The Hissing Goose

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Last month, at the 20th Oxford Offshore Symposium arranged by this journal, I spoke about taxes in relation to Latin America. In my opinion the main problem is that not enough people pay them – before one addresses the issue of tax evasion, although it plays its part in the process. No, what it amounts to is that not enough people have sufficient earnings to draw them into the tax net in the first place.

But if insufficient taxes are being collected (exacerbated, I should add, by a lack of experienced tax collectors and antiquated systems often riddled with complexity) the good news is that Gross Public Debt (GPD) in emerging markets as a whole as a percentage of Gross Domestic Product (GDP) is reckoned to be below 40%, and, so far, is staying there.

According to the mid-year report issued by the United Nation's Economic Commission for Latin America and the Caribbean (ECLAC) in July there was an economic contraction of 1.9% in 2009 in the region but the recovery since then has been remarkable which points to strong macroeconomic fundamentals, not to mention conservative fiscal and monetary policies. Even Argentina (the highest GPD in relation to GDP in the region) is just 48.5%; this is some achievement when it was almost 146% of GDP back in 2002. By contrast rich countries' GPD in 2007, when the economic balloon went up, represented some 75% of GDP; today that figure is expected to reach 110% by 2015 according to the International Monetary Fund. The emerging powers are on the rise and just like the appellation "third world" is no longer appropriate for them, so is the belief that they are in third, rather than second, place in the global economy groupings. Demographers are predicting that the US and Europe may represent only 12% of the world's population by 2050.

To be frank, I haven't thought about that term, "third world", for many years (but then it has been a very long time since I lived in Africa) and in relation to Latin America I would say, depending on the location, either developing, or less developed, country is a more realistic tag. ECLAC now believes that the 2010 GDP growth in the region will reach 5.2% (4.3% in its December, 2009, report). Although the IMF, like ECLAC, sees Brazil as this year's regional star, the former predicts its GDP growth will be 5.5% while the latter says 7.6 %; Brazil shouldn't quibble if it achieved 6.5%, the average of both estimates.

All South American countries will see encouraging growth this year with the (predictable) odd man out being Venezuela where a contraction of 3% is expected and whereas average inflation across the region will still be in single digits (this has been the case since 2003) Venezuelans can expect no better than last year when the rate almost reached 27%. On the other hand, Venezuela's neighbour, Colombia, where the recently elected president, Juan Manuel Santos, has struck a tenuous truce with Hugo Chávez, is expected to have positive growth of 3.7%.

Whether Venezuela's relations with Colombia remain positive I doubt if its brand of politics will soften – unless petrol prices do and for a sustained period: at present the country has the largest oil reserves outside the Middle East and by one estimate the net present value of its heavy oil alone is USD13,047 billion. For now, at least, I imagine that its president can ignore Margaret Thatcher's admonishment: "The problem with socialism is that eventually you run out of other people's money".

Speaking of other people's money, Brazil is turning its attention to taxes, the subject I began with. According to the Latin Business Chronicle which prepares the Latin Tax

Index, Brazil has the worst tax environment and its tax regime is last in the 2009 rankings. The index looks at a number of factors and the data is drawn also from the World Bank, KPMG, the international accounting firm, and the Heritage Foundation in the US. Firms in high-income countries spend on average 177 hours a year in tax-related transactions (such as preparing, filing and paying taxes) while the average hours spent by a Latin American businessman is 320 hours. Bolivians, in fact, spend an average of 1,080 hours but, even so, that average is nothing when compared to Brazilians who need some 2,600 hours.

I am not sure whether Brazilians can expect to see the burden of compliance become less complex, but certainly the government is casting its net far and wide in its drive to improve the collection of taxes. And because the country is attracting so many foreign investors, the impact is sure to be felt by some of them, especially those using US Limited Liability Companies.

In "Man, Angels and Brazil" (February 2009 - Issue 193) I wrote about Brazil's tax law broadening the definition of what is considered a company located in a tax haven for the purposes of assessing its liability to Brazilian taxes. A new tax law became effective from January 2009, and covered the issue of non-disclosure of corporate owners and corporate secrecy in general, opening the way for a new blacklist (the last one was issued in 2002) that would include Delaware. The new tax law expanded the definition of "low tax jurisdiction" and by broadening it a new concept was introduced, namely, a "tax privileged regime". The blacklist was eventually issued in June and clearly political pressure from foreign governments, whose tax regimes are included on it, has been applied because the blacklist incorporates a grey one.

Delaware's corporate privacy, the hallmark of a traditional tax haven, has not been addressed and ignoring any obvious word play that excludes the term "tax haven", lets accept that just as a rose would smell as sweet by any other name, so would the smell remain the same if the object of one's olfactory glands was called something else. I read once that in America about 2 million people have no sense of smell; but there may be others who lose it temporarily, which must surely be so in the case of Senator Carl Levin who is in the vanguard of the US investigation of tax abuse and who has pummelled the Cayman Islands for having Delaware-style corporate privacy.

Brazil's blacklist has 65 countries on it and the grey sub-list has 9, although at the end of June new amendments to the rules were introduced which allow a foreign country to file an application to be removed from either the black or grey categories; the Netherlands and Denmark, both coloured grey, have negotiated a dilution of the tax implications and Switzerland has been suspended from the blacklist.

Meanwhile, the US Treasury is considering its options after it discovered that US LLCs with certain characteristics meant states in which they were incorporated would be "tax privileged regimes". This means, inter alia, that both transfer pricing and thin capitalisation rules will now apply and whereas LLCs in the past were exempt from capital gains, they will not be any more if their membership comprises non-residents who do not pay US federal income tax. As I write this there is no clarity yet on whether such LLC membership would be tainted if just one member was non-resident and the Brazilians can change the rules at any time which could hike capital gains and withholding taxes from 15% to 25%. For non-resident investment funds who have enjoyed (up to now) exemption from capital gains on the disposition of shares in publicly-traded Brazilian companies using a US LLC, this will be a harsh blow. And for most large and medium-sized multinational companies investing in Brazil through US LLCs, preferential tax withholding rates on interest and royalties is important.

Has Brazil drawn blood? Delaware's privacy may remain but many of the LLCs may not. Jean Baptiste Colbert, the Sun King's (Louis XIV) minister of finance, said that the art of taxation consisted of plucking the goose in such a way as to obtain the largest possible amount of feathers with the least possible amount of hissing. Expect a lot of hissing beyond Brazil's borders.