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Global Tax Alert

Japan and Argentina sign new tax treaty

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Executive summary

On 27 June 2019, Japan and Argentina signed an Income Tax Treaty and Protocol (the New Treaty).

Significant provisions in the New Treaty are:

- Incorporation of BEPS[1] Action 7 and anti-fragmentation concepts in the determination of a permanent establishment (Article 5)
- Reduction of withholding tax on dividends, interest and royalties (Articles 10, 11 and 12)
- Source country capital gains on certain share dispositions (Article 13)
- Mutual Agreement Procedure (Article 25)
- Principal purpose test for the entitlement of benefits (Article 29)

This Alert summarizes the key provisions of the New Treaty.

Detailed discussion

Fiscally transparent entity/arrangement concept

Paragraph 2 of Article 1 states that income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State would be considered to be income of

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a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that Contracting State, as the income of a resident of that Contracting State.

Tie-breaker rule for determining treaty residency of non-individual dual resident persons

Paragraph 3 of Article 4 provides that, in cases where a person other than an individual is a dual resident, the competent authorities of the two Contracting States will seek a determination by mutual agreement of the country of residence based on the place of the head office, the place of effective management, the place of incorporation or otherwise constituted and any other relevant factors. In the absence of such agreement, such person will not be entitled to any relief under the New Treaty.

Permanent establishment (PE)

Article 5 under the New Treaty includes the concept of a service PE (Paragraph 3(b)), dependent agent PE (Paragraph 6) and independent agent (Paragraph 7). The threshold for a construction PE is six months.[2] The definitions of dependent and independent agents are in line with the recommendations of Action 7 of the 2015 BEPS final report.

Similarly, the New Treaty includes an anti-fragmentation rule and an anti-abuse rule for PEs situated in third jurisdictions.

Business income

The New Treaty's taxation of business income attributable to a PE follows the pre-2010 OECD[3] version of business income (non-Authorized OECD Approach).

Reinsurance income may be taxed in that Contracting State, if reinsurance is for property situated in that Contracting State or persons who are residents of that Contracting State and the premiums for such reinsurance are paid by a resident of that Contracting State. However, the tax may not exceed 2.5% of the gross amount of such premiums.

Dividends

- The New Treaty provides for a 10% withholding tax rate on dividends if the beneficial owner of the dividends is a company that has owned directly or indirectly at least 25% of the voting power of the company paying the dividends for at least six months.
- A 15% rate applies to all other cases, including dividends which are deductible in computing the taxable income of the company paying the dividends.

Interest

- A 12% withholding tax rate applies to interest.
- The New Treaty provides a full exemption on interest if the interest is beneficially owned by that Contracting State, local authority or the central bank of that Contracting State or any institution wholly owned by that Contracting State.

Royalties

- The New Treaty provides for a 3% withholding tax rate on royalties paid for the use of any news.
- A 5% withholding tax rate applies to royalties paid for the use of any copyright of literary, artistic or scientific work. However, the withholding tax rate is 10%, not 5%, if the beneficial owner is not the author of such work or the author's heirs.
- A 10% rate applies to all other cases.

Capital gains

The New Treaty grants the full taxing right to the Contracting State on gains derived from the transfer of shares in a company deriving at least 50% of the value directly or indirectly from immovable property situated in that Contracting State, at any time during the 365 days preceding the transfer (a "real property rich" company), unless the shares are traded on a recognized stock exchange and the resident (including persons related to that resident) owns in the aggregate 5% or less of the shares.

The New Treaty provides reduced tax rates on gains derived from the transfer of shares of a non-real property rich company. The tax rate is 10% if the transferor owned, directly or indirectly, shares representing at least 25% of the capital of the company. The tax rate is 15% in all other cases.

Tokumei Kumiai (TK)

The New Treaty grants the taxing rights to Japan for income and gains derived in Japan by a silent partner who is an Argentina resident and a party to a TK or another similar contract.

Mutual Agreement Procedure (MAP)

The New Treaty contains the remedies based on the MAP if the actions of one or both Contracting States result or will result in taxation not in accordance with the provisions of the New Treaty. The case must be presented within three years.

The New Treaty does not include Mandatory Arbitration.

Entitlement to benefits

Paragraph 2 of Article 29 of the New Treaty states that a benefit under the New Treaty will be denied if obtaining the benefit under the treaty is one of the principle purposes of any arrangement or transaction that would result directly or indirectly in that benefit.

Entry Into Force

After the approval in accordance with the domestic procedures of the two countries (in the case of Japan, approval by the Diet is necessary), the New Treaty will enter into force on the 30th day after the date of exchange of diplomatic notes indicating such approval and will have effect as follows:

a. With respect to taxes imposed on the basis of a taxable year, for taxes for any taxable years beginning on or after 1 January in the calendar year next following that in which the New Treaty enters into force.

b. With respect to taxes imposed not on the basis of a taxable year, for taxes imposed on or after 1 January in the calendar year next following that in which the New Treaty enters into force.

Endnotes

1. Base Erosion and Profit Shifting.
2. For a construction PE in Japan, the 12-month threshold under Japanese domestic tax law applies.
3. Organisation for Economic Co-operation and Development.

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