substance)
  - Failure to comply with conditions triggers taxable transfer of assets of disappearing entity at fair-market value

No stamp taxes or other similar taxes or duties at federal level

II. Indirect Taxes and M&A (USA)

- **Excise tax**
  - Section 4501, enacted as part of the Inflation Reduction Act, imposes 1% nondeductible tax on certain stock repurchases.
  - Notice 2023-2 (issued on December 27, 2022) provided interim guidance.
  - Two sets of proposed regulations were published in the Federal Register on April 12.
  - Excise tax = 1% × Excise Tax Base of the **<u>covered corporation</u>**, which is:
    - Aggregate FMV of all repurchases during the covered corporation's tax year (Repurchase Base);
    - Reduced to the extent statutory exceptions apply;
    - Reduced under the netting rule for aggregate FMV of covered corporation stock issued or provided by the covered corporation during its tax year
  - Applies to repurchases after **<u>December 31, 2022</u>**
  - FY25 Green Book includes a proposal to increase the tax rate from 1% to 4%.

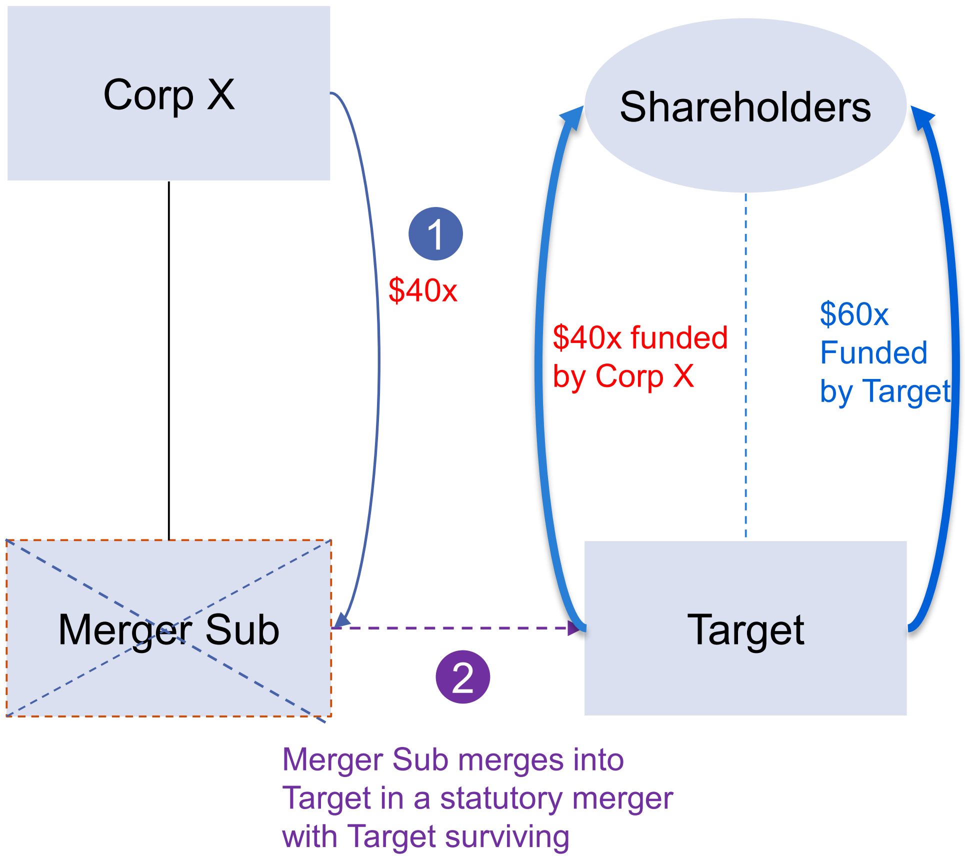
II. Indirect Taxes and M&A (USA)

- **Application to foreign parented groups**
  - Can apply to repurchases of foreign publicly traded stock
    - Repurchase of stock of covered surrogate foreign corporation by the covered surrogate foreign corporation (or acquisitions by its specified affiliates)
    - Acquisitions of applicable foreign corporation stock by certain specified affiliates
  - **Funding rule** - an applicable specified affiliate is treated as acquiring stock of an applicable foreign corporation ifz,
    - it funds by any means (including through distributions, debt, or capital contributions) the repurchase (or acquisition) of the foreign corporation's stock by the foreign corporation (or by a specified affiliate that isn't an applicable specified affiliate) (a '**covered purchase**'), **and**
    - Such funding is undertaken for a principal purpose of avoiding the excise tax (a funding with such a principal purpose, a '**covered funding**').
    - A **rebuttable presumption** set forth in the proposed regulations provides that a funding is presumed to have been made with the principal purpose of avoiding the excise tax if:
      - (i) A domestic affiliate of a publicly traded foreign corporation engages in a 'downstream' funding of an entity in which the domestic affiliate has a material direct or indirect interest, and;
      - (ii) That affiliate repurchases stock of the foreign parent (or a purchase is made on its behalf) within two years of the funding.

II. Indirect Taxes and M&A (USA)

Not repurchases	**Repurchases (but statutory exception may apply)**
• Deemed redemptions under Section 304(a)(1) • Actual distribution subject to Section 301(c)(2) or (3) • Certain cash payments by covered corporation in lieu of fractional shares • Complete liquidations to which Section 331 or Section 332 applies (liquidating corporation is covered corporation) • Divisive transactions under Section 355 other than split-offs • Net cash settlement of an option contract except for 'deep-in-the-money' options treated as constructively exercised at the time of their grant. • Redemptions of convertible debt that is treated as debt for tax purposes	• Redemptions under stock repurchase programs • 'In-form' Section 317(b) redemptions treated as a distribution to which Section 301(c)(2) or (3) applies • Acquisitive reorganizations (Target is covered corporation), except B reorganizations • E reorganizations (of covered corporation) • F reorganizations (of covered corporation) • Split-off (where Distributing is covered corporation) • Distribution under Section 331 where Section 332 also applies (liquidating corporation is covered corporation) • Redemptions of preferred stock • Acquisitions funded by Target cash (Target is covered corporation) • Certain leveraged acquisitions (Target is covered corporation) • Stock received pursuant to a claw back agreement or the forfeiture of restricted stock if such stock was treated as issued or provided under the netting rule

II. Indirect Taxes and M&A (USA)



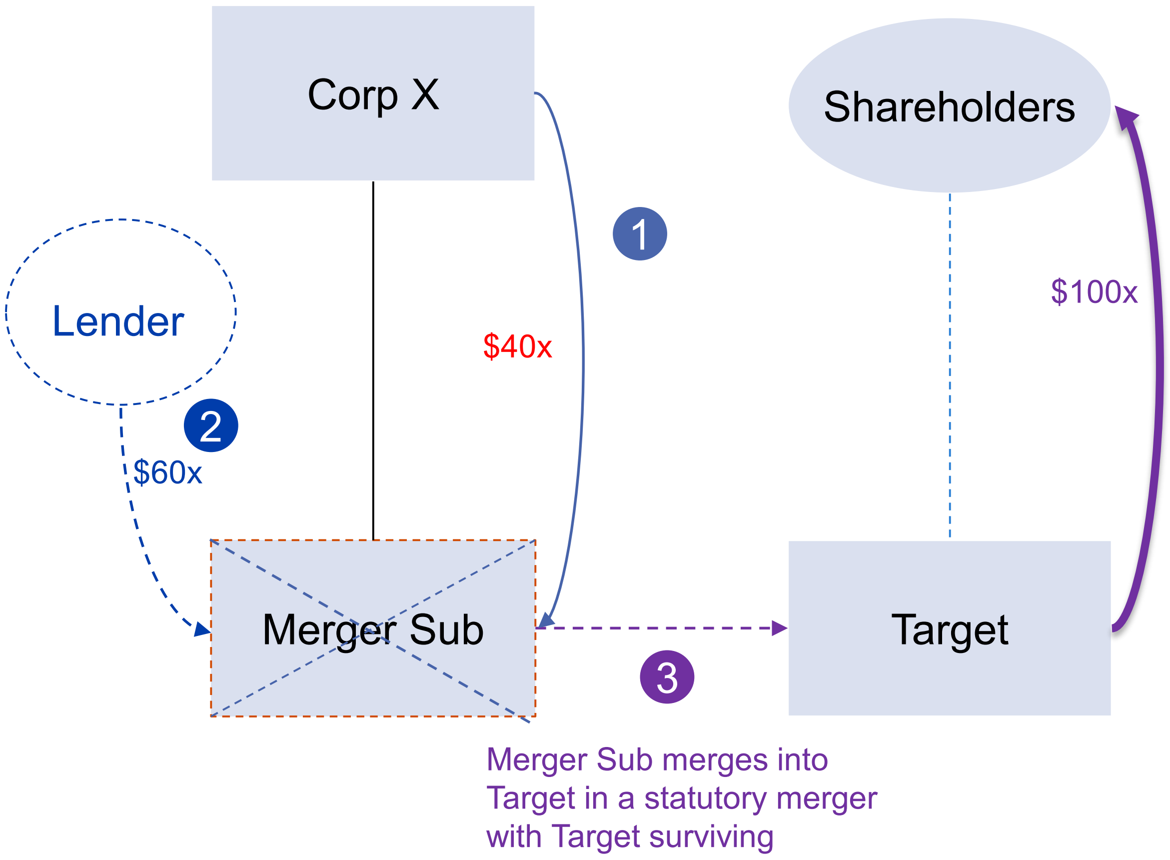
Facts

- On May 30, 2024, Corp X acquires all of Target's outstanding stock with the following steps:
  - Corp X contributes $40x to a newly formed corporation (Merger Sub); and
  - Merger Sub merges into Target, with Target surviving.
- At the time of the merger, Target has an FMV of $100x, and Target shareholders exchange all their Target stock for $100x of cash.
- $60x of the consideration received by the Target's shareholders is funded by Target and $40x is funded by Corp X.

Analysis

- Because Merger Sub is transitory, the acquisition is treated as though Target redeemed 60 percent of its outstanding stock for $60x.
- The amount of the repurchase is $60x, which is equal to the portion of the consideration funded by Target.
- Target's excise tax base is increased by $60x.

II. Indirect Taxes and M&A (USA)



<u>Facts</u>

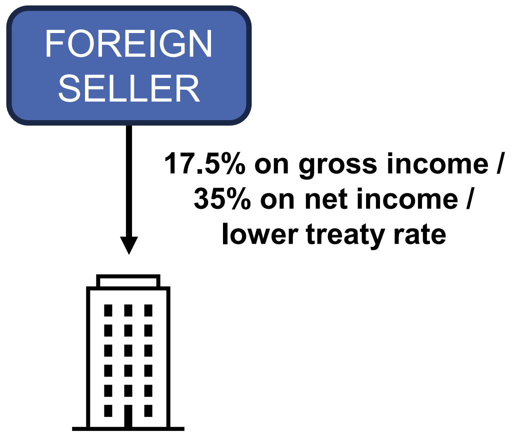
- On May 30, 2023, Corp X acquires all of Target's outstanding stock with the following steps:
    - Corp X contributes $40x to a newly formed corporation (Merger Sub);
    - Merger Sub borrows $60x from an unrelated lender; and
    - Merger Sub merges into Target with Target surviving the merger (Target assumes Merger Sub's liability).
- At the time of the merger, Target has an FMV of $100x and Target shareholders exchange all their Target stock for $100x of cash.
- $60x of the consideration received by the Target's shareholders is funded by a $60x loan from an unrelated lender.

<u>Analysis</u>

- Because Merger Sub is transitory, the acquisition is treated as though Target directly borrowed $60x from an unrelated lender and used the loan proceeds to redeem $60x of its stock in a section 317(b) redemption.
    - See Rev. Rul. 78-250. <u>Note</u>: Treated as if Corp X purchased other 40% from shareholders in a section 1001 transaction.
- The amount of the repurchase is $60x, which is equal to the cash received by the Target shareholders from Target.
- Target's excise tax base is increased by $60x.

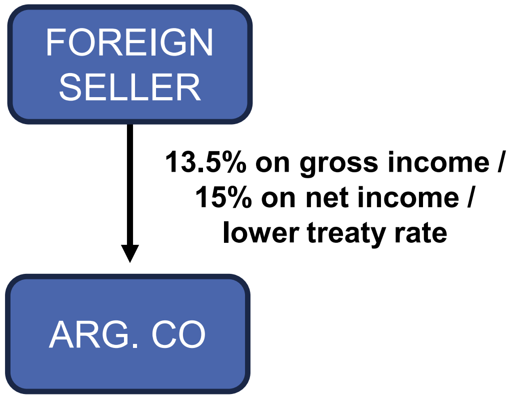
III. Non-resident Capital Gains

III. Non-resident Capital Gains (Argentina)



Non-resident capital gains on sale of Argentine assets (other than Argentine equity participations)

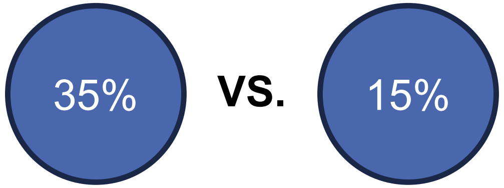
- Argentina applies capital gains tax (CGT) on results derived by non-residents on transfers of Argentine assets (*e.g.*, real estate, movable assets, rights, etc.).
- Applicable rates to all assets (except for equity participations): (i) 17.5% effective rate on gross income; (ii) 35% on actual net income; (iii) lower treaty rate.
- CGT is assessed in Argentine Pesos (due to the devaluation of the Argentine Peso, transactions may result in a taxable gain even if no real gain is realized when measured in foreign currency).



Non-resident capital gains on sale of Argentine shares

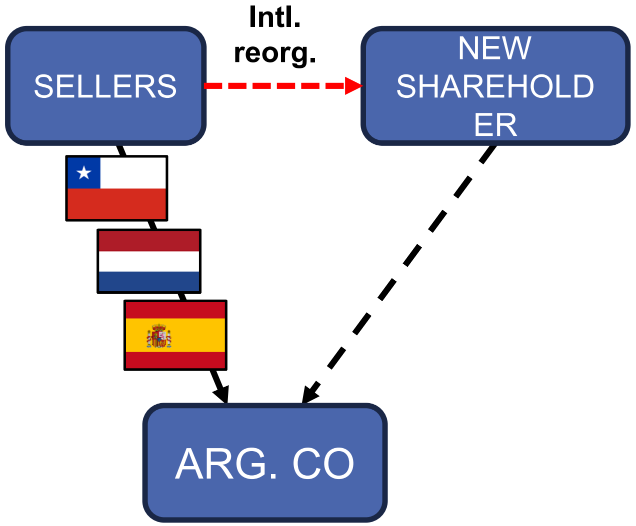
- Applicable rates on sale of shares: (i) 13.5% on gross sale price; (ii) 15% on actual net income; (iii) reduced treaty rate (if applicable). Seller resident in non-cooperative jurisdiction: 31.5% on gross sale price.
- CGT payable by seller unless buyer is an Argentine tax resident.
- Exemption only applies on direct sale of Argentine shares in IPO context (listing on Argentine SEC is required).
- Since 2018, indirect sale of Argentine assets could be potentially subject to CGT to the extent certain conditions are concurrently met. Exceptions to application of CGT on indirect sales of Argentine assets: Equity participations acquired before December 30, 2017 (grandfathering rule); Transfers within the same economic group (no step-up basis).

III. Non-resident Capital Gains (Argentina)



Asset deals vs. Share deals

- Since asset deals generally involve the divestment of a particular division or product line, incorporation of Argentine vehicle is required.
- Sellers may be subject to higher taxes if the assets sold have appreciated in value (applicable rate on the sale of individual assets may range up to 35% on net income).
- Buyers can receive a step-up in the tax basis of the acquired assets, potentially leading to future tax deductions.
- In the case of Argentine branches, divestment requires the sale of each individual asset (up to 35% rate on net income) and tax-free reorganizations are possible only through intra-group transfers.



M&A tax-free regime

- Argentina has a tax-free reorganization regime that is exclusively applicable to Argentine corporate entities.
- Corporate reorganizations taking place abroad that result in transfers of Argentine assets are not covered by this exemption. Special provisions under treaties to avoid double taxation in force with Chile, Netherlands and Spain could provide tax relief.

III. Non-resident Capital Gains (BRAZIL)

FOREIGN SELLER

Brazilian situs assets (including shares)

Non-resident capital gains taxation

- Capital gains derived by foreigners that are not resident or domiciled in Low Tax Jurisdictions ("LTJ") are subject to WHT in Brazil at progressive rates from 15% up to 22.5%. Same tax treatment applicable to Brazilian individuals.
- If the foreign investor is located in an LTJ, a flat 25% rate shall apply upon the capital gains derived on the transaction.
- Limitation by tax treaties – e.g. Israel, Switzerland (flat 15% rate)
- Taxpayer of the WHT: foreign party that derives the income corresponding to the taxable capital gain
- Legal responsibility for the withholding and collection of said tax is attributed to the buyer – whenever a Brazilian party – or to the legal representative of the buyer in Brazil – whenever foreigner
- Capital gains correspond to the positive difference between the sale price and the acquisition cost of the disposed asset - specifically in connection with foreign investors, the acquisition cost does not necessarily correspond to the book value of the disposed asset recorded by the seller for accounting purposes, but rather to the amount effectively incurred by it for the acquisition of said asset (i.e., purchase price, contributions and capital increases eventually made, including in the event of reinvestment of profits), which shall be properly documented and evidenced.
- If seller is unable to present any accepted and valid documents to back its acquisition cost for Brazilian tax purposes, the acquisition cost is to be deemed zero
- FX gains are also taxed

III. Non-resident Capital Gains (BRAZIL)

Asset deals vs. Share deals

	Stock Deal	Asset Deal
Capital gains	Capital gains assessed by sellers (shareholders of target) • Brazilian individuals would be subject to Individual´s Income Tax at rates varying from 15% to 22,5% • Brazilian legal entities would generally be subject Corporate Income Taxes at a nominal 34% rate	Capital gains assessed by Target would be subject to corporate income taxes at an aggregate 34%. If the assets are not booked at the level of Target, its cost of acquisition will be deemed to be zero. Accordingly, the full amount of the price will qualify as taxable capital gain. There are no specific tax reliefs applicable to capital gains assessed by Brazilian legal entities. However, corporate income taxes impact could be reduced by (i) offsetting Target´s current year´s losses (without limitation); and (ii) offsetting of net operating losses (up to 30% of the current year´s profits).
Indirect Taxes	Not applicable, unless selling/buying is part of Target's general business	The potential imposition of indirect taxes should be considered. Among those taxes, the most relevant ones are State Value-Added Tax (ICMS – Imposto sobre Circulação de Mercadorias) and PIS and COFINS. <u>ICMS</u>: In order to ensure that State Value-Added Tax (ICMS – Imposto sobre Circulação de Mercadorias) is not imposed on inventories, the transaction could be structured as to involve the transfer of the establishment as a whole. If however this is not the case and the Asset Deal is structured with the transfer of certain assets on an individualized basis, the transaction would remain valid and the result will be that there will be ICMS taxation on the transfer of inventories (fixed assets are not subject to ICMS as a general rule). Actual rates and deduction of credits depend on products involved. This effect may be mitigated by use of credits generated as a result of the transaction. <u>PIS and COFINS</u>: Target revenues derived from the sale of inventories (current assets) and other non-booked assets (intangibles) would be subject to PIS and COFINS at a 9.25% rate under the non-cumulative, with the deduction of certain credits allowed by applicable legislation.

III. Non-resident Capital Gains (BRAZIL)

Asset deals vs. Share deals

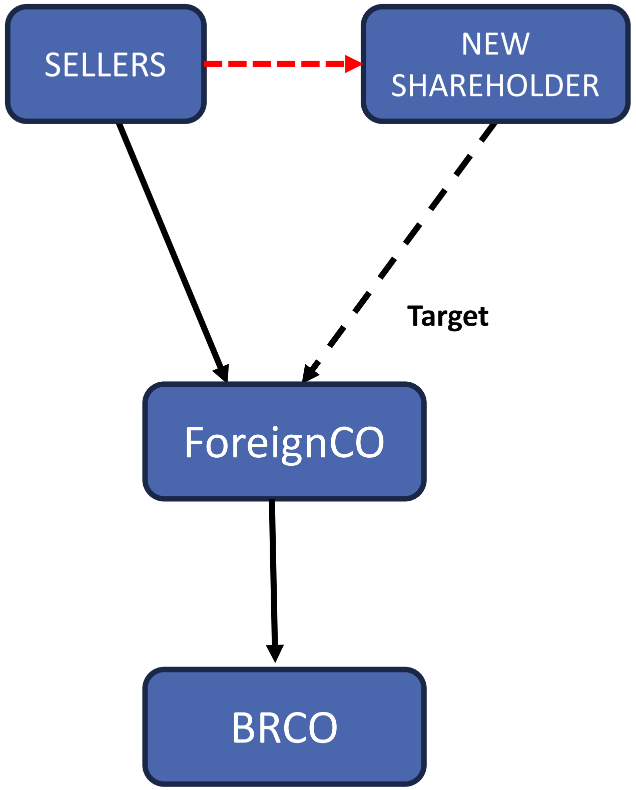
	Stock Deal	Asset Deal
Tax: Tax loss carry forward	The mere sale of equity of a legal entity in a tax loss position does not affect its ability to use tax losses to offset taxable profits within the limits provided by legislation (up to the yearly legal limit of 30% of the taxable profits). Therefore, tax losses in principle would be transferred jointly with Target to Buyer. However, the use of tax losses will be prevented whenever there is a cumulative change in the control of the entity and a change in its business activity in the period between the generation of the loss and its effective use.	In principle, the sale of assets should not impact Targets's ability to use the tax losses. Nevertheless, tax losses will not be transferred to the Buyer acquiring the assets.
Tax: Allocation of the purchase price	Under a Stock Deal, Brazilian corporate taxpayer that is obliged to use the equity pick-up method must split the purchase price of its investment into: (i) the equity, (ii) the positive or negative differences between the fair value of the net assets, in the proportion of the acquired equity stake, and their accounting value; and (iii) goodwill based on future profitability, corresponding to the residual value after the deduction of (i) and (ii) from the acquisition cost (following International Financial Reporting Standards standards). Those amounts should be demonstrated in separate entries. In general, a Stock Deal tends to be more appealing to investor (Brazilian company) rather than an Asset Deal, considering the possibility of amortizing, in a minimum 5 (five) year term, the goodwill paid after a corporate restructuring and upon the fulfillment of specific conditions to be analyzed in each specific case.	Under an Asset Deal, instead of registering the transaction by splitting the purchase price (equity pick-up), Buyer would register the amounts paid for the assets as acquisition cost of them, which would be taken into account for amortization or depreciation of those assets for both accounting and tax purposes. Amounts paid for the acquisition of intangible assets (such as customer portfolio of Target/services agreements), to be registered as such by Buyer in compliance with the accounting rules (to be further discussed with accounting advisors), may be amortized for tax purposes. In this case, the amortization would have to be carried out within the lifetime of the intangible asset. We may expand this analysis upon request.

III. Non-resident Capital Gains (BRAZIL)

Asset deals vs. Share deals

	Stock Deal	Asset Deal
Tax Succession	Assuming that Buyer would acquire Target, such entity would continue to be primarily liable for all of its tax liabilities (materialized or not) and Buyer would indirectly inherit those liabilities.	Under an Asset Deal, if the assets acquired qualify as the acquisition of a commercial establishment (or of the so called ongoing concern), Buyer shall have a subsidiary liability if Target continues the same activity or business, or starts within a six-month term from the date of the sale to perform a new activity in the same or another commercial, industrial or professional business. We may expand this analysis upon receipt of further information and details regarding the assets to be potentially acquired. Subsidiary liability means that Buyer would be liable for the tax liabilities of Target only after tax authorities finish all routes to collect the outstanding debts from Target. In other words, in order to redirect the tax claims to Buyer, tax authorities would have to try to collect the debts from Target. Therefore, even with the qualification of the acquisition of ongoing concern, the primary target of tax authorities to collect the outstanding tax liabilities should be, in principle, Target. Buyer shall be jointly and fully liable if Target no longer continues to explore the same activity or business. In any case, depending on the assets involved in the transaction, there may be grounds to Buyer to uphold that the transaction does not involve the acquisition of an ongoing concern, situation in which no tax succession should be attributed to Buyer. This analysis depends substantially on the assets involved and we may expand on this upon receipt of further information.

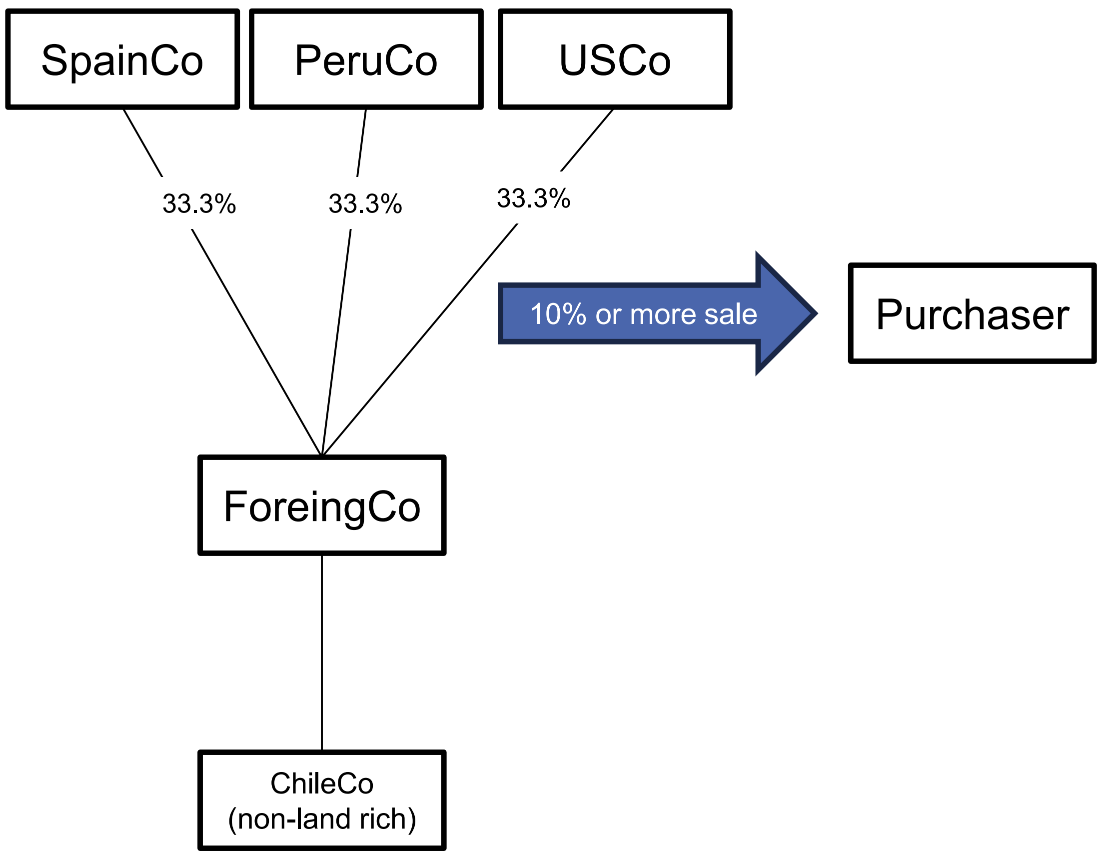
III. Non-resident Capital Gains (BRAZIL)



Indirect Capital Gains

- Brazilian legislation currently in force does not provide for the taxation of indirect capital gains
  - If a certain transaction involves a foreign seller and a foreign asset (with an underlying Brazilian asset), no tax impacts should arise in Brazil.
- In the past years, there were some attempts to create a legal provision that expressly dealt with this matter, but this has not been passed into law. This may be potentially addressed and rediscussed in the near future – especially within the context of the potential implementation of a Brazilian income tax reform – but it is not possible to anticipate if, when nor under which terms this shall occur.
- In spite of the above, whenever the foreign asset disposed by the foreign seller consists of a pure holding company which portfolio is solely comprised by Brazilian assets, such a transaction may be challenged by the Brazilian tax authorities under a substance over form approach.
  - Albeit this is a controversial matter that should be carefully evaluated based on the elements of the concrete case, our position is that this risk shall be as relevant as less diversified is the portfolio of the foreign holding company that holds the investment in Brazilian entities.
- There are precedents in which the Brazilian IRS has already claimed that the sale of the foreign holding company only intended to avoid the Brazilian taxation that would apply if a direct sale of the Brazilian assets had taken place, which ultimately means that the risk of questioning set out above is not merely theoretical
- Practical effect: tax authorities have charged the legal representative of the buyer in Brazil for the WHT that would have been due upon the capital gains derived by the foreign seller, added by interest calculated based on the SELIC rate and penalty of 75% (a 100% penalty may be applicable in cases which tax authorities deem to have involved sham, fraud or willful misconduct).

III. Non-resident Capital Gains (Chile)



Chile

- April 23 decision by Santiago Court of Appeals
  - Transfer made by Spanish resident of shares in another Spanish resident, can only be taxed in Spain. Gain covered by Article 13(5) of the DTA.
  - When Chile has sought to retain tax authority over indirect sales, this has been explicitly stated in the DTA (e.g. Argentina, Uruguay).
- Recent rulings:
  - SII Ruling 373/2024: Chile and Peru retain tax authority under Art. 13(4)
  - SUNAT ruling 117-2023: Reverses ruling 001-2021

III. Non-resident Capital Gains (Mexico)

Sale of shares

- Domestic law: **(i)** 25% tax on gross proceeds, or **(ii)** 35% on net gains for eligible sellers (subject to requirements and filings, including tax agent and filing of tax report issued by CPA)

- Broad DTT network ~60 countries
  - Practical issues in formalistic filings to recognize treaty benefits
  - Entry into force of MLI in 2024 implies higher substance standard for foreign structures

- 2020 tax reform included complex rules for transparent vehicles/entities
  - Eligible private equity funds need registration to maintain transparency
  - Application of DTTs implies fulfilling requirements (e.g. tax agent) individually

III. Non-resident Capital Gains (Mexico)

Sale of real estate

- Domestic law:
  - **(i)** 25% tax on gross proceeds, or
  - **(ii)** 35% on net gains for eligible sellers (subject to appointing a tax agent and notarizing the documents of the transaction)

- DTTs generally do not provide any relief on direct sales

- Sale of foreign shares whose book value directly or indirectly derives in >50% from Mexican real estate will be subject to tax under rules for sale of shares (with limited relief under tax treaties)

III. Non-resident Capital Gains (USA)

Issue 1: Creditability

- Whether a non-resident capital gains (“**NRCG**”) tax levied on the sale of shares in a foreign entity by a U.S. corporation is a **creditable** foreign income tax under Treas. Reg. Section 1.901-2 or 1.903-1?
- Attribution requirement under the FTC final regulations unlikely to be satisfied.
- However, Notices 2023-55 and 2023-80 permit taxpayers to apply certain creditability regulations in effect as of April 1, 2021, with minor adjustments. Many NRCG taxes qualify either as income taxes or taxes in lieu of income taxes, particularly if the base of the tax is reduced by the taxpayer’s cost of acquiring the target shares.

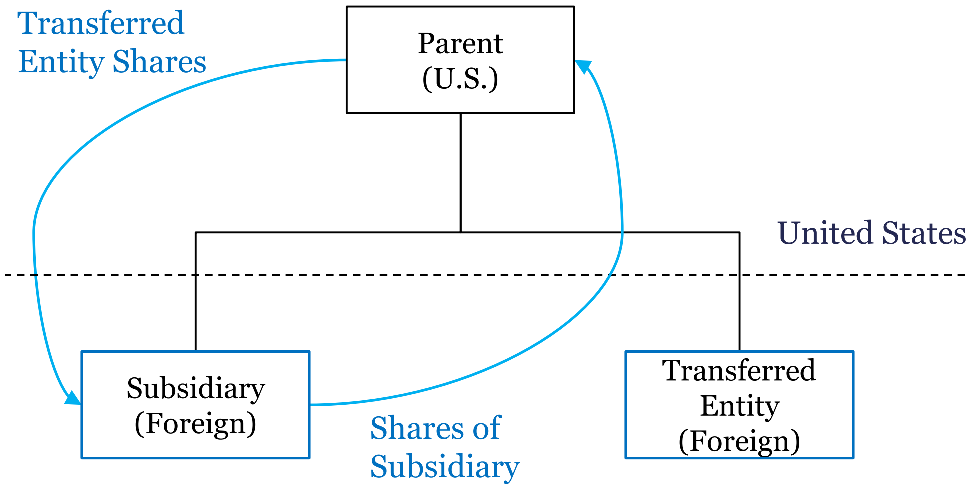
Issue 2: Resourcing

- Sales of personal property, such as stock sales, generally are sourced under section 865(a) - residence of the seller rule
- Assuming a re-sourcing provision in the relevant treaty, a U.S. taxpayer may elect to source stock sales in accordance with the treaty under 865(h).

Issue 3: Allocation & Apportionment

- **Treas. Reg. Section 1.861-20** provides rules for allocating and apportioning foreign income taxes to statutory and residual groupings for foreign tax credit purposes.
- The framework of these complex provisions generally allocates and apportions foreign gross income included in the foreign tax base to statutory and residual groupings relevant to the operative section based on U.S. items that arise from the same transaction, or special rules designed to approximate the U.S. items that Treasury and the IRS believe relate economically to the foreign gross income.
- Different rules apply depending on whether there is a "corresponding U.S. item" or not.
- Foreign taxes follow the foreign income allocation after expense A&A.

III. Non-resident Capital Gains (USA)



Facts:

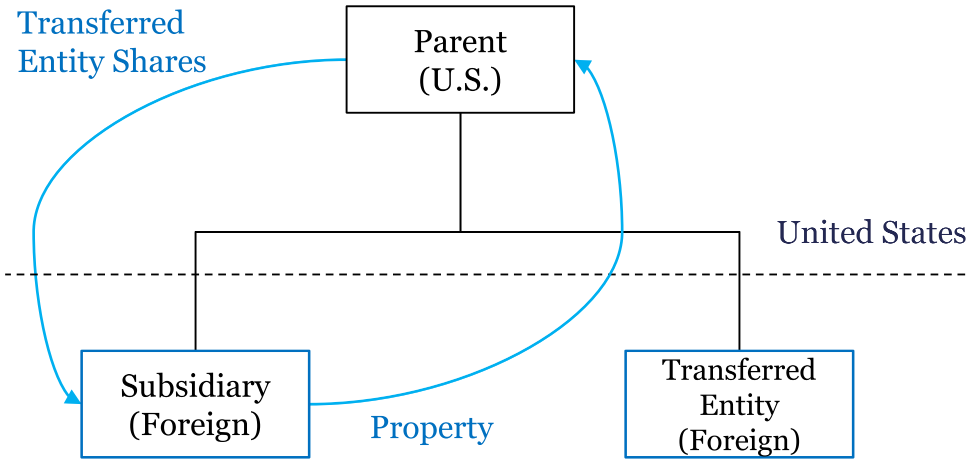
- Parent transfers the shares of Transferred Entity in exchange for shares of a Subsidiary in a Section 351 transaction. A GRA is timely filed.
- Transfer of Transferred Entity Shares results in NRCG tax assessed on Parent.
- The NRCG tax is considered a creditable foreign income tax under the treaty coordination rule.

Issue: Is there a corresponding U.S. item for TR Section 1.861-20 purposes?

Discussion and analysis:

- Assuming Parent enters into a GRA, the non-recognition transaction does not result in a corresponding U.S. item, although it is a disposition of stock for U.S tax purposes
- Consider application of
  - TR Section 1.861-20(d)(2)(ii)(C) - hypothetical disposition of stock; or
  - TR Section 1.861-20(d)(3)(i)(D) - waterfall rule

III. Non-resident Capital Gains (USA)



Facts:

- Parent transfers the shares of Transferred Entity in exchange for (i) shares of a Subsidiary and (ii) other property (e.g., cash) in a transaction characterized as a Section 304 transaction. A GRA is timely filed.
- Transfer of Transferred Entity Shares results in NRCG tax assessed on Parent. The NRCG tax is considered a creditable foreign income tax under the treaty coordination rule.

Issue: What is the corresponding U.S. item for TR Section 1.861-20 purposes?

Discussion and analysis:

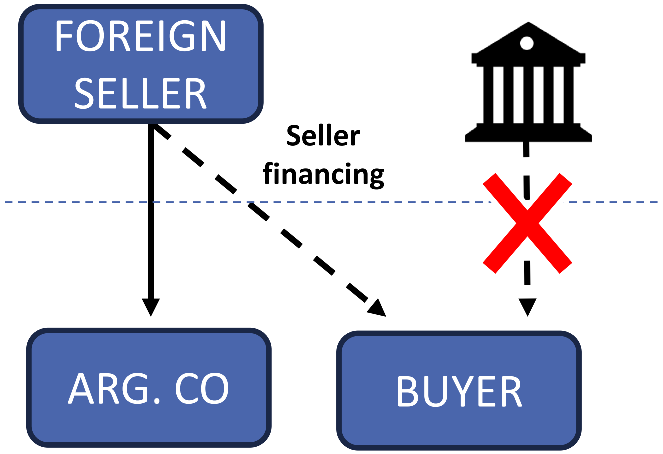
- It is unclear whether the foreign taxes are attributable to the deemed section 351 leg in a section 304 exchange or if a section 304 disposition should be considered in its entirety for purposes of TR Section 1.861-20.
  - If only considering the deemed section 351, application of TR Section 1.861-20(d)(2)(ii)(C) or TR Section 1.861–20(d)(3)(i)(D)
  - If section 304 transaction considered in its entirety, consider application of rules to dividend equivalent redemption.

IV. M&A Funding Structures

IV. M&A Funding Structures (Argentina)

Challenges to interest (and FX) deductions

- For interest expenses (and foreign exchange losses, if any) to be deductible, they must be related to borrower's taxable income.
- Argentine tax authorities challenged deductions in cases in which loan proceeds were used for certain purposes alleging the lack of nexus with taxable income (*e.g.*, payment of dividends, reduction of capital, purchase of shares, redemption of shares, etc.). Existing judicial precedents are not conclusive, although there are reasonable arguments favorable to taxpayers.



Current trends in M&A financing

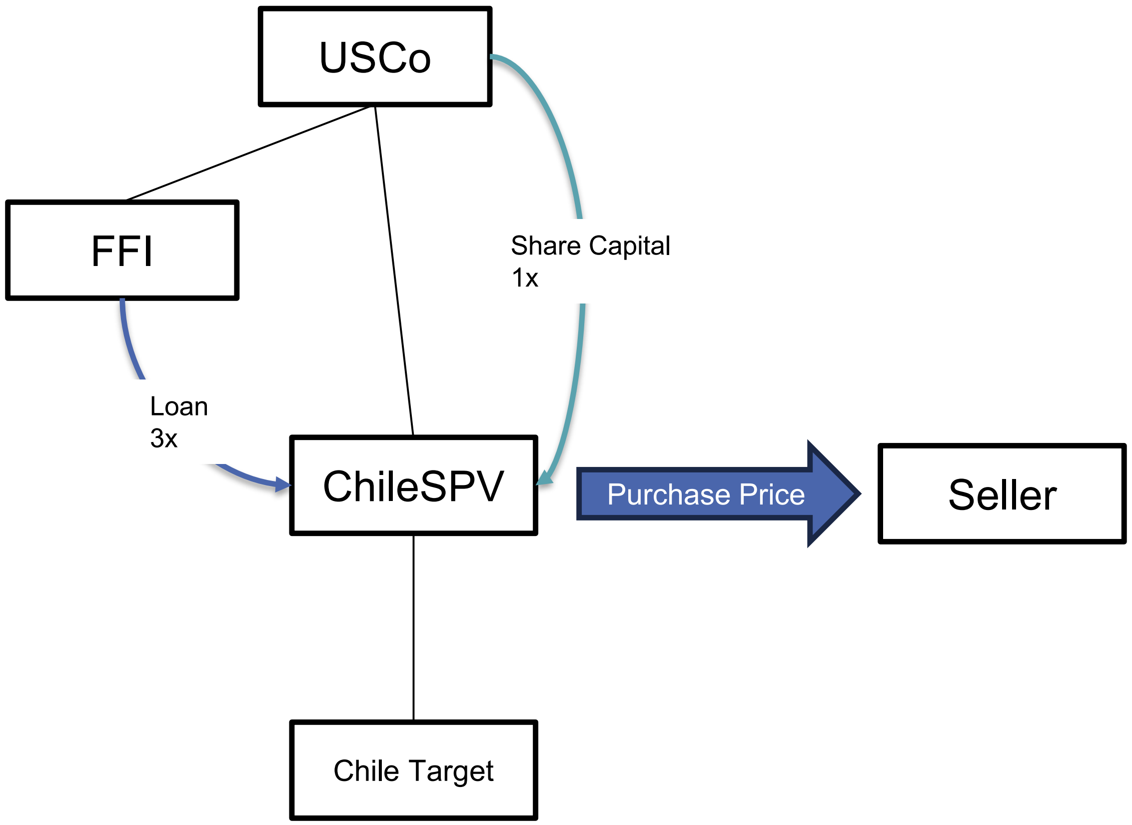
- Traditional financing has been less accesible due to many factors, including Argentina's FX restrictions.
- Seller financing has been a common practice during the past months, with sellers offering flexible repayment schedules to buyers for the acquisition of Argentine shares.
- Sellers are willing to concede on price to the extent that they are paid in dollars abroad.

IV. M&A Funding Structures (Brazil)

Challenges to interest (and FX) deductions

- Likewise Argentina, deductibility of interest expenses (and foreign exchange losses) is contingent upon the existence of a link with to borrower's taxable income.
- Brazilian tax authorities have also challenged deductions in cases in which loan proceeds were used for certain purposes alleging the lack of nexus with taxable income (*e.g.*, payment of dividends, reduction of capital, redemption of shares, etc.) but existing precedents allow deductibility of interest paid within the context of a leveraged M&A
- Thin cap and TP rules may apply
- WHT imposed on interest at a general 15% rate – unless:
    - LTJ: 25%
    - Multilaterals, World Bank: 0%
    - Tax treaties: Japan – 12,5%
    - No specific relief for M&A funding
- Leveraged acquisitions may require setting up a specific purpose company to play the role of borrower – for instance, if the buyer is a private equity fund (FIP).
    - In this cases, enjoying deductibility requires debt push down to Target and may be challenged by tax authorities.

IV. M&A Funding Structures (Chile)



- Common funding mechanism
  - Reduced interest WHT rate
  - Loan repayment not subject to tax
  - Interest deductibility: Not so much
- Specific antiavoidance rules
  - Expense deductibility requirements
  - Transfer pricing
  - Thin capitalization
  - FFI substance
- General antiavoidance rule: Recent case decided by tax court
  - Facts
    - Related party lender
    - Incorporated 1 month prior to making loan
    - Registered as an FFI with the SII
    - No loans made by lender to other persons (related or unrelated)
    - Interest payments subject to preferential 4% WHT rate
  - Decision
    - No reason other than tax to lend funds that were already available to USCo
    - ChileSPV in reality obtained capital and not a loan
    - Interest payment resulted in an artificial reduction of the WHT rate
    - FFI in substance was not a financial entity
    - A 35% tax is imposed on payments to FFI

IV. M&A Funding Structures (Mexico)

Deduction of interest and FX:

- Interest expenses and related FX losses (if any) must be indispensable for the borrower's business to be deductible
- Complex rules (substance and form) limit deductibility of interest payments:
  - Direct or indirect payments to tax haven jurisdictions
  - 30% EBITDA threshold
  - Thin capitalizations rules
  - Recharacterization of back-to-back loans
- WHT on interest ranges from 4.9% (public placement of bonds) to 40% (specific cases of residents in tax haven jurisdictions)
  - Formalistic requirements may apply
  - DTT benefits may apply subject to eligibility and proper support

V. Tax insurance in Latam M&A

V. Tax insurance in Latam M&A (Argentina)

- Argentine legislation does not provide a specialized insurance product designed to protect against the financial risks associated with potential tax liabilities that may arise during or after an M&A transaction in Argentina.
- Commonly used mechanisms to manage and mitigate tax-related risks:
  - Due diligence
  - Tax indemnities
  - Reps & warranties
  - Escrow accounts (in Seller financing transactions escrow accounts are used for unforeseen liabilities that may emerge during financing period)

V. Tax insurance in Latam M&A (Brazil)

- Brazilian legislation does not provide a specialized insurance product designed to protect against the financial risks associated with potential tax liabilities that may arise during or after an M&A transaction in Brazil.
- This market is still incipient – high level of litigation, long lasting discussions at courts, difficulty to provide an outcome evaluation
- Likewise Argentina, commonly used mechanisms to manage and mitigate tax-related risks:
    - Due diligence
    - Tax indemnities
    - Reps & warranties
    - Escrow accounts

V. Tax insurance in Latam M&A (Chile)

Chile

- Risk can be covered by out of country insurers
- 22% WHT on insurance premiums paid to non-Chilean insurer
- 2% WHT on reinsurance premiums paid to non-Chilean company
- No WHT under most tax treaties when insurance company has no permanent establishment in Chile. 19% reverse charge VAT applies.

V. Tax insurance in Latam M&A (Mexico)

- Not commonly offered during M&A transactions due to broad exclusions

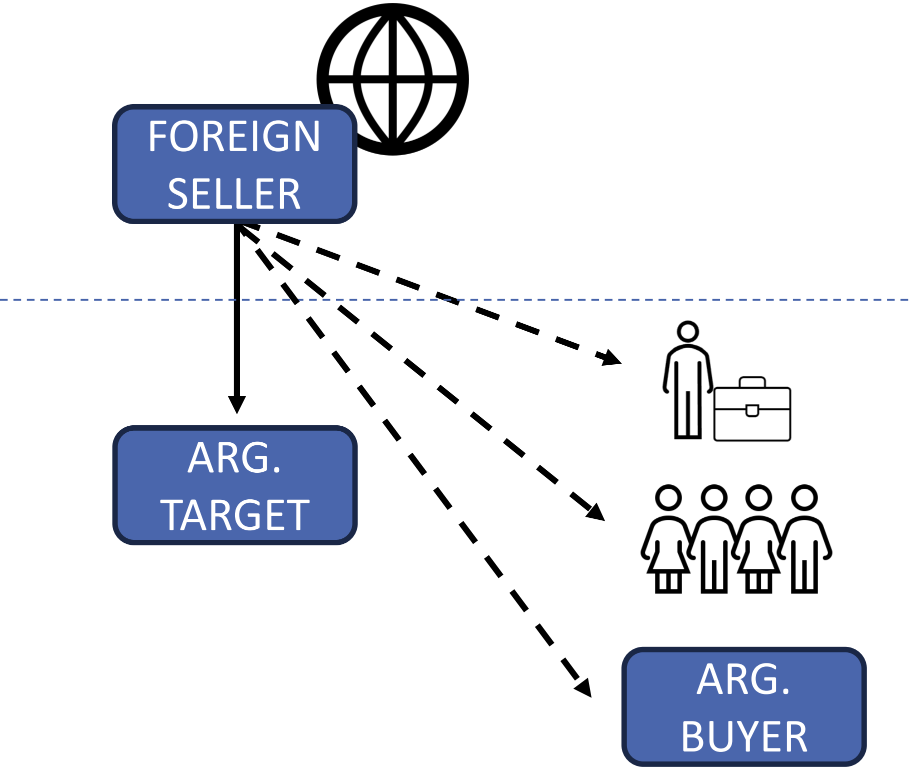
- Instead, buyers typically rely on following mechanisms to mitigate tax-related risks:
  - Due diligence
  - Reps & warranties, tax indemnities in purchase agreements
  - Holdbacks and/or escrow accounts to mitigate liabilities that may emerge during period equal to statute of limitations on pre-closing periods

V. Tax insurance in Latam M&A (USA)

- Section 7701(o) - "In the case of any transaction in which the economic substance doctrine is relevant… The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if [section 7701(o)] had never been enacted."
- Liberty Global engaged in a series of pre-disposition transactions, two of which were disregarded for US tax purposes. The government challenged the transactions on economic substance grounds.
- <u>Relevance Inquiry Rejected by Liberty Global Court</u>
  - "[T]here is no threshold 'relevance' inquiry that precedes the inquiry" into a transaction's economic substance. Instead, "the doctrine's relevance is coextensive with the statute's test for economic substance." "The question of whether the [transaction] lacks economic substance is equivalent to the question of whether the tax benefits achieved in the transaction violate congressional intent and is analyzed using the enumerated statutory prongs," i.e., (1) no meaningful change to non-tax economic position, and (2) no substantial purpose apart from tax effects.
- <u>No Exemption Available to LGI</u>
  - LGI's transaction was not a "basic business transaction." "[A] series of transactions that constitute a corporate organization or reorganization" might fall outside the economic substance doctrine, but a series of transactions "that merely includes a reorganization" is not necessarily exempt.

VI. Troubled Company/ Distressed Asset Acquisition

VI. Troubled Company/ Distressed Asset Acquisition (Argentina)



Insights

- Many Argentine distressed companies are transitioning from multinational shareholder groups to Argentine entities, including local management and businessmen acting as buyers.
  - Argentine companies traded on an "as is" basis
  - Lower prices and flexible seller financing terms
  - Limited set of indemnities
  - High risk assets (potential for higher returns or losses)
  - Potential to implement more aggressive policies post-acquisition, diverging from structured approaches typically seen under multinational corporate governance

- CGT could still be applicable even if the price paid for the Argentine shares results in no real gain when measured in foreign currency.

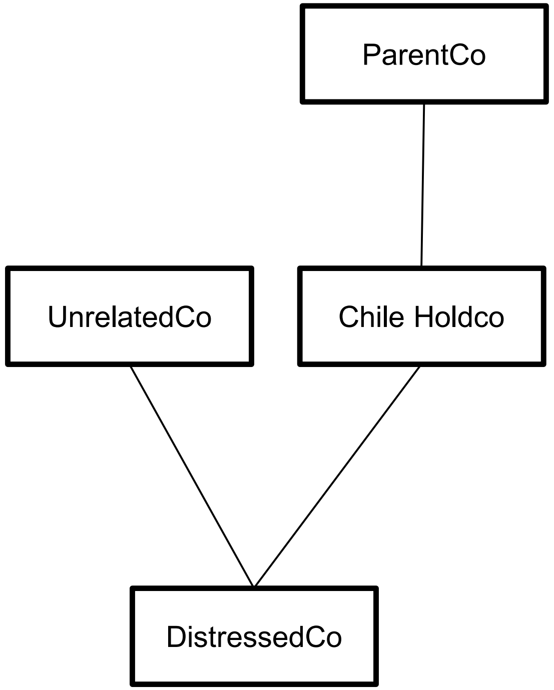
VI. Troubled Company/ Distressed Asset Acquisition (Brazil)

Main challenges

- Many Brazilian distressed companies try to make money out of the sale of their assets to cover their debt positions
- Main challenge from buyers' perspective (and also to make the sell down of assets an appealing and feasible alternative) is the level of tax contingencies of seller and whether sellers' liabilities could be transferred to their assets/equity stake (target)
- Brazilian Tax code coped with old Bankruptcy and Judicial recovery legislation to circumvent a so-called "UPI" from seller's tax contingencies
  - UPI stands for an isolated productive unit, a group of assets that allows for the development of operational activity and is sold within the judicial recovery process, under a plan dully authorized by creditors and by the judge
  - More recently, a change to Bankruptcy and Judicial recovery legislation has updated to concept of UPI: it can be the distressed company itself, equity stake held by the distressed company, a pool of assets, among others
  - Question: tax law has not change to cope with new UPI concept – What is the level of buyers' protection against seller tax contingencies?
- Special relief is granted to capital gains derived by sellers under judicial recovery if certain requirements are met: the gain can be fully absorbed against NOLs (without the 30% limitation)

VI. Troubled Company/ Distressed Asset Acquisition (Chile)

- **Chile** – Conversion of debt acquired at deep discount



STEPS

(1) $100m subordinated loan made by each shareholder to DistressedCo

(2) Chile Holdco transferred its debt claim to ParentCo at $1. Supported by valuation

(3) ParentCo converts debt claim into equity of Distressed Co for $100m sharecapital

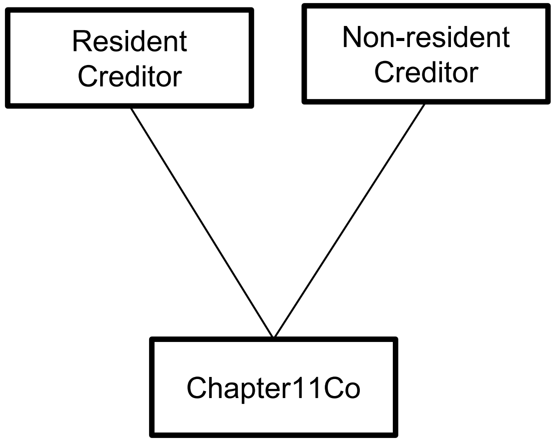
(4) ParentCo sells shares in DistressedCo for $20m

ISSUES

- Character and source of income for ParentCo upon conversion: Interest, capital gains, other?
- Withholding obligations for DistressedCo upon convertion
- Risk of adjustment of transfer of debt claim
- Risk of adjustment of value of debt conversion (in-kind capital contribution) if not done at tax value.
- Gain for the borrower from issuing share capital at a value lower than the nominal value of its liability.

VI. Troubled Company/ Distressed Asset Acquisition (Chile)

- **Chile –** Convertible Bonds issued in exchange for written-off debt. Ruling 2142-2023



STEPS

(1) Issuance of convertible bonds by company under Chapter 11 reorganization

(2) Each bond has $1 nominal value and is used to cancel valid debt claims for the same nominal value,

(3) Each creditor receives a number of bonds equal to their claims which as a result are settled in full.

(4) The share price is implicitly determined as the nominal value of the bond divided by the number of shares to be delivered upon conversion

(5) The company issues the shares necessary to back up the conversion and a capital increase for an amount equal to the sum of the nominal value of all the bonds to be issued.

ISSUES

- Tax treatment of cancelation of claims upon receipt of bonds . Resident vs. non-resident
- Tax treatment of bond conversion into equity
- Tax value of the shares received upon conversion

VI. Troubled Company/ Distressed Asset Acquisition (Mexico)

- Renegotiation of debts could trigger non desired tax consequences
  - WHT payable on due date, whether interest is paid or not
  - Acquisition of debt-claims at a discount triggers taxable income for non-resident acquirers, subject to 10% WHT

- Debt forgiveness triggers taxable income
  - Challenges for lenders to obtain a deduction for income tax purposes

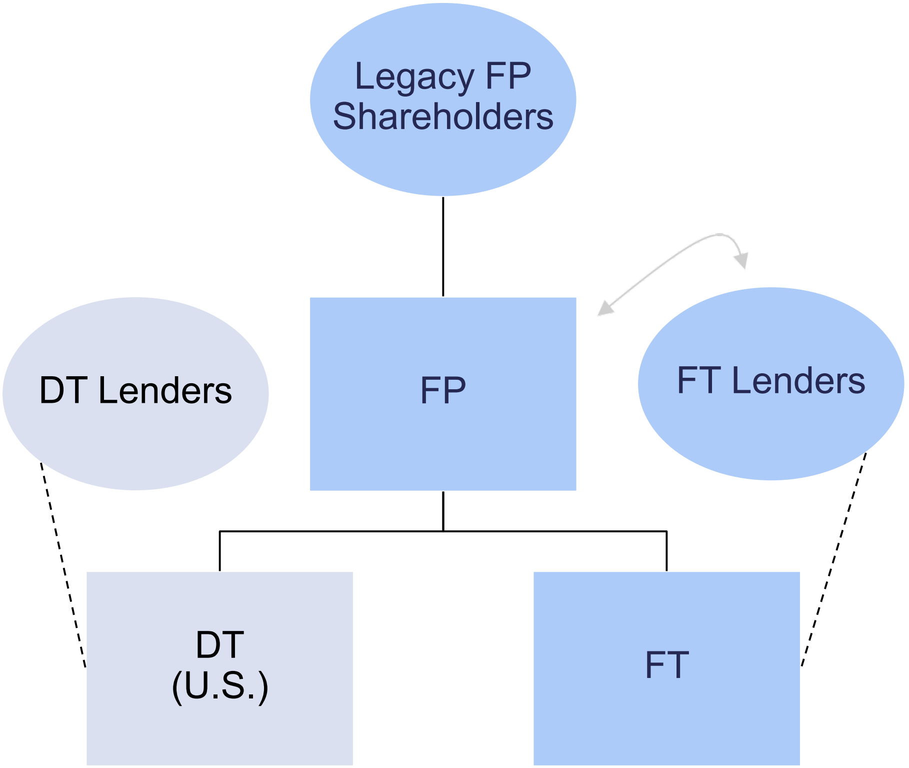
- Current administration against forgiveness of tax liabilities/assessments
  - Possibility to claim reduction on surcharges and penalties under certain scenarios

VI. Troubled Company/ Distressed Asset Acquisition (USA)

- Under Treas. Reg. § 1.7874-2(i)(2)(i), creditor claims in a domestic corporation can be treated as stock if:
  - Corporation is in a Title 11 or similar case
  - Corporation’s liabilities exceed the value of its assets.
- Thus, creditors can be deemed shareholders for purposes of Section 7874 upon the consummation of the bankruptcy case or a domestic corporation’s insolvency
- Certain bankruptcy or distressed work-outs involving the transfer of equity in a foreign corporation can give rise to Section 7874 complications

VI. Troubled Company/ Distressed Asset Acquisition (USA)

- Insolvency/bankruptcy proceedings where debt of each of the U.S. group and foreign group is being equitized.



FP owns 100% of the DT stock before and after the equitization. The 7874 rules, however, treat the DT debt as equity, resulting in a deemed acquisition of DT by FP and the FP shares held by the DT lenders being “by reason of” stock. In addition, the 7874 rules reduce the Inversion Ratio denominator by ignoring the FP shares issued to the FT lenders. So the Inversion Ratio is:

$$99Y / (1{,}000Y – 891Y) > 80\%.$$

Is FP now a U.S. corporation by application of Section 7874? The DT lenders acquired less than 10% of the FP shares, far less than the 80% (or even the 60%) threshold.

Questions?