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KPMG INTERNATIONAL

Taxation of Cross-Border Mergers and Acquisitions

Uruguay

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Uruguay

Introduction

The competitive forces in the global economic environment are increasingly causing companies to consolidate their operations. As a result, mergers and acquisitions (M&A) have become an important component of business strategies throughout the world. Uruguay is no exception, particularly after the recovery from the region's economic crisis in 2002.

Recent developments

In 2007, Law 18.083 introduced a complete reform of the Uruguayan tax system, which has affected M&As in several ways. The changes are a follows:

- A non-resident income tax (IRNR) was introduced for Uruguayan-source income obtained by non-residents. This tax requires the withholding on certain payments made abroad by local companies, including dividends, interest, royalties and technical fees. Capital gains resulting from the disposal of local assets (including shares) by a non-resident are also considered taxable, except for bearer shares, which are subject to an exemption.
- Corporate Income Tax (IRAE) was reformulated, and important limitations were introduced on the deductibility of expenses, which are now only deductible where they represent taxable income for the counterparty (for non-residents, taxation by IRNR or a foreign income tax is required).

Asset purchase or share purchase

Asset purchases and share purchases, the two main options for acquisitions, have different legal and tax consequences in Uruguay, as explained later in the chapter.

Purchase of assets

In most cases, the purchase of substantial assets of an existing business falls into the category of a transfer of a commercial establishment, requiring a special procedure to be followed under Laws 2.904 and 14.433. According to court precedents, the concept of substantial assets includes those that, on being transferred, would make it impossible for the transferor to continue developing its business as before.

This procedure is quite lengthy and complex, involving a promise to sell the commercial establishment, a request for special certificates from the Tax and Social Security Offices, and the convening of a meeting of the seller's creditors by means of special publications.

Purchase price

The proceeds from a sale of local assets are subject to corporate income tax.

Goodwill

The difference between the purchase price and the fiscal value of the transferred assets is considered goodwill for tax purposes (the fiscal value of an asset depends on its nature and may or may not be equivalent to market value).

Depreciation

The fiscal goodwill is booked as an asset by the buyer, but it is not depreciated or revalued.

Other assets must be booked at the same fiscal value used by the seller and are subject to the general rules for depreciation and revaluation.

Tax attributes

Tax losses are not transferred to the buyer.

Value added tax

Generally, the transfer of local assets resulting from the transaction is subject to value added tax (VAT). This tax is levied at a basic rate of 22 percent, with a lower rate of 10 percent for a prescribed list of goods and services (some items are exempt). The fiscal goodwill is also subject to VAT at the basic 22 percent rate.

Transfer taxes

There is no stamp duty or stamp duty land tax in Uruguay. An acquisition that includes a transfer of real estate is subject to real estate transfer tax, levied at the rate of 4 percent (2 percent each for the buyer and seller) on the cadastral value of the real estate (a notional value established by the National Direction of Cadaster).

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Purchase of shares

The transfer of shares takes place through a simple procedure (basically by their simple delivery in the case of bearer shares or through their endorsement in the case of nominative titles).

Tax indemnities and warranties

When the buyer purchases a company, it takes over all its tax liabilities, existing or contingent. Therefore, the buyer usually protects itself from eventual contingencies by commissioning a due diligence investigation of the target's affairs, including its tax affairs, and by requiring contractual tax indemnities and warranties from the seller.

Tax losses

The tax losses of the purchased company are not affected by the sale of its shares.

Choice of acquisition vehicle

Several potential acquisition vehicles are available to the foreign purchaser.

Local holding company

A local holding company is not normally suitable for a purchase of shares because it does not produce any tax advantages in Uruguay. Moreover, apart from investment companies (entities whose main business consists of investment activities), local companies cannot participate in the capital of other entities for a value that exceeds their net worth.

Foreign parent company

Foreign parent companies are used most frequently as acquisition vehicles by foreign investors. Dividends received from Uruguay are subject to IRNR withholding (discussed later in this chapter), and gains on a subsequent disposal of the shares of the local company, notionally established at 20 percent of the selling price, are taxable under IRNR.

Non-resident intermediate holding company

From the Uruguayan viewpoint, non-resident intermediate holding companies do not generate any tax advantage.

Local branch

A local branch of a foreign company is considered a permanent establishment (PE) of the foreign entity. Uruguay applies the force of attraction principle, under which all income obtained in Uruguay by the foreign entity must be imputed to the PE (whether or not it has participated in obtaining it). The effects of this rule should be carefully evaluated before choosing a branch structure for investment purposes.

Joint venture

A joint venture is not a separate entity in itself, but rather a contractual arrangement. Its use should be analyzed on a case-by-case basis.

Choice of acquisition funding

The purchaser needs to decide whether to fund its acquisition with debt or equity. Some factors to be considered when making this decision are discussed below.

Debt

The principal attraction of debt is the potential tax deductibility of interest. Uruguay has no thin capitalization rules, but other aspects of the Uruguayan tax regime may limit such deductibility.

Deductibility of interest

As indicated in previous sections, under Uruguayan corporate income tax rules, deductibility of expenses is conditional on their taxability as income to the counterparty.

This general rule also applies to interest. Assuming all income of the local company is of Uruguay source, the deductibility is determined by the difference between (a) the IRNR withholding rate (12 percent) plus the foreign tax rate applied to the interest in the foreign lender's country; and (b) the corporate income tax rate of 25 percent. Thus, 100 percent deductibility is only allowed where the IRNR withholding rate plus the foreign tax rate exceeds 25 percent.

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Financing through debt generates additional tax effects for foreign currency gains or losses (where the loan is denominated in foreign currency), and inflation adjustment must also be taken into account. The combined tax effects of these external factors may be material but are difficult to predict in a particular case.

Withholding tax on debt and methods to reduce or eliminate it

Interest paid by a local company on foreign loans is subject to IRNR withholding at 12 percent. However, interest is exempt for loans granted to local entities that employ more than 90 percent of their assets in obtaining non-taxable income.

Checklist for debt funding

- No thin capitalization rules.
- No restrictions on interest payments or currency exchange limitations.
- 12 percent IRNR withholding.
- Full deductibility by local company is conditional on foreign tax treatment.
- Additional effects in terms of inflation adjustment and currency exchange are difficult to forecast and may result in taxable gains.

Equity

A purchaser may also fund its acquisition through equity. The disadvantage of funding through equity is that there would be no interest to deduct and dividends are not deductible. But equity may be preferable for non-tax reasons, and the limitations on interest relief and the negative effects that might result from external factors such as inflation and currency exchange rates must also be taken into account.

For these reasons, no general rules can be established for the choice of debt or equity as alternatives for financing. Each case must be evaluated on its own merits.

Hybrids

There are no specific rules in Uruguay relating to hybrid instruments. Their potential use should be analyzed on a case-by-case basis.

Discounted securities

There are no specific rules in Uruguay relating to discounted securities. Their potential use should be analyzed on a case-by-case basis.

Deferred settlement

Uruguay has no specific provisions regarding deferred settlement, which is computed for tax purposes on its accrual.

Other considerations

In addition to the options considered earlier in this chapter, a legal merger may be another option for acquiring a local target.

Under article 26 of Law 16.906, the Executive Power can exempt merger transactions from applicable taxes (corporate income tax, VAT and real estate transfer tax) where the operation is likely to strengthen the activities of the companies involved. To obtain this exemption, a special request must be submitted demonstrating the economic purposes of the transaction.

Concerns of the seller

The tax position of the seller may be relevant when deciding how to structure the transaction, but there are no general rules.

Company law and accounting

Company Law 16.060 contains the main legal provisions applicable to commercial companies in Uruguay, including formation, operation, reorganization and dissolution.

Mergers are specifically regulated in article 115 and following articles 114 to 135, which stipulate that a merger by creation takes place when two or more companies dissolve without liquidation and transfer their whole net worth to a newly created company. A merger by absorption occurs when one or more companies dissolve without liquidation and transfer their whole net worth to a pre-existing company.

In both alternatives, the shareholders or partners of the merged companies receive as compensation shares, quotas or participations in the newly created or absorbing company.

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A merger is effected by majority votes and the formal requirements of corporate by-laws, as amended.

A special balance sheet must be prepared by each of the merging companies before the merging resolution can be adopted by the competent corporate bodies. In preparing the special balance sheets, uniform criteria should be applied by the merging companies for the valuation of the assets and liabilities, the valuation date and the treatment of subsequent changes.

The decision to merge should be preceded by a promissory contract setting out the bases of the merger. Special publications of the promissory contract must be made for 10 days, summoning the shareholder and creditors.

Company creditors need to justify their credits within 20 days of the final publication. Creditors who oppose the merger must be paid or provided guarantees of payment.

Shareholders who oppose the merger may opt to leave the company within 30 days of the final publication and have their holdings paid for out of the special balance.

Once these notification periods have ended, the final merger contract will be executed and filed in the Register of Commerce.

Group relief/consolidation

Group relief or consolidation does not apply for tax purposes in Uruguay.

Transfer pricing

Uruguay introduced transfer pricing provisions in 2007 based on Organisation for Economic Co-operation and Development (OECD) guidelines. Uruguay's transfer pricing rules are regulated by a decree issued in 2009.

Foreign investments of a local target company

Uruguay generally applies the source principle for income taxation purposes, so foreign investments made by local companies are not subject to tax.

Comparison of asset and share purchases

Advantages of asset purchases

- Possible to isolate the purchasing entity from previous tax liabilities by following a special procedure (transfer of commercial establishment).
- Possible to acquire only part of a business.

Disadvantages of asset purchases

- The purchase procedure is fairly complex and lengthy (involving publications and obtaining special certificates from the tax authorities).
- The transaction is subject to local taxes, including corporate income tax, VAT and real estate transfer tax (if real estate is involved). Where the transaction is structured as a merger, the Executive Power may grant an exemption.
- Tax losses remain with the seller.

Advantages of share purchases

- The legal procedure for share transfers is very simple and quick.
- Consent of third parties (e.g. creditors) generally is not required.
- No special certificates are needed from the tax authorities.
- From the legal viewpoint, the operation of the target company remains unchanged since the transaction is between the purchaser and the shareholders of the target company.
- The fiscal costs are usually lower (e.g. sale of shares is exempt from VAT, real estate transfer tax does not apply, etc.).

Disadvantages of share purchases

- Purchaser acquires the target company with all its liabilities and contingencies (declared or not), so due diligence procedures have special importance and are normally more intense.

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Uruguay – Withholding tax rates

This table sets out reduced withholding tax rates that may be available for various types of payments to non-residents under Uruguay's tax treaties. This table is based on information available up to 10 January 2014.

Source: *International Bureau of Fiscal Documentation, 2014*

	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies (%)		
Domestic rates				
Companies:	7	7	3/5/12	12
Individuals:	7	N/A	3/5/12	12
Treaty rates				
Treaty with:				
Ecuador	15	10[2]	15	10/15[3]
Finland	15	5	10	5/10[4]
Germany	15	5	10	10
Hungary	15	15	15	15
India	5	5	10	10
Korea (Rep.)	15	5[5]	10	10
Liechtenstein	10	5[6]	10	10
Malta	15	5	10	5/10[7]
Mexico	5	5	10	10
Portugal	10	5	10	10
Spain	0/5[8]	0/5	10	5/10[9]
Switzerland	15	5[10]	0/10[11]	10

Notes:

1. Many treaties provide for an exemption for certain types of interest, e.g. interest paid to public bodies and institutions or in relation to sales on credit. Such exemptions are not considered in this column.
2. The rate generally applies with respect to participations of at least 25 percent of capital.
3. The 10 percent rate applies to the use of, or the right to use, industrial, commercial or scientists equipment.
4. The 5 percent rate applies to the use of, or the right to use, industrial, commercial or scientists equipment; or the use of, or the right to use software.
5. The 5 percent rate generally applies with respect to participations of at least 20 percent of capital.
6. The rate generally applies with respect to participations of at least 10 percent of capital.
7. The 5 percent rate applies to royalties for the use of, or right to use, any copyright of literary, artistic or scientific work and to leasing of equipment.
8. The zero rate generally applies with respect to participations of at least 75 percent of capital.
9. The 5 percent rate applies to royalties from the use of, or right to use, any copyright of literary, artistic or scientific work.
10. The rate generally applies with respect to participations of at least 25 percent of capital.
11. The zero rate applies to interest paid to banks with respect to investment projects.

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