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CORPORATE Tax

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Trends & Developments

Contributed by Carrillo y Asociados

Carillo y Asociados' tax practice group is a leader in providing innovative and effective tax advice, both on a stand-alone basis and as an integral part of the firm's transactional representations. Experts advise on tax issues across the full spectrum of corporate, financing, investment and real estate transactions; for both domestic and international tax issues. This domestic powerhouse has a strong reputation in the tax field and provides international, transactional, estate planning and day-to-day tax advice to an impressive clientele of multinationals and high net worth individuals.

Alfonso Carrillo is a highly respected all-rounder who has been involved in drafting commissions for the reform of the country's tax laws; pension plans; securities and market law; VAT; and the United Nations Modernization Program for Guatemala. Alfonso Carrillo is recognised for his expertise advising domestic and foreign financial institutions in complex cross-border transactions.

Saul Donado has advised the Tax Administration, the Guatemalan Central Bank, private banks, and the Guatemalan Public Finance Ministry. Before joining Carrillo y Asociados he was Manager of the Technical Advisory board of the Tax Administration.

Andres Hernández has advised international corporations in different aspects of taxation and corporate law. He has participated in restructuring operations and advising on tax efficient structures in foreign investment projects. He has assisted high net worth individuals and their families on cross-border wealth and estate planning concerns with particular focus on issues arising from civil law and common law application.

Recent tax developments in Guatemala

Guatemala's territorial tax system means that taxes are levied on individuals and entities with income generated from sources within Guatemala.

At the start of 2013, substantial amendments were made to the existing tax legislation (Book I of the Tax Update Law, Decree No 10-2012). As anticipated by experts and analysts, the uncertainty regarding how these amendments will be interpreted has been a cause of concern for taxpayers, legal counsel and the Tax Administration. Furthermore, the fact that regulations regarding Income Tax have not yet been issued is also a source of confusion.

Income Tax

Income is taxed according to its source under one of the following categories: (i) Income from Lucrative Activities; (ii) Labour Income; and (iii) Capital Income and Capital Gains.

(i) Income from lucrative activities includes, among others, income from the production, purchase and marketing of goods in Guatemala; exports, services provided in Guatemala and services exported from Guatemala; income from travel allowances; commissions; representation expenses and professional fees. Within this category of income, taxpayers are able to

choose to be taxed under either of the following two regimes:

- (a) Net Income Regime: as its name implies, in this regime taxpayers will pay, for 2013, a 31% income tax on net profits; this is calculated by subtracting any exempt income and deducting applicable costs and expenses from the gross income. The tax rate set for 2014 will be reduced to 28% and, starting in 2015, the rate will be lowered to a 25% flat rate.

A comprehensive list of those costs and expenses that can be deducted from the gross income is provided by the Tax Update Law, including among other items, the cost of production and sale of goods; expenses incurred in the provision of services; transport and fuel expenses; salaries; fees paid to Social Security; pensions; leases of real estate and identifiable movable assets; the cost of maintenance and repair; depreciations and amortisations; donations to the State and to universities and cultural or scientific institutions; and advertising costs and other general sale expenses. As a general rule, the criteria for an expense to be deductible is for the expense to be useful, necessary, relevant or necessary to produce or preserve the source of taxable income.

- (b) Optional Gross Income Regime: taxpayers will be taxed on gross income (deducting the exempted income only) according to their range of monthly taxable income as follows: for the first GTQ30,000 at a tax rate of 5% and the excess at a tax rate of 7%.

(ii) Labour Income tax includes any form of remuneration or income coming from personal work performed in Guatemala or in any other country by a resident of Guatemala with an employment relationship. There is a 5% tax on income generated through labour, if the taxable income is lower than GTQ300,000 and a 7% tax for the excess. The employer is required to withhold income tax at source.

The following expenses are exempt from taxation: representation expenses; travel expenses related to work; and two bonuses which are mandatory by law, the holiday bonus called “Aguinaldo” [Christmas bonus] and the annual bonus (“Bonificación anual”) of up to 100% of the monthly basic salary.

The following expenses can be deducted from labour income tax: (i) GTQ48,000 without any need of verification (*minimum vitae*); (ii) GTQ12,000 which may be credited to the value added tax paid on personal expenses during the annual definitive liquidation period; (iii) donations; and (iv) Social Security contributions.

(iii) The Capital Income and Capital Gains category taxes: dividends, interest and royalties paid for copyrights or trade marks; income from real estate and identifiable movable assets located in Guatemala; and capital gains. Capital income and capital gains are taxed at a flat rate of 10%, excluding dividends, which are taxed at a rate of 5%. This has been a significant change for taxpayers, as before the enactment of the amendments to the tax law dividends were subject to a 3% Stamp Tax only. In addition, the re-evaluation of real estate which was previously taxed at a 0% rate will as of this year be deemed to be a capital gain.

Non-resident Income Tax

The Tax Update Law includes a chapter which regulates the Income Tax of non-residents who have a source of income within Guatemala. In general terms, if the non-resident obtains taxable income, or is deemed to have a permanent establishment, then the non-resident becomes subject to Guatemalan Income Tax. The withholding rates for non-residents are:

- (i) 3% applied to the delivery of international news to local users in the country and the use of films and other musical recordings;
- (ii) 5% applied to international transportation activities, insurance, telecommunications, data transmissions, communication services, dividends and repatriation of capital;
- (iii) 10% applied to interests paid to non-residents;
- (iv) 15% for salaries, commissions and other remunerations, royalties, professional fees, and technical, scientific and economic counselling; and
- (v) 25% default rate, applied to any income not specified above.

The new Income Tax regulation has caused uncertainty about a number of issues, including the tax rate applicable to a capital gain obtained by a non-resident. In the new regulation capital gains obtained by non-residents are not taxed at a specific rate, and therefore are taxed at the default rate. This treatment is considered discriminatory and unconstitutional under domestic laws.

Transfer pricing issues

The Tax Update Law has, for the first time, included transfer pricing issues in Guatemalan legislation. Even though transfer pricing is based on international standards, the Guatemalan Tax Administration is unused to handling issues of this nature. It will take time for taxpayers to understand and apply transfer pricing issues and for the Tax Administration to become efficient when auditing such operations.

Conclusion

As a result of a number of inconsistencies in the amendment, tax experts and members of the business community have presented more than 20 actions to the Constitutional Court claiming that the tax amendments are a violation of constitutional rights. A few provisions have been suspended on a short-term basis, and there are many others pending resolution. The sudden tax reform has resulted in several contradictions with the regulations and other tax laws in force, which must be corrected in the near future.

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Business entities and basic tax treatment

Corporate structures

Businesses generally adopt the form of a corporation in Guatemala. The Guatemalan Commercial Code regulates commercial companies and classifies them as follows:

Sociedad Colectiva [Collective Company]: The capital of this type of company is represented by contributions made by legal entities or persons. The percentage of each contributor's (ie, partner's) participation must be established in the Articles of Incorporation. The partners are jointly and severally liable for the company's debts and obligations.

The company name is restricted: it must include either the name and surname of one partner or the surnames of several partners and must end with the words: "y Compañía, Sociedad Colectiva" [and Company, Collective Company]. If a person that is not a partner allows his name to appear in the company name, he shall be subject to the same obligations and liabilities as partners.

Sociedad en comandita simple [Limited Partnership]: The capital of this type of company is represented by contributions made by legal entities or persons. A key difference between this type of company and the Collective Company is that the capital of the Limited

Partnership must be paid in full at the time the company is formed. This company has two types of partners: those who are jointly and severally liable for the company's debts and obligations (ie, a general partner), who are also entitled to administrate this type of company and those that have limited liability up to the amount contributed. The latter type of partner is not entitled to be a director of the company and will not be allowed to vote or use their name or surname in the company name. The company must include either the name of one of the general partners or the surname of several general partners, adding the words: "y Compañía Sociedad en Comandita" [and Company, Limited Partnership].

Sociedad de responsabilidad limitada ("S.R.L.") [Limited Liability Company]: The capital of this company is made up of contributions made by legal entities or persons. Such companies are formed by no more than 20 members and the liability of each member is limited to the capital they contributed, unless the Articles of Incorporation stipulate that the members will be liable for a greater amount. The capital cannot be represented by shares. Capital must be fully paid before the company issues its Articles of Incorporation.

The company name must include either the name of one partner or the surnames of several, or specify the main activity that the company will undertake. In this case it is also necessary to add the words "y Compañía Limitada" [and Limited Liability Company].

Sociedad Anónima ("S.A.") [Corporation]: This is the most commonly used type of corporate entity; the capital of the company is represented by contributions made by legal entities or persons. In this type of company the capital is divided and represented by shares that can be issued only for the amount of the authorised capital. Corporations can be formed for an indefinite period of time.

The shares can be totally or partially subscribed at the time of incorporation; if partially subscribed, this must be recorded in the Articles of Incorporation. The initial paid-in capital must be at least GTQ5,000, with each shareholder given nominative shares proportionate to the amount of capital contributed. Each share gives the right to one vote at shareholder meetings. The responsibility of the shareholders for the company's debts and obligations is limited to their contribution. The corporation name is unrestricted, although it is necessary to add the words "Sociedad Anónima ("S.A.")" [Corporation] to the company name.

The Shareholders' General Assembly is the supreme organ of control in corporation. The default rules are that: (i) the shares can be transferred without approval of other shareholders; (ii) the agreement of the majority of shareholders is enough to amend the Articles of Incorporation; and (iii) members of the Board of Directors do not have to be shareholders. These default rules can be amended in the Articles of Incorporation.

Sociedad en comandita por acciones [Partnership Limited by Shares]: This is a mixed type of company in which there are also two types of partners: general partners and regular partners who receive the same treatment as shareholders of a corporation. Thus the regulations for corporations are also applicable to this type of company.

The company name must include the name of one general partner or the surnames of several general partners and the words: "y Compañía, Sociedad Comandita por acciones" [and Company, Limited Partnership Company by Shares].

These types of companies, which are regulated in the Guatemalan Commercial Code, are considered separate legal entities independent from their members; consequently these companies are taxed as separate legal entities.

Types of entities

Guatemalan tax legislation does not provide for fiscally transparent entities nor provide “flow-through” treatment to legal entities. Income derived by an entity is not attributable to members, shareholders, partners, investors or owners.

Generally, businesses in Guatemala adopt the form of a corporation; there are no special types of entities that are commonly used for particular industries or commercial sectors.

Tax rates

The Guatemalan tax regime is a territorial system. In Guatemala any income obtained through any capital, assets, services and rights of any nature invested or utilised within Guatemala will be subject to income tax.

The following type of taxes are applicable to income generated by businesses incorporated in Guatemala:

Impuesto Sobre la Renta (“I.S.R.”) [Income Tax]: levied on income generated within Guatemala. Entities and individuals can elect to be taxed under one of two regimes:

Regimen sobre las utilidades de actividades lucrativas [Net Income Regime]: As of 2013, taxpayers will pay 31% income tax on their net income. To calculate the tax basis, taxpayers need to subtract from their gross income any exempted income and deductible costs and expenses. The tax rate for 2014 will be 28%; starting 2015, the rate will be fixed at 25%.

Regimen opcional simplificado sobre ingresos de actividades lucrativas [Optional Gross Income Regime]: Taxpayers opting for this regime will pay income tax on gross income (deducting the exempted income only); the tax rate will vary according to the range of monthly taxable income, ie, for the first GTQ30,000 the tax rate will be 5% and for any excess the tax rate will be 7%. Capital gains are taxed at a 10% rate, and dividends at a 5% rate.

Impuesto al valor agregado [Value Added Tax]: A 12% tax will apply generally to all sales of goods and services provided; the tax will also apply to imports and to an extensive list of other business activities enumerated in the Value Added Tax Law.

Impuesto de solidaridad [Solidarity Tax]: A 1% tax rate must be paid by individuals or entities dedicated to commercial or agricultural activities operating within Guatemala, if their gross profit increases by a 4% ratio over their gross income. The tax basis will be calculated on a quarterly basis from either the net assets or gross income, whichever is higher. Taxpayers that opt for the Optional Gross Income Regime will be exempted from this tax.

Other taxes: there are other taxes applicable in Guatemala, ranging from real estate tax to taxes applied to specific sectors or industries such as the distribution of tobacco, crude oil, cement and alcoholic beverages.

As mentioned above, it is not possible to elect to be treated as a transparent or flow-through entity in Guatemala.

The tax regime for incorporated businesses

Taxable profits

Please refer to **Tax rates** with regard to the two tax regimes applicable in Guatemala and the tax rates applicable to income and profits.

Under the Net Income Regime, the tax basis for the taxable profit is calculated by subtracting the exempted income and deductible costs and expenses from the gross income.

For the Optional Gross Income Regime, the tax basis will be calculated by deducting applicable exempted income from the gross profit.

To determine whether profits will be taxed on an accruals or receipts basis, the Tax Update Law requires that for those taxpayers that keep accounting records in accordance with the Commercial Code, the profits shall be calculated on an accrual basis, including both revenue and costs and expenses. These taxpayers can seek authorisation, under very special circumstances, from the Tax Administration to calculate their profits on a receipts basis.

Other taxpayers may choose between the accrual basis or receipts basis, with the caveat that once a taxpayer chooses a method, authorisation from the Tax Administration shall be attained to switch from one method to another.

Special incentives

There are no specific regulations for how technology and R&D expenses shall be treated; the only incentive would be that these types of expenses can be considered deductible from gross income under the Net Income Regime.

There are specific incentives for companies that generate jobs, such as the possibility to establish Free Trade Zones, or tax relief.

For those companies dedicated to commercial or agricultural activities that are subject to the Solidarity Tax Law, a tax exemption will be granted for the first two years of operation.

A proposal for a new bill was submitted to Congress at the beginning of 2013. The bill includes provisions for the generation of tax incentives for developing sectors and for those creating jobs in rural areas.

Loss relief

Once capital losses are realised they can be offset against capital gains and can be carried forward for a maximum period of two years.

The deduction of interest

There are several rules regarding deduction of interest by local corporations, specifically:

- interest must originate from operations that generate taxable income for the taxpayer;
- the interest rate must not exceed the maximum annual simple interest rate for tax purposes as determined by the Monetary Board of the Central Bank within the first 15 days of January and July. The rate is applicable during each respective semester, taking as a basis the determined Bank rate for active operations during the previous semester; and

- the amount that is deductible may not exceed the interest rate multiplied by three times the total average net active income presented by the taxpayer in its yearly tax statements (Rule of sub-capitalisation).

Consolidated tax groups

Consolidated tax grouping is not regulated in Guatemala; as a consequence the losses of one company may not be utilised by another company within the same holding or group of companies.

It is common practice for groups of companies to take advantage of losses from related companies through M&A.

Selling shares

Capital gains resulting from the sale of shares of Guatemalan companies are taxed at a 10% rate under the Income Tax Law.

The basis cost of the shares will be the lower of the acquisition price and the price registered in the books of the issuing corporation.

The sale of shares will be exempt from Value Added Tax and Stamp Tax.

The audit cycle

There is no regular audit cycle; however, special (large) taxpayers are closely audited by tax officers, who constantly review their tax declarations and their tax behaviour. Taking those aspects into consideration, as well as analysis of risk, audits for such large taxpayers can be generally scheduled.

It is important to note that the statute of limitation for both audits and adjustments by the Tax Administration is four years.

Corporations and non-corporate businesses

Closely-held corporations

Most closely-held local businesses operate in a corporate form. Since corporate rates are the same as individual rates, the decision to operate in a corporate or non-corporate form is not tax-oriented. However, other factors such as confidentiality, protection of assets, administration and accountability are taken into account.

There is no rule to prevent corporations from accumulating earnings for investment purposes, provided they pay Income Tax every tax year. The reinvestment of profits is not a deductible expense.

Rules relating to individual professionals

The sale of shares in publicly traded corporations: There is no difference in the tax treatment when selling shares in a closely-held corporation or a publicly traded corporation.

The sale of shares in closely-held corporations: Individuals are taxed at the same rate as corporations on dividends from and on capital gain for the sale of shares. Capital gain

is taxed at a 10% rate and dividends are subject to a 5% withholding at source under the Income Tax Law.

Rules to prevent individual professionals earning income at corporate rates: Corporate rates are not lower than individual rates. Professionals are free to offer their services individually or through a corporate form.

Taxation of inbound investments

Withholding taxes

Guatemala has not signed tax treaties with other countries.

The treatment of withholding tax treatment for non-residents is 10% for interest, 5% for dividends and 15% for royalties.

Interest paid to financial institutions located abroad and to governmental and international institutions will be exempted from Income Tax.

Tax treaties

Guatemala does not have any taxation treaties with other countries.

Capital gains of non-residents: The Tax Update Law regulates the tax rates for non-residents who obtain Guatemalan source income. The capital gain on the sale of local stock is considered to be Guatemalan source income. Considering that the Tax Update Law does not provide a specific tax rate for capital gains to non-residents, the default rate of 25% will apply.

If the gain is made on the shares of a non-local holding company that owns the stock of the domestic corporation, the tax will not apply because the operation is beyond the limits of the territorial tax principle and does not constitute Guatemalan source income.

Transfer pricing issues

Transfer pricing is standardised throughout most of Central America. The definitions of related parties, analysis of comparable transactions, treatment applicable to services between related parties and advanced price agreements, among others, are based on international standards. The five traditional methods for the determination of the value of the operation in free competition conditions (as determined by the OECD) are included in the new Income Tax regulation. There is also a sixth method which is based on the Argentine regulation.

The regulation regarding transfer pricing is narrow and is mostly based on OECD standards.

Related party limited risk distribution

Local tax authorities do not challenge the use of related party limited distribution arrangements for the sale of goods or provision of services locally. However, there is a rule of oner-

ous presumption between operations that are considered to be paid at market value, unless proven otherwise.

Foreign-owned local affiliates

Guatemalan legislation does not provide a specific formula to determine the income of foreign-owned affiliates selling goods or providing services, although the Tax Administration may, at its own discretion, apply one when auditing.

Expenses incurred by non-local affiliates: There are two rules to consider with regard to deductions for payments by local affiliates for management and administrative expenses incurred by a non-local affiliate:

Firstly, the costs of services received from a related affiliate, such as providing a physical address for tax registering purposes, legal, accounting, financial, technical services, or any other, can be deducted from income tax, under the Net Income Regime, if those expenses are closely related to income generated subject to tax.

Secondly, when services for several related parties are provided jointly and it is possible to quantify each service provided as an individual service, then the income shall be attributable directly to the recipient. If it is not possible to quantify the services provided as individual services, then the income shall be distributed among the beneficiaries in accordance with rules of distribution that are deemed to be reasonable. The rules are understood to be reasonable when the distribution method is based on a variable that takes into account the nature of the service, the circumstances in which it is provided, and the benefits obtained or likely to be obtained by the recipients.

Related party borrowing: According to Guatemalan legislation, there are no constraints on related party borrowing by foreign-owned local affiliates paid to non-local affiliates. However, it is important to consider the onerous presumption, as well as the rules for sub-capitalisation on the deductibility of the expenses and the limitation in terms of interest rates applicable to the operation.

Taxation of foreign income of local corporations

Exemptions

The nature of foreign income, how it is generated and where it is received has to be analysed in order to determine whether income will be subject to Income Tax.

According to Guatemalan legislation all income received in Guatemalan territory is subject to Income Tax; otherwise, all income generated from sources outside of Guatemala will not be subject to tax.

All income derived from the following activities is considered to be Guatemalan-source income: the production, sale and marketing of assets, provision of services, fees, etc.

Generally, Guatemalan-source income results from the investment of capital and capital gains received or earned from property, capital or work carried out within Guatemalan territory. For example, income will be deemed to be Guatemalan if it involves the combination

of one or more elements of production in order to create, process, sell, transport or distribute goods for sale or provision of services within Guatemala.

Foreign income is not subject to tax, so expenses can only be deducted from Guatemalan-source income.

Taxation of dividends

If the activities of a foreign corporation occur exclusively outside of Guatemala, dividends paid to local corporations will not be subject to tax. If the local corporation receives dividends or profits from a foreign subsidiary and the foreign corporation has a permanent establishment in Guatemala, then the proportion of dividends corresponding to the activities of the permanent establishment is subject to a 5% Income Tax.

Rules relating to intangibles

Intangibles developed by local corporations can be used by non-local subsidiaries without incurring local corporate tax.

Royalties paid or to be used in Guatemala, by resident individuals or entities, or by permanent establishments of foreign corporations operating in Guatemala, are considered to be Guatemalan-source income.

Expenses for royalties paid in Guatemala are deductible expenses. However, the deductible amount cannot exceed 5% of the gross income and the right for royalties must be supported with a formal contract stating the amount and conditions of payment to the beneficiary.

Taxation of non-local subsidiaries

Guatemala does not have controlled foreign corporation type rules. Non-local subsidiaries are not subject to Guatemalan tax because there is no point of connection or control tests.

Sale of shares in non local affiliates

The gain on the sale of shares in non-local affiliates is not subject to tax in Guatemala: it is deemed to be foreign source income. Guatemala only taxes capital gains when they are derived from stock or securities issued by residents or entities within Guatemala, and from other movable assets other than the shares or securities or from rights that must be met or exercised in Guatemala.

